

MID CENTRAL EDUCATIONAL COOPERATIVE

AUDIT REPORT

For the Fiscal Year Ended June 30, 2015



State of South Dakota
Department of Legislative Audit
427 South Chapelle
% 500 East Capitol
Pierre, SD 57501-5070

MID CENTRAL EDUCATIONAL COOPERATIVE
COOPERATIVE OFFICIALS
June 30, 2015

MEMBER SCHOOL

Armour
Burke
Colome
Corsica
Ethan
Gregory
Kimball
Mt. Vernon
Plankinton
Platte-Geddes
Stickney
Wessington Springs
White Lake
Wolsey-Wessington

BOARD MEMBERS

Tina Westendorf
Brandon York
Pamela Haukaas
Nicole Bamberg
Tim Neugebauer
Sharon Pederson
Todd Reinesch
Ryan Youngstrom
David Merrill
Tammie Olson
Lloyd Persson
Tonya Aldrich
Jim Munson
Richard Peterson

ADVISORY BOARD

Burnell Glanzer
Erik Person
Alan Armstrong
Vern DeGeest
Terry Eckstaine
Sara Klein
Jeff Rieckman
Patrick Mikkonen
Steve Randall
Joel Bailey
Robert Krietlow
Lance Witte
Robert Schroeder
James Cutshaw

DIRECTOR:

Daniel Guericke

BUSINESS MANAGER:

Scott Westerhuis

MID CENTRAL EDUCATIONAL COOPERATIVE
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PIERRE SD 57501-5070
(605) 773-3595

MARTIN L. GUINDON, CPA
AUDITOR GENERAL

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Cooperative Board
Mid Central Education Cooperative
Platte, South Dakota

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Mid Central Educational Cooperative, Platte, South Dakota (Cooperative), as of June 30, 2015 and for the year then ended, and the related notes to the financial statements, which collectively comprise the Cooperative's basic financial statements and have issued our report thereon dated May 19, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Cooperative's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Current Audit Findings and Questioned Costs, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Cooperative's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Current Audit Findings and Questioned Costs as items No. 2015-001, 2015-009, and 2015-010 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws,

regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Current Audit Findings and Questioned Costs as items No. 2015-001, 2015-002, 2015-003, 2015-004, 2015-005, 2015-006, 2015-007, 2015-008, and 2015-009.

Cooperative's Response to Findings

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report. The Cooperative's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Cooperative's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. As required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.



Martin L. Guindon, CPA
Auditor General

May 19, 2017



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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR
FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

Cooperative Board
Mid Central Educational Cooperative
Platte, South Dakota

Report on Compliance for Each Major Federal Program

We have audited the Mid Central Educational Cooperative's, Platte, South Dakota (Cooperative), compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Cooperative's major federal programs for the year ended June 30, 2015. The Cooperative's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Current Audit Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Cooperative's major federal programs based on our audit of the types of compliance requirements referred to above.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Cooperative's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination on the Cooperative's compliance.

Basis for Adverse Opinion on Gaining Early Awareness and Readiness for Undergraduate Programs

As described in Findings No. 2015-001, 2015-002, 2015-003, and 2015-004 in the accompanying Schedule of Current Audit Findings and Questioned Costs, the Cooperative did not comply with requirements regarding the following:

<u>Finding No.</u>	<u>CFDA #</u>	<u>Program Name</u>	<u>Compliance Requirement</u>
2015-001	84.334	Gaining Early Awareness and Readiness for Undergraduate Programs	Management Override of Internal Controls
2015-002	84.334	Gaining Early Awareness and Readiness for Undergraduate Programs	Allowable Costs/Cost Principles
2015-003	84.334	Gaining Early Awareness and Readiness for Undergraduate Programs	Matching
2015-004	84.334	Gaining Early Awareness and Readiness for Undergraduate Programs	Subrecipient Monitoring

Compliance with such requirements is necessary, in our opinion, for the Cooperative to comply with requirements applicable to that program.

Adverse Opinion on Gaining Early Awareness and Readiness for Undergraduate Programs

In our opinion, because of the effects of the noncompliance described in the Basis for Adverse Opinion paragraph, the Cooperative did not comply, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on Gaining Early Awareness and Readiness for Undergraduate Programs for the year ended June 30, 2015.

Basis for Adverse Opinion on Teacher Quality Partnership Grants

As described in Findings No. 2015-001, 2015-005, and 2015-006 in the accompanying Schedule of Current Audit Findings and Questioned Costs, the Cooperative did not comply with requirements regarding the following:

<u>Finding No.</u>	<u>CFDA #</u>	<u>Program Name</u>	<u>Compliance Requirement</u>
2015-001	84.336	Teacher Quality Partnership Grants	Management Override of Internal Controls
2015-005	84.336	Teacher Quality Partnership Grants	Allowable Costs/Cost Principles
2015-006	84.336	Teacher Quality Partnership Grants	Matching

Compliance with such requirements is necessary, in our opinion, for the Cooperative to comply with requirements applicable to that program.

Adverse Opinion on Teacher Quality Partnership Grants

In our opinion, because of the effects of the noncompliance described in the Basis for Adverse Opinion paragraph, the Cooperative did not comply, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on Teacher Quality Partnership Grants for the year ended June 30, 2015.

Basis for Qualified Opinion on Carol M. White Physical Education Program, College Access Challenge and Special Education Cluster – Grants to States and Preschool Grants

As described in the accompanying Schedule of Current Audit Findings and Questioned Costs, the Cooperative did not comply with requirements regarding the following:

<u>Finding No.</u>	<u>CFDA #</u>	<u>Program Name</u>	<u>Compliance Requirement</u>
2015-001	84.215F	Carol M. White Physical Education Program	Management Override of Internal Controls
2015-001	84.378	College Access Challenge Grant Program	Management Override of Internal Controls
2015-001	84.027A & 84.173A	Special Education Cluster – Grants to States and Preschool Grants	Management Override of Internal Controls

Compliance with such requirements is necessary, in our opinion, for the Cooperative to comply with requirements applicable to those programs.

Qualified Opinion on Carol M. White Physical Education Program, College Access Challenge Grant Program and Special Education Cluster – Grants to States and Preschool Grants

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, the Cooperative complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the Carol M. White Physical Education Program, College Access Challenge Grant Program and Special Education Cluster – Grants to States and Preschool Grants for the year ended June 30, 2015.

Other Matters

The results of our auditing procedures disclosed other instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Current Audit Findings and Questioned Costs as items No. 2015-007 and 2015-008. Our opinion on each major federal program is not modified with respect to these matters.

Report on Internal Control Over Compliance

Management of the Cooperative is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Cooperative’s internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Cooperative’s internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency in internal control over compliance described in the accompanying Schedule of Current Audit Findings and Questioned Costs as items No. 2015-001 and 2015-009 to be material weaknesses.

Cooperative's Response to Findings

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report. The Cooperative's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purposes. As required by South Dakota Codified Law 4-11-11, this report and our report on compliance for each major federal program are matters of public record and their distribution is not limited.



Martin L. Guindon, CPA
Auditor General

May 19, 2017

MID CENTRAL EDUCATIONAL COOPERATIVE
SCHEDULE OF PRIOR AND CURRENT AUDIT FINDINGS AND QUESTIONED COSTS

SCHEDULE OF PRIOR AUDIT FINDINGS

Prior Federal Audit Findings:

The prior audit report contained no written federal audit findings.

Prior Other Audit Finding:

Finding No. 2014-001:

The annual financial report contained numerous material errors and omissions resulting in inaccurate and incomplete information being presented to the users of the financial statements. This finding has not been resolved and is restated as current audit finding No. 2015-010.

SCHEDULE OF CURRENT AUDIT FINDINGS AND QUESTIONED COSTS

Summary of the Independent Auditor's Results:

Financial Statements

- a. An unmodified opinion was issued on the financial statements of each opinion unit.
- b. Material weaknesses were disclosed by our audit of the financial statements for inadequate oversight of financial activities and failure to establish adequate internal control over related party transactions as discussed in finding No. 2015-001, for unauthorized withdrawals from Mid Central Educational Cooperative's checking account as discussed in finding No. 2015-009 and for financial reporting errors as discussed in finding No. 2015-010.
- c. Our audit did disclose noncompliance which was material to the financial statements for the noncompliance with federal rules and regulations as discussed in finding No. 2015-002, 2015-003, 2015-004, 2015-005, 2015-006, 2015-007, 2015-008 and for unauthorized withdrawals from Mid Central Educational Cooperative's checking account as discussed in finding No. 2015-009.

Federal Awards

- d. A material weakness was disclosed for internal control over major federal programs for inadequate oversight of financial activities and failure to establish adequate internal control over related party transactions as discussed in finding No. 2015-001 and for unauthorized withdrawals from Mid Central Educational Cooperative's checking account as discussed in finding No. 2015-009.
- e. We issued a qualified opinion on compliance with requirements applicable to the following major federal programs:

- Carol M. White Physical Education Program – CFDA # 84.215F
- College Access Challenge Grant Program – CFDA # 84.378
- Special Education Cluster:
 - Special Education – Grants to States – CFDA # 84.027A
 - Special Education – Preschool Grants – CFDA # 84.173A

We issued an adverse opinion on compliance with requirements applicable to the following major federal programs:

Teacher Quality Partnership Grants – CFDA # 84.336S
Gaining Early Awareness and Readiness for Undergraduate Programs – CFDA # 84.334

- f. Our audit disclosed audit findings that are required to be disclosed in accordance with the Office of Management and Budget Circular A-133, Section .510(a). See findings No. 2015-002, 2015-003, 2015-004, 2015-005, 2015-006, 2015-007, 2015-008 and 2015-009.
- g. The federal awards tested as major programs were:
 - 1. Teacher Quality Partnership Grants – CFDA # 84.336S
 - 2. Carol M. White Physical Education Program – CFDA # 84.215F
 - 3. College Access Challenge Grant Program – CFDA # 84.378
 - 4. Gaining Early Awareness and Readiness for Undergraduate Programs – CFDA # 84.334
 - 5. Special Education Cluster:
 - Special Education – Grants to States – CFDA # 84.027A
 - Special Education – Preschool Grants – CFDA # 84.173A
- h. The dollar threshold used to distinguish between Type A and Type B federal award programs was \$300,000.
- i. Mid Central Educational Cooperative did not qualify as a low-risk auditee.

Current Federal Audit Findings:

Internal Control-Related Finding - Material Weakness:

Inadequate Oversight of Financial Activities

Finding No. 2015-001:

Mid Central Educational Cooperative's (Cooperative) inadequate oversight of financial activities and failure to establish adequate internal control over related party transactions resulted in diminished assurance that the Cooperative's financial transactions were properly recorded and its assets were adequately safeguarded, and increased the risk of management override of the existing internal control structure. Key employees of the Cooperative held positions with partnered entities resulting in management override of internal controls and numerous related party transactions. This weakness affected all major programs.

The major federal programs affected were:

CFDA Title: Teacher Quality Partnership Grants
CFDA Number: 84.336S
Federal Award Number: U3365090010
Federal Award Year: 2015
Federal Agency: Department of Education

CFDA Title: Carol M. White Physical Education Program
CFDA Number: 84.215F
Federal Award Number: S215F140147
Federal Award Year: 2015
Federal Agency: Department of Education

CFDA Title: College Access Challenge Grant Program
CFDA Number: 84.378
Federal Award Number: P378A140014
Federal Award Year: 2015
Federal Agency: Department of Education
Pass Through Entity: SD Department of Education

CFDA Title: Gaining Early Awareness and Readiness for Undergraduate Programs
CFDA Number: 84.334
Federal Award Number: P334S110022
Federal Award Year: 2015
Federal Agency: Department of Education
Pass Through Entity: SD Department of Education

CFDA Titles: Special Education Cluster, Grants to States and Preschool Grants
CFDA Numbers: 84.027A and 84.173A
Federal Award Number: 15-611-048 and 15-619-043
Federal Award Year: 2015
Federal Agency: Department of Education
Pass Through Entity: SD Department of Education

Analysis:

Background Information

The Cooperative is an educational service cooperative with fourteen member school districts that was organized to provide services for the member schools. The Cooperative'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.

The Cooperative 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 the Cooperative 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 Cooperative 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 the Cooperative programs and for keeping the Governing Board informed about the operations and problems of the Cooperative.

United States General Accounting Office, Government Auditing Standards, 2011 revisions, state:

Internal control serves as a defense in safeguarding assets and in preventing and detecting errors; fraud; noncompliance with provisions of laws, regulations, contracts, or grant agreements; or abuse.

The Cooperative's 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.

Generally Accepted Auditing Standards states:

Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is, nevertheless, present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and, thus, a significant risk.

Over the past several years, the Cooperative 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 school districts and were not overseen by the South Dakota Department of Education (SDDOE). However, we found no evidence that the Cooperative'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 Cooperative Governing Board members that we interviewed, there were two whose tenure covered the Cooperative's expansion of services and programs. Both told us they did not believe that the Cooperative's management had adequately informed them of the risks associated with providing the new services and programs. The following failures in oversight of the Cooperative programs occurred.

Failure to Identify Related Parties and Conflicts of Interest

Although the Cooperative's policy prohibits financial interests that would conflict with employees' responsibilities to the Cooperative, 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 the Cooperative's programs. Of the Cooperative Governing Board members that we interviewed, there were two whose tenure covered the Cooperative's initiation of business dealings with these related parties. Both told us they did not believe that the Cooperative's management had adequately informed them of the related party organizations and associated risks. As discussed in the following paragraphs, the Cooperative failed to identify related parties and conflicts of interest.

American Indian Institute for Innovation (AIII)

The Cooperative 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 the Cooperative established the GEAR UP partnership with AIII, Stacy Phelps and Scott Westerhuis were employed by the Cooperative 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 the Cooperative and AIII and Stacy Phelps would be involved in administering the Cooperative's programs for both organizations.

The following employment and contractual relationships existed during our audit period:

Scott Westerhuis was both the Business Manager of the Cooperative and the Chief Financial Officer (CFO) of AIII during FY 2015. The Cooperative paid a salary to Scott Westerhuis of \$65,236.08 in FY 2015. According to AIII's IRS Form 990 for 2014, the latest IRS Form 990 available, Scott Westerhuis was identified as AIII's CFO and reported zero compensation.

Stacy Phelps was both an employee of the Cooperative and the Chief Executive Officer (CEO) of AIII. The Cooperative paid a salary to Stacy Phelps of \$70,980.00 in FY 2015. In addition, we found that

\$65,000 of Stacy Phelps' Cooperative salary was reimbursed by the South Dakota Department of Education (SDDOE) from GEAR UP funds for FFY 2014. Also, in August 2014 the Cooperative 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 IRS Form 990 for 2014, the latest IRS Form 990 available, reported zero compensation for Stacy Phelps.

The Superintendent of a Cooperative 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 the Cooperative's Advisory Board. The Superintendent informed us that the Cooperative's Director 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 Cooperative Governing Board member since fiscal year 2011. Thus, the member school district's representatives on the Cooperative Governing Board and Advisory Board should have been aware that the member district had a contractual relationship with AIII and that the Cooperative had a business relationship with AIII where Scott Westerhuis and Stacy Phelps served as CFO and CEO.

Oceti Sakowin Education Consortium (OSEC)

The Cooperative also partnered with OSEC to provide services to participating GEAR UP schools. According to the OSEC IRS Form 990 submitted for its fiscal year ended June 30, 2014, Nicole Westerhuis worked an average of 30 hours per week as the Business Manager of OSEC. During this year, Nicole Westerhuis also had a full-time employment contract with the Cooperative in its business office. Based on documents we reviewed, this dual employment extended back to 2009. Thus, Nicole Westerhuis was simultaneously employed in the business office of both the Cooperative and OSEC.

The following employment and contractual relationships existed during our audit period:

Nicole Westerhuis, wife of Scott Westerhuis, was both an employee of the Cooperative and the Business Manager for OSEC. The Cooperative paid a salary to Nicole Westerhuis of \$62,129.60 in FY 2015. According to OSEC's IRS Form 990 for 2014, the latest IRS Form 990 available, Nicole Westerhuis was compensated \$38,521 as the Business Manager of OSEC.

Failure to Disclose Related Party Transactions

The nature of the employment and operational relationships between the Cooperative and AIII and OSEC makes them related parties of the Cooperative. 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 the Cooperative. Although the Cooperative's financial statements report that they were prepared in accordance with GAAP, there were no related party transactions reported in previously issued financial statements. We believe the amounts were material and should have been disclosed.

Inadequate Oversight of Partner Organizations

Since key employees of the Cooperative 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 some of the Cooperative 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.

The Cooperative's Director informed us that he believed Scott Westerhuis was a financial advisor or consultant to AIII.

A review of invoices submitted by AIII to the Cooperative revealed that many invoices submitted by AIII were signed by Scott Westerhuis and that the claim payment authorization and check at the Cooperative were also approved by Scott Westerhuis. No documentation to support the reimbursement claim, other than the invoice from AIII signed by Scott Westerhuis, was available. The lack of adequate monitoring of these related party transactions exposed the Cooperative to potential violation of federal regulations, and an increased risk of fraud, waste, and abuse.

Lack of Competition in Contracting for Services

The Cooperative's policy and state law require compliance with South Dakota procurement statutes. Our review of the Cooperative's files and discussions with the Director revealed no evidence that competition was used in the process of contracting with educational services vendors and consultants. Although the majority of the Cooperative'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 the Director 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 services provided by and payments made to this vendor.

The Cooperative's accounting records showed that BC Kuhn Evaluation, LLC was paid \$82,452.97 that was coded to the GEAR UP grant for FY 2015. There were three contracts between the Cooperative and BC Kuhn Evaluation, LLC for services to the GEAR UP program during FY 2015. Two of these contracts specified that BC Kuhn Evaluation, LLC was to assist in the administration of the GEAR UP program. A third contract provided that BC Kuhn Evaluation, LLC would perform the formative evaluation of the grant through August 03, 2014 even though the firm had been assisting with administration of the GEAR UP program for the same period. In addition, for two of the three contracts we were unable to find evidence in the Cooperative Governing Board minutes that these contracts had been approved by the Governing Board.

The Cooperative's accounting records showed that BC Kuhn Evaluation, LLC was paid \$32,083.37 that was coded to the College Access grant for FY 2015. BC Kuhn Evaluation, LLC contracted with the Cooperative, from August 14, 2014 through August 13, 2015, to assist in the administration of the College Access program. The Cooperative 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.

The Cooperative's accounting records showed that BC Kuhn Evaluation, LLC was paid \$82,873.42 that was coded to the Teacher Quality grant for FY 2015. We found one subaward agreement in place between the Cooperative and BC Kuhn Evaluation, LLC for the time period from October 1, 2009 through

September 30, 2010. We found no other subawards or contracts with BC Kuhn Evaluation, LLC for the amount that was paid from the Teacher Quality grant in FY 2015. Additionally, we found no evidence in the Cooperative Governing Board meeting minutes that the Board had approved any contracts with BC Kuhn Evaluation, LLC relating to the Teacher Quality grant.

Effects of the Inadequate Oversight of Related Parties and Conflicts of Interest

The Cooperative's failure to establish adequate policies and procedures to address the risks associated with related parties and conflicts of interest allowed a misappropriation of the Cooperative funds to continue undetected for several years as discussed in the Current Audit Finding No. 2015-009. In addition, we identified significant unsupported expenditures for the GEAR UP, Teacher Quality and Wakan Gli Federal grant programs as discussed in the Current Audit Findings No. 2015-002, 2015-003, 2015-004, 2015-005, 2015-006, 2015-007, and 2015-008.

RECOMMENDATIONS:

1. We recommend the Cooperative review its policies and procedures and revise them to reflect current services provided by the cooperative and the risks associated with providing those services.
2. We recommend the Cooperative improve its conflict of interest policies and procedures.
3. We recommend the Cooperative ensure that contracts or agreements be created for all contractual services associated with each program or activity of the Cooperative and that these contracts or agreements be approved by the Governing Board.
4. We recommend the Cooperative introduce competition into the process of contracting for professional services.

Auditee's Corrective Action Plan:

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report.

Federal Compliance-Related Audit Findings and Questioned Costs:

Gear Up Grant Allowable Costs

Finding No. 2015-002:

Mid Central Educational Cooperative (Cooperative) 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: 2014, 2015

Federal Agency: Department of Education

Type of Finding: Material Noncompliance

Category of Finding: Allowable Costs/Cost Principles

Questioned Costs: \$97,544.14

Analysis:

All costs incurred under the GEAR UP program are 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 C.1.j., the costs must be adequately documented.

As it relates to compensation for personal services, U.S. Office of Management and Budget (OMB) Circular A-87 Attachment B (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 (5) ...
- (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..."

There were a total of fourteen Cooperative employees that charged time to the GEAR UP program throughout the year. This does not include the seasonal summer employees. We reviewed all salaries and wages charged to the grant. Of the fourteen employees, there were four fiscal employees who had monthly signed personnel activity reports which stated they either worked 25% or 50% of their time directly on the GEAR UP program. We determined that the percentage of salaries charged directly to the GEAR UP program did not agree with the signed personnel activity reports percentages. We recalculated the four fiscal employees' time based on the percentage of time worked directly on the GEAR UP program from the signed personnel activity reports and this resulted in a total of \$18,094.83 in salaries that were overbilled to the GEAR UP program. This amount will be a questioned cost as it is not accurately supported.

One employee, whose salary and benefits were charged to the GEAR UP program, had no personnel activity reports to support the time charged to the program during FY 2015. The total salary and benefits charged to the program were \$11,324.70. This amount will be a questioned cost as it is not adequately supported.

We obtained the Cooperative's employment contracts with Mr. Stacy Phelps for periods from September 2014 through October 2015. The contracts identify Mr. Phelps as the Cooperative's Outreach Coordinator and Native American Technical Advisor. The employment contracts for fiscal year 2015 and 2016 specified that Mr. Phelps would work 185 days each year for the Cooperative in this capacity. None of the contracts mention the GEAR UP program.

The partnership agreement for 2015, between the Cooperative and American Indian Institute for Innovation (AIII) specified that AIII would administer the six week GEAR UP summer program. On March 20, 2015, the Cooperative billed the SDDOE \$65,000 for GEAR UP summer program services performed by Mr. Phelps, as a Cooperative employee. Billing the SDDOE \$65,000 for Mr. Phelps's GEAR UP summer program services as a Cooperative employee is inconsistent with both Mr. Phelps's employment contracts and the Cooperative/AIII partnership agreements. We found no evidence of amendments to either the employment contracts or partnership agreements to support this billing.

We also reviewed the Cooperative's accounting records for salary expenditures for Mr. Phelps and determined that none of his salary was coded to GEAR UP in FY 2015. We found nothing in the Cooperative's payroll records to support the \$65,000 payroll charge to GEAR UP for Mr. Phelps. This amount will be a questioned cost as it is not adequately supported.

In order for a cost to be allowable under OMB Circular A-87, the costs must be adequately documented. In our testing of expenditures, there were two travel vouchers that did not contain Cooperative approval

documentation which is used by the Cooperative to document approval as a proper GEAR UP program expense. These two travel vouchers totaled \$1,795.61. We also reviewed a claim submitted for food expense. The receipt for the food expense claim did not have the restaurant location or date of the receipt to determine if it was truly an allowable cost of the program. This claim totaled \$1,329.00. These amounts will be a questioned cost as it is not adequately supported or documented.

RECOMMENDATION:

5. We recommend the Cooperative comply with allowable cost and cost principles requirements.

Auditee's Corrective Action Plan:

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report.

Gear Up Grant Matching Requirements

Finding No. 2015-003:

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

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

Questioned Costs: \$4,165,185.00

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 the Cooperative for the administration of GEAR UP grant. The partnership agreement placed the responsibility for compliance with the GEAR UP matching requirements with the Cooperative. This responsibility required that the Cooperative demonstrate how matching contributions benefited the GEAR UP program and that these contributions were properly supported and verifiable. 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....

We 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.

The Cooperative 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 the Cooperative 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 the Cooperative 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 questioned costs for 2014 and 2015.

The Cooperative also reported a matching contribution in the form of payroll from a partner school totaling \$165,185.00. The partner school and the Cooperative 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 \$165,185.00. 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 \$165,185.00 to be questioned costs.

RECOMMENDATION:

6. We recommend the Cooperative establish internal controls to ensure compliance with federal program matching requirements.

Auditee's Corrective Action Plan:

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report.

Gear Up Subrecipient Monitoring

Finding No. 2015-004:

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

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 South Dakota Department of Education (SDDOE) had a partnership agreement with the Cooperative for administration of the GEAR UP program. The Cooperative 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 SDDOE. The partnership agreement between the Cooperative 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 SDDOE and the Cooperative by reference. According to the agreement, the Cooperative 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 the Cooperative and AIII was a subaward of GEAR UP funds and not a contract for services. As a subaward, the Cooperative would be considered the pass-through entity, and AIII would be considered a 2nd tier 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 IRS 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. The Cooperative did not have internal controls in place to ensure that the agreement with AIII was correctly identified as a subaward and that AIII had complied with the Single Audit Act.

RECOMMENDATION:

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

Auditee's Corrective Action Plan:

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report.

Teacher Quality Partnership Grants Allowable Costs

Finding No. 2015-005:

Mid Central Educational Cooperative (Cooperative) did not comply with allowable costs and cost principles requirements.

CFDA Title: Teacher Quality Partnership Grants
CFDA Number: 84.336
Federal Award Number: U336S090010
Federal Award Year: 2015
Federal Agency: Department of Education
Type of Finding: Material Weakness
Category of Finding: Allowable Costs/Cost Principles
Questioned Costs: \$213,897.25

Analysis:

All costs incurred under the Teacher Quality Partnership Grants (Teacher Quality) program are 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 C.1.j., the costs must be adequately documented.

As it relates to compensation for personal services, U.S. Office of Management and Budget (OMB) Circular A-87 Attachment B (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 (5) ...
- (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..."

During Fiscal Year 2015 a total of \$41,666.40 was charged to Teacher Quality for salaries and benefits expense. These expenses were coded to Teacher Quality by means of a journal entry made on April 14, 2015 and were for salaries relating to Nicole Westerhuis and Stephanie Hubers. A total of \$18,574.16 of Nicole Westerhuis' and \$13,043.35 of Stephanie Huber's salaries and benefits were coded to Teacher Quality.

According to the Cooperative's files, Nicole Westerhuis' signed Personnel Activity reports from July 2014 – June 2015 stated she worked 50% of her time on GEAR UP and 50% of her time on Cooperative fiscal work. There were no effort logs or timesheets to support that Nicole Westerhuis worked any time directly on Teacher Quality. Her job title was Assistant Business Manager.

The Cooperative did not have any personnel activity report or signed certifications on file for Stephanie Hubers, who was also employed as an Assistant Business Manager. All of Stephanie Hubers' time for FY 2015 was coded directly to the General Fund. There were no effort logs or timesheets to support that Stephanie Hubers worked any time directly on Teacher Quality.

The salaries and benefits amount of \$41,666.40 for these two employees will be a questioned cost as it is not adequately supported.

We reviewed vouchers and supporting invoices for a sample of Teacher Quality expenditures totaling \$405,615.61. Our review identified that vouchers totaling \$170,171.81 (41.95% of the sample of expenditures reviewed) did not have adequate support. The vouchers related to entities the Cooperative partnered with to help administer the Teacher Quality grant program; American Indian Institute for Innovation (AIII) in the amount of \$78,026.72 and BC Kuhn Evaluation, LLC in the amount of \$92,145.09.

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. There was no additional evidence to support the expenses claimed by each partner. The amount of \$170,171.81 will be a questioned cost as it is not adequately supported.

We also found that another entity the Cooperative partnered with to help administer the Teacher Quality grant program, Rural Learning Center, incorrectly billed the Teacher Quality grant program at a flat indirect cost rate in excess of the approved 8% indirect cost rate, resulting in overbilling the Teacher Quality grant program in the amount of \$859.04. This amount will be a questioned cost as it was billed in excess of agreed amount.

Finally, we found that the Cooperative incorrectly coded a voucher, charging the Teacher Quality grant for \$1,200.00 for a charge related to a different grant program. This amount will be a questioned cost as it was incorrectly billed to the Teacher Quality grant program.

RECOMMENDATION:

8. We recommend the Cooperative comply with allowable cost and cost principles requirements.

Auditee's Corrective Action Plan:

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report.

Teacher Quality Partnership Grants Matching

Finding No. 2015-006:

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

CFDA Title: Teacher Quality Partnership Grants
CFDA Number: 84.336
Federal Award Number: U336S090010
Federal Award Year: 2015
Federal Agency: Department of Education
Type of Finding: Material Noncompliance
Category of Finding: Matching, Level of Effort, Earmarking

Questioned Costs: \$1,262,131.43

Analysis:

Title 20 of the U.S. Code (USC), part 1022b(c) specifies that at 100 percent of the Teacher Quality Partnership Grants (Teacher Quality) program must be matched with cash or in-kind contributions from non-Federal sources, however the US Department of Education may provide a waiver for any fiscal year for all or part of the matching requirement. The Cooperative received a 65% waiver for the first two years of the grant award. The Cooperative was required to match a total of \$4,446,358.08 over the course of the grant period. However, the Cooperative was under the required match amount by \$1,262,131.43. The amount under the match requirement consists of (\$892,032.98) under matched by the Teacher Quality grant partners [*American Indian Institute for Innovation (\$802,000.42)*, *BC Kuhn Evaluation, LLC (\$25,133.69)*, *Rural Learning Center (\$7,228.43)* and *the Cooperative (\$307,139.71)*] and the over match of the *University of South Dakota \$116,449.81*, *Cooperative Region 3 ESA \$72,165.36*, *Past Foundation \$55,204.10* and *TIE \$5,650.00*] and the unsupported indirect cost claimed by the Cooperative in the amount of (\$370,098.45).

The table below shows the breakdown of the amount (under) or over the required match amount by each year of the grant and the total for the Teacher Quality grant.

Total All Partners				
	<u>Total Amount Spent</u>	<u>Match Requirement</u>	<u>Actual Supported Match Amount</u>	<u>(Under) / Over Match Requirement</u>
Year 1 (2009-10)	\$ 795,959.15	\$ 278,585.70	\$ 319,565.01	\$ 40,979.31
Year 2 (2010-11)	1,023,837.67	358,343.18	459,076.36	100,733.18
Year 3 (2011-12)	1,408,722.11	1,408,722.11	662,756.26	(745,965.85)
Year 4 (2012-13)	989,434.15	989,434.15	579,792.80	(409,641.35)
Year 5 (2013-14)	915,252.97	915,252.97	598,935.38	(316,317.59)
Year 6 (2014-15)	496,019.97	496,019.97	564,100.84	68,080.87
Totals	<u>\$ 5,629,226.02</u>	<u>\$ 4,446,358.08</u>	<u>\$ 3,184,226.65</u>	<u>\$ (1,262,131.43)</u>

Based upon our testing, the Cooperative was not in compliance with federal matching requirements. The amount of \$1,262,131.43 will be a questioned cost as the actual match requirements were not met and the indirect cost used was not adequately supported.

RECOMMENDATION:

- We recommend that the Cooperative comply with the Teacher Quality Partnership Grants program federal matching requirements.

Auditee's Corrective Action Plan:

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report.

Wakan Gli Allowable Costs

Finding No. 2015-007:

Mid Central Educational Cooperative's (Cooperative) internal controls were not adequate to ensure compliance with allowable costs and cost principles requirements.

CFDA Title: Wakan Gli (Sacred Movement)
CFDA Number: 84.299A
Federal Award Number: S299A090028-12
Federal Award Year: 2014
Federal Agency: Department of Education
Type of Finding: Material Weakness
Category of Finding: Allowable Costs/Cost Principles

Questioned Costs: \$76,208.00

Analysis:

All costs incurred under the Wakan Gli grant program are 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 C.1.j., the costs must be adequately documented.

As it relates to compensation for personal services, U.S. Office of Management and Budget (OMB) Circular A-87 Attachment B (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 (5) ...

- (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..."

During Fiscal Year 2015 the Cooperative received the final drawdown of federal grant revenues related to the Wakan Gli grant in the amount of \$76,208.00. The only support for this drawdown was a copy of an Account Inquiry report from the Cooperative's accounting system. The Account Inquiry showed only \$0.00 balances in all of the accounts shown on the report. At the bottom of the Account Inquiry report there was a handwritten note that stated "July 2014 – Drawdown Remaining Funds to cover a portion of Stacy Phelps' Salary & Benefits Receipt into #12-4910-000". There were no time and effort logs documenting that Stacy Phelps spent time on Wakan Gli activities. This amount will be a questioned cost as it is not accurately supported.

RECOMMENDATION:

10. We recommend the Cooperative comply with allowable cost and cost principles requirements.

Auditee's Corrective Action Plan:

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report.

Compliance with Indirect Cost Federal Requirements

Finding No. 2015-008:

Information reported to the U.S. Department of Education (USDOE) in Mid Central Educational Cooperative's (Cooperative) 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 the Cooperative using actual fiscal year 2013 accounting information. To calculate an indirect cost rate, the Cooperative 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 Cooperative 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 the Cooperative 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:

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

Auditee's Corrective Action Plan:

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report.

Current Other Audit Findings:

Internal Control-Related Findings - Material Weaknesses:

Unauthorized Withdrawals from Mid Central Educational Cooperative's Checking Account

Finding No. 2015-009:

Unauthorized withdrawals totaling \$7,837,967 were made from Mid Central Educational Cooperative's (Cooperative) 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 the Cooperative's checking account that were not permitted by law or authorized by the Cooperative's Governing Board or Director. We noted transactions in the Cooperative's bank statements that were identified as, "electronic dbt Intuit payrolls QuickBooks". Intuit payroll software is a component of QuickBooks accounting nonprofit software and in this case was used to make withdrawals from the Cooperative's checking account for other nonprofit organizations' payrolls. The Cooperative's accounting software vendor is Software Unlimited and the Cooperative does not use QuickBooks for processing its payroll.

We reviewed the Cooperative's bank statements from 2007 through 2015 to determine the amount of QuickBooks's payrolls withdrawn from the Cooperative's checking account. We found that payrolls for three nonprofit organizations were being withdrawn from the Cooperative'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 the Cooperative to loan money to or pay the general expenses of nonprofit organizations. We did not find any evidence that either the Director of the Cooperative or the Cooperative Governing Board authorized payroll withdrawals for the three nonprofit organizations. We interviewed the Director of the Cooperative and he told us that he was not aware that OSEC and AIII payrolls were being withdrawn from the Cooperative's checking account. We also interviewed Cooperative Board members and they informed us that they were not aware that OSEC and AIII payrolls were being withdrawn from the Cooperative's checking account.

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

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

The total loss due to misappropriation of the Cooperative's funds as it relates to the FY 2015 financial statements is as follows:

Misappropriation Loss June 30, 2014 and prior	\$ 839,256
Misappropriation Loss July 1, 2014 to June 30, 2015	294,214
Misappropriation Loss July 1, 2015 to September 2015	<u>255,160</u>
Total Misappropriation Loss	<u>\$ 1,388,630</u>

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

RECOMMENDATION:

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

Auditee's Corrective Action Plan:

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report.

Financial Reporting Errors

Finding No. 2015-010:

Internal accounting controls over financial reporting for the year 2015 were inadequate resulting in inaccurate information being presented to users of the annual financial reports. This is the ninth consecutive audit in which a similar finding was noted.

Analysis:

We noted the following significant errors in Mid Central Educational Cooperative's (Cooperative) annual financial reports for the year ended June 30, 2015:

- a. The 2015 Statement of Net Position contained the following errors:
- Accounts Receivable was overstated by \$451,369.11.
 - Net Pension Asset was understated by \$1,052,389.74.
 - Other Capital Asset, Net of Depreciation was overstated by \$864.28.
 - Pension Related Deferred Outflows of Resources was understated by \$938,832.65.
 - Accounts Payable was understated by \$629,488.77.
 - Other Current Liabilities was understated by \$67,408.71.
 - Unrestricted Net Position was overstated by \$17,595.69.
 - Pension Related Deferred Inflows of Resources was understated by \$1,218,844.74.
 - Net Investment in Capital Asset was understated by \$864.28.
 - Restricted Net Position related to Pension was understated by \$772,377.65.
 - Unrestricted Net Position was overstated by \$1,148,266.59.
- b. The 2015 Statement of Activities contained the following errors:
- Instruction Expenses were overstated by \$748.23 and Support Service Expenses were overstated by \$1,121,309.16 due to removing the effects of prior year accounts payable and adding the effects current year unreported accounts payable.
 - Other General Revenue was overstated by \$640,470.55.
 - An Extraordinary Item – Loss Due To Misappropriation, in the amount of \$294,214.66 was not reflected on the financial statements.
 - A Prior Period Adjustment, in the amount of \$387,887.29, was necessary to remove the effect of Prior Year Accounts Receivable Overstatement.
 - A Prior Period Adjustment, in the amount of \$694,818.73, was necessary to remove the effect of Prior Year Accounts Payable Understatement.
 - A Prior Period Adjustment, in the amount of \$56,422.99, was necessary to remove the effect of Prior Year Contracts Payable Understatement.
 - A Prior Period Adjustment related to a Net Pension Asset in the amount of \$561,052.14 was not reported.
 - A Prior Period Adjustment, in the amount of \$839,256.40, was necessary to properly reflect Prior Years Loss Due To Misappropriation.
- c. The 2015 Governmental Funds Balance Sheet contained the following errors:
- Accounts Receivable was overstated by \$451,369.11.
 - Accounts Payable was understated by \$629,488.77.
 - Contracts Payable was understated by \$62,513.47 and Payroll Deductions Payable was understated by \$4,895.24.
 - Unassigned Fund Balance was overstated by \$1,148,266.59.
- d. The 2015 Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances contained the following errors:
- Other Revenue from Local Sources – Other were overstated by \$684,923.10.
 - Various expenditure functions were misstated due to removing the effects of prior year accounts payable and adding the effects current year unreported accounts payable. The most significant expenditure overstatement was Support Services – School Administration – Other which overstated \$1,030,655.70. The total Expenditures were overstated \$1,033,482.00.
 - An Extraordinary Item – Loss Due To Misappropriation, in the amount of \$294,214.66 was not reflected on the financial statements.
 - A Prior Period Adjustment, in the amount of \$387,887.29, was necessary to remove the effect of Prior Year Accounts Receivable Overstatement.

- A Prior Period Adjustment, in the amount of \$694,818.73, was necessary to remove the effect of Prior Year Accounts Payable Understatement.
- A Prior Period Adjustment, in the amount of \$56,422.99, was necessary to remove the effect of Prior Year Contracts Payable Understatement.
- A Prior Period Adjustment, in the amount of \$839,256.40, was necessary to properly reflect Prior Years Loss Due To Misappropriation.

e. The 2015 Fiduciary Funds Statement of Net Position contained the following errors:

- Cash and Cash Equivalents and Amounts Held for Others were understated by \$34,877.04.

Other less significant errors were also noted in the Cooperative's annual financial reports.

We were able to correct the material reporting errors and therefore have issued an unmodified auditor's opinion on the financial statements contained in this audit report. However, users of the annual financial reports received information of diminished reliability.

RECOMMENDATION:

13. We recommend the Cooperative strengthen internal accounting controls over financial reporting.

Auditee's Corrective Action Plan:

The Cooperative's response and corrective action plan are on pages 57 to 67 of the report.



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MARTIN L. GUINDON, CPA
AUDITOR GENERAL

INDEPENDENT AUDITOR'S REPORT

Cooperative Board
Mid Central Educational Cooperative
Platte, South Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Mid Central Educational Cooperative, Platte, South Dakota (Cooperative), as of June 30, 2015 and for the year then ended, and the related notes to the financial statements, which collectively comprise the Cooperative's basic financial statements as listed in the Table of Contents.

Management's Responsibility for the Financial Statements

The Cooperative's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Cooperative's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Cooperative as of June 30, 2015, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Adoption of New Accounting Standard. As described in Note 8 to the financial statements, the Cooperative adopted the provisions of Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions* and Statement No. 71 *Pension Transition for Contributions Made Subsequent to the Measurement Date*. As discussed in Note 7 to the financial statements, the Cooperative has retroactively restated the previously reported Net Position in accordance with this statement. Our opinions are not modified with respect to this matter.

Contingent Liability. As described in Note 14 to the financial statements, there is a potential for the Cooperative to be held liable for repayment of federal grant related questioned costs. No provision has been made in the financial statements for any potential losses. Our opinions are not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Budgetary Comparison Schedule on page 50, the Schedule of the Cooperative's Contributions on page 52, and the Schedule of the Cooperative's Proportionate Share of the Net Pension Liability (Asset) on page 53 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

The Cooperative has omitted the Management's Discussion and Analysis (MD&A) that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Cooperative's basic financial statements. The Schedule of Expenditures of Federal Awards, which as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* listed in the Table of Contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the

responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 19, 2017 on our consideration of the Cooperative's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Cooperative's internal control over financial reporting and compliance.

A handwritten signature in black ink, appearing to read "Martin L. Guindon". The signature is fluid and cursive, with a large initial "M" and "G".

Martin L. Guindon, CPA
Auditor General

May 19, 2017

MID CENTRAL EDUCATIONAL COOPERATIVE
STATEMENT OF NET POSITION
June 30, 2015

	Primary Government Governmental Activities
ASSETS:	
Cash and Cash Equivalents	\$ 1,262,867.15
Advanced Payments	10,000.00
Accounts Receivable, Net	146,246.13
Due from Federal Government	299,915.00
Due from State Government	766,227.57
Net Pension Asset	1,052,389.74
Capital Assets:	
Land, Improvements and Construction in Progress	27,149.00
Other Capital Assets, Net of Depreciation	577,573.50
	<u>577,573.50</u>
TOTAL ASSETS	\$ 4,142,368.09
	<u>4,142,368.09</u>
DEFERRED OUTFLOWS OF RESOURCES:	
Pension Related Deferred Outflows	\$ 938,832.65
	<u>938,832.65</u>
TOTAL DEFERRED OUTFLOWS OF RESOURCES	\$ 938,832.65
	<u>938,832.65</u>
LIABILITIES:	
Accounts Payable	\$ 629,488.77
Other Current Liabilities	333,578.97
Noncurrent Liabilities:	
Due Within One Year	15,000.00
Due in More than One Year	68,590.23
	<u>68,590.23</u>
TOTAL LIABILITIES	\$ 1,046,657.97
	<u>1,046,657.97</u>
DEFERRED INFLOWS OF RESOURCES:	
Pension Related Deferred Inflows	\$ 1,218,844.74
	<u>1,218,844.74</u>
TOTAL DEFERRED INFLOWS OF RESOURCES	\$ 1,218,844.74
	<u>1,218,844.74</u>
NET POSITION: (See Note 6)	
Net Investment in Capital Assets	\$ 604,722.50
Restricted For:	
Pension Fund Purposes	772,377.65
Unrestricted	1,438,597.88
	<u>1,438,597.88</u>
TOTAL NET POSITION	\$ 2,815,698.03
	<u>2,815,698.03</u>

The notes to the financial statements are an integral part of this statement.

**MID CENTRAL EDUCATIONAL COOPERATIVE
STATEMENT OF ACTIVITIES
For the Year Ended June 30, 2015**

Functions/Programs	Program Revenues			Net (Expense) Revenue and Changes in Net Position
	Expenses	Charges for Services	Operating Grants and Contributions	
Primary Government:				
Governmental Activities:				
Instruction	\$ 158,960.50	\$ 409,665.89	\$	\$ 250,705.39
Support Services	8,304,837.72	764,557.88	6,212,963.85	(1,327,315.99)
Total Primary Government	\$ 8,463,798.22	\$ 1,174,223.77	\$ 6,212,963.85	(1,076,610.60)
General Revenues:				
Other General Revenues				1,431,653.34
Extraordinary Items - Loss Due to Misappropriation (See Note 11)				(294,214.66)
Total General Revenues and Extraordinary Items				1,137,438.68
Change in Net Position				60,828.08
Net Position - Beginning				3,610,168.10
Adjustments: (See Note 7)				
Refund of Federal Grant Revenues to State of South Dakota				(213,739.46)
Remove Effect of Prior Year Accounts Receivable Overstatement				387,887.29
Remove Effect of Prior Year Accounts Payable Understatement				(694,818.73)
Remove Effect of Prior Year Contracts Payable Understatement				(56,422.99)
Add Effect of Prior Year Net Pension Asset				561,052.14
Prior Years Loss Due to Misappropriation (See Note 11)				(839,256.40)
Adjusted Net Position - Beginning				2,754,869.95
NET POSITION - ENDING				\$ 2,815,698.03

The notes to the financial statements are an integral part of this statement.

**MID CENTRAL EDUCATIONAL COOPERATIVE
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2015**

		General Fund
<hr/>		
ASSETS:		
Cash and Cash Equivalents	\$	1,262,867.15
Advance Payments		10,000.00
Accounts Receivable, Net		146,246.13
Due from Federal Government		299,915.00
Due from State Government		766,227.57
<hr/>		
TOTAL ASSETS	\$	<u>2,485,255.85</u>
LIABILITIES AND FUND BLANCES:		
Liabilities:		
Accounts Payable	\$	629,488.77
Contracts Payable		267,977.70
Payroll Deductions and Withholdings and Employer Matching Payable		65,601.27
<hr/>		
Total Liabilities		<u>963,067.74</u>
Fund Balances:		
Unassigned		<u>1,522,188.11</u>
Total Fund Balances		<u>1,522,188.11</u>
TOTAL LIABILITIES AND FUND BALANCES	\$	<u><u>2,485,255.85</u></u>

The notes to the financial statements are an integral part of this statement.

**MID CENTRAL EDUCATIONAL COOPERATIVE
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET POSITION
June 30, 2015**

Total Fund Balances - Governmental Funds	\$	1,522,188.11
Amounts reported for governmental activities in the Statement of Net Position are different because:		
Capital assets used in governmental activities are not current financial resources and therefore are not reported in the funds.		604,722.50
Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds.		(83,590.23)
Net pension asset reported in governmental activities is not an available financial resource and therefore is not reported in the funds.		1,052,389.74
Pension related deferred outflows are components of pension liability (asset) and therefore are not reported in the funds.		938,832.65
Pension related deferred inflows are components of pension liability (asset) and therefore are not reported in the funds.		(1,218,844.74)
Net Position - Governmental Activities	<u>\$</u>	<u>2,815,698.03</u>

The notes to the financial statements are an integral part of this statement.

**MID CENTRAL EDUCATIONAL COOPERATIVE
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
For the Year Ended June 30, 2015**

	General Fund
Revenues:	
Revenue from Local Sources:	
Tuition and Fees:	
Student Tuition	\$ 409,665.89
Other Revenue from Local Sources:	
Contributions and Donations	1,000.00
Services Provided Other LEAs	764,557.88
Other	1,387,200.79
Revenue from State Sources:	
Other State Revenue	971,040.85
Revenue from Federal Sources:	
Grants-in-Aid:	
Restricted Grants-in-Aid	
Received from Federal	
Government Through the State	4,260,805.01
Other Federal Revenue	980,117.99
Total Revenues	8,774,388.41
Expenditures:	
Instruction:	
Special Programs:	
Programs for Special Education	75,378.60
Other Special Programs	83,581.90
Support Services:	
Pupils:	
Guidance	1,870.11
Psychological	529,919.58
Speech Pathology	547,904.67
Audiology Services	172,939.76
Student Therapy Services	234,836.59
Support Services - Instructional Staff:	
Improvement of Instruction	979,009.41
Educational Media	90,253.33
Support Services - General Administration:	
Board of Education	150,638.83
Executive Administration	151,588.55
Support Services - School Administration:	
Other	5,336,866.21

MID CENTRAL EDUCATIONAL COOPERATIVE
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
For the Year Ended June 30, 2015
(Continued)

	General Fund
Support Services - Business:	
Fiscal Services	121,784.33
Operation and Maintenance of Plant	75,801.74
Total Expenditures	8,552,373.61
Excess of Revenues Over (Under) Expenditures	222,014.80
Extraordinary Items - Loss Due to Misappropriation (See Note 11)	(294,214.66)
Net Change in Fund Balance	(72,199.86)
Fund Balance - Beginning	3,010,738.26
Adjustments: (See Note 7)	
Refund of Federal Grant Revenues to State of South Dakota	(213,739.46)
Remove Effect of Prior Year Accounts Receivable Overstatement	387,887.29
Remove Effect of Prior Year Accounts Payable Understatement	(694,818.73)
Remove Effect of Prior year Contracts Payable Understatement	(56,422.99)
Prior Years Loss Due to Misappropriation (See Note 11)	(839,256.40)
Adjusted Fund Balance - Beginning	1,594,387.97
FUND BALANCE - ENDING	\$ 1,522,188.11

The notes to the financial statements are an integral part of this statement.

**MID CENTRAL EDUCATIONAL COOPERATIVE
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCES TO THE STATEMENT OF ACITIVITES
For the Year Ended June 30, 2015**

Net Change in Fund Balances - Total Governmental Funds	\$	(72,199.86)
Amounts reported for governmental activities in the Statement of Activities are different because:		
This amount represents the current year depreciation expense reported in the Statement of Activities which is not reported on the fund financial statements because it does not require the use of current financial resources.		(73,587.88)
Governmental funds recognize expenditures for amounts of compensated absences and early retirement benefits actually paid to employees with current financial resources during the fiscal year. Amounts of compensated absences earned by employees are not recognized in the funds. In the Statement of Activities, expenses for these benefits are recognized when the employees earn leave credits or elect to retire early.		(4,709.69)
Changes in the pension related deferred outflows/inflows are direct components of pension liability (asset) and are not reflected in the governmental funds.		211,325.51
Change in Net Position of Governmental Activities	<u>\$</u>	<u>60,828.08</u>

The notes to the financial statements are an integral part of this statement.

**MID CENTRAL EDUCATIONAL COOPERATIVE
STATEMENT OF FIDUCIARY NET POSITION
FIDUCIARY FUNDS
June 30, 2015**

	<u>Agency Funds</u>
ASSETS:	
Cash and Cash Equivalents	\$ 385,038.85
TOTAL ASSETS	<u>\$ 385,038.85</u>
LIABILITIES:	
Amounts Held for Others	\$ 385,038.85
TOTAL LIABILITIES	<u>\$ 385,038.85</u>

The notes to the financial statements are an integral part of this statement.

MID CENTRAL EDUCATIONAL COOPERATIVE
NOTES TO THE FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Mid Central Educational Cooperative conform to generally accepted accounting principles applicable to government entities in the United States of America.

a. Financial Reporting Entity:

The reporting entity of Mid Central Educational Cooperative(Cooperative), consists of the primary government (which includes all of the funds, organizations, institutions, agencies, departments, and offices that make up the legal entity, plus those funds for which the primary government has a fiduciary responsibility, even though those fiduciary funds may represent organizations that do not meet the criteria for inclusion in the financial reporting entity); those organizations for which the primary government is financially accountable; and other organizations for which the nature and significance of their relationship with the primary government are such that their exclusion would cause the financial reporting entity's financial statements to be misleading or incomplete.

Local financing of the Cooperative is raised by each member school district contributing a pro-rated share of said amount based upon the number of children listed in the Annual Accreditation Report, plus any children enrolled in private schools from each member district.

The members of the Cooperative and their relative percentage of participation are as follows:

Armour School District	4.73%
Burke School District	5.92%
Colome Consolidated School District	7.56%
Corsica School District	4.16%
Ethan School District	7.04%
Gregory School District	10.85%
Kimball School District	7.85%
Mt. Vernon School District	6.64%
Plankinton School District	9.15%
Platte-Geddes School District	12.60%
Stickney School District	3.35%
Wessington Springs School District	8.11%
White Lake School District	3.29%
Wolsey-Wessington School District	8.75%

b. Basis of Presentation:

Government-wide Financial Statements:

The Statement of Net Position and Statement of Activities display information about the reporting entity as a whole. They include all funds of the reporting entity except for fiduciary funds. Governmental activities generally are financed through school assessments, intergovernmental revenues, and other non-exchange revenues.

The Statement of Net Position reports all financial and capital resources, in a net position form (assets minus liabilities equal net position). Net Position are displayed in three components, as applicable, net investment in capital assets, restricted (distinguishing between major categories of restrictions), and unrestricted.

The Statement of Activities presents a comparison between direct expenses and program revenues for each function of the Cooperative's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by recipients of goods and services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues.

Fund Financial Statements:

Fund financial statements of the reporting entity are organized into funds, each of which is considered to be a separate accounting entity. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, fund equity, revenues, and expenditures/expenses. Funds are organized into two major categories: governmental and fiduciary. An emphasis is placed on major funds within the governmental category. A fund is considered major if it is the primary operating fund of the Cooperative or it meets the following criteria:

1. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental or enterprise fund are at least 10 percent of the corresponding total for all funds of that category or type, and
2. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined, or
3. Management has elected to classify one or more governmental or enterprise funds as major for consistency in reporting from year to year, or because of public interest in the fund's operations.

The funds of the Cooperative financial reporting entity are described below within their respective fund types:

Governmental Funds:

General Fund – A fund established by South Dakota Codified Law (SDCL) 13-16-3 to meet all the general operational costs of the Cooperative. The General Fund is always a major fund.

Fiduciary Funds:

Fiduciary funds consist of the following sub-category and are never considered to be major funds:

Agency Funds – Agency funds are used to account for resources held by the Cooperative in a purely custodial capacity (assets equal liabilities). Since agency funds are custodial in nature they do not involve the measurement of results of operations. The Cooperative maintains agency funds to account for the custodial purposes for amounts held for other organizations.

c. Measurement Focus and Basis of Accounting:

Measurement focus is a term used to describe "how" transactions are recorded within the various financial statements. Basis of accounting refers to "when" revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus.

Measurement Focus:

Government-wide Financial Statements:

In the government-wide Statement of Net Position and Statement of Activities, governmental activities are presented using the economic resources measurement focus, applied on the accrual basis of accounting.

Fund Financial Statements:

In the fund financial statements, the “current financial resources” measurement focus and the modified accrual basis of accounting are applied to governmental funds, while the “economic resources” measurement focus and the accrual basis of accounting are applied to the fiduciary fund types.

Basis of Accounting:

Government-wide Financial Statements:

In the government-wide Statement of Net Position and Statement of Activities, governmental activities are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues and related assets generally are recorded when earned (usually when the right to receive cash vests); and, expenses and related liabilities are recorded when an obligation is incurred (usually when the obligation to pay cash in the future vests).

Fund Financial Statements:

All governmental fund types are accounted for using the modified accrual basis of accounting. Their revenues, generally are recognized when they become measurable and available. “Available” means resources are collected or to be collected soon enough after the end of the fiscal year that they can be used to pay the bills of the current period. The accrual period for the Cooperative is 60 days. The revenues which are accrued at June 30, 2015 are grant reimbursements and contracts for services.

Under the modified accrual basis of accounting, receivables may be measurable but not available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period.

Expenditures generally are recognized when the related fund liability is incurred. Exceptions to this general rule include principal and interest on general long-term debt which are recognized when due.

All fiduciary fund types are accounted for using the accrual basis of accounting. Their revenues are recognized when they are earned and their expenses are recognized when they are incurred.

d. Deposits and Investments:

For the purpose of financial reporting, “cash and cash equivalents” includes all demand and savings accounts and certificates of deposit or short-term investments with a term to maturity at date of acquisition of three months or less. Investments in open-end mutual fund shares, or similar investments in external investment pools, are also considered to be cash equivalents.

e. Capital Assets:

Capital assets include land, buildings, machinery and equipment, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.

The accounting treatment over capital assets depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements.

Government-wide Financial Statements:

All capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are valued at their estimated fair value on the date donated. Reported cost values include ancillary charges necessary to place the asset into its intended location and condition for use. Subsequent to initial capitalization, improvements or betterments that are significant and which extend the useful life of a capital asset are also capitalized.

For governmental activities Capital Assets, construction-period interest is not capitalized, in accordance with USGAAP.

Depreciation of all exhaustible capital assets is recorded as an allocated expense in the government-wide Statement of Activities, with net capital assets reflected in the Statement of Net Position. Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts), depreciation methods, and estimated useful lives of capital assets reported in the government-wide statements and proprietary funds are as follows:

	<u>Capitalization Threshold</u>	<u>Depreciation Method</u>	<u>Estimated Useful Life</u>
Land	\$ 0.00	----N/A----	----N/A----
Improvements	\$ 5,000.00	Straight-line	15 yrs.
Buildings	\$ 5,000.00	Straight-line	50 yrs.
Machinery and Equipment	\$ 5,000.00	Straight-line	5 yrs.

Land is an inexhaustible capital asset and is not depreciated.

Fund Financial Statements:

In the fund financial statements, capital assets used in governmental fund operations are accounted for as capital expenditures of the appropriate governmental fund upon acquisition.

f. Long-Term Liabilities:

The accounting treatment of long-term liabilities depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements.

All long-term liabilities to be repaid from governmental resources are reported as liabilities in the government-wide statements. The long-term liabilities consist entirely of compensated absences payable.

In the fund financial statements, debt proceeds are reported as revenues (other financing sources), while payments of principal and interest are reported as expenditures when they become due.

g. Program Revenues:

In the government-wide Statement of Activities, reported program revenues derive directly from the program and from the Cooperative's member School Districts. Program revenues are classified into three categories, as follows:

1. Charges for services – These arise from charges to customers, applicants, or others who purchase, use, or directly benefit from the goods, services, or privileges provided, or are otherwise directly affected by the services.
2. Program-specific operating grants and contributions – These arise from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program.
3. Program-specific capital grants and contributions – These arise from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for the acquisition of capital assets for use in a particular program.

h. Equity Classifications:

Government-wide Financial Statements:

Equity is classified as Net Position and is displayed in three components:

1. Net Investment in Capital Assets – Consists of capital assets, including restricted capital assets, net of accumulated depreciation (if applicable) and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
2. Restricted Net Position – Consists of net position with constraints placed on their use either by (a) external groups such as creditors, grantors, contributors, or laws and regulations of other governments; or (b) law through constitutional provisions or enabling legislation.
3. Unrestricted Net Position – All other net position that do not meet the definition of “restricted” or “net investment in capital assets.”

Fund Financial Statements:

Governmental fund equity is classified as fund balance, and is distinguished between Nonspendable, Restricted, Committed, Assigned, or Unassigned components. Fiduciary fund equity (except for Agency Funds, which have no fund equity) is reported as net position held in trust for other purposes.

i. Application of Net Position:

It is the Cooperative’s policy to first use restricted net position, prior to the use of unrestricted net position, when an expense is incurred for purposes for which both restricted and unrestricted net position are available.

j. Fund Balance Classification Policies and Procedures:

In accordance with Government Accounting Standards Board (GASB) No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, the Cooperative classifies governmental fund balances as follows:

- Nonspendable – includes fund balance amounts that cannot be spent either because it is not in spendable form or because of legal or contractual constraints.
- Restricted – includes fund balance amounts that are constrained for specific purposes which are externally imposed by providers, such as creditors or amounts constrained due to constitutional provisions or enabling legislation.

- Committed – includes fund balance amounts that are constrained for specific purposes that are internally imposed by the government through formal action of the highest level of decision making authority and does not lapse at year-end.
- Assigned – includes fund balance amounts that are intended to be used for specific purposes that are neither considered restricted or committed. Fund Balance may be assigned by the Cooperative Board.
- Unassigned – includes positive fund balance within the General Fund which has not been classified within the above mentioned categories and negative fund balances in other governmental funds.

The Cooperative uses *restricted/committed* amounts first when both restricted and unrestricted fund balance is available unless there are legal documents/contracts that prohibit doing this, such as a grant agreement requiring dollar for dollar spending. Additionally, the Government would first use *committed, then assigned, and lastly unassigned amounts* of unrestricted fund balance when expenditures are made.

The Government *does not* have a formal minimum fund balance policy.

The Cooperative has only Unassigned Fund Balance for the General Fund.

k. Pensions:

For purposes of measuring the net pension liability (asset), deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense (revenue), information about the fiduciary net position of the South Dakota Retirement System (SDRS) and additions to/deletions from SDRS's fiduciary net position have been determined on the same basis as they are reported by SDRS. The Cooperative's contributions and net pension liability (asset) are recognized on an accrual basis of accounting.

2. DEPOSITS AND INVESTMENTS CREDIT RISK, CONCENTRATIONS OF CREDIT RISK AND INTEREST RATE RISK

The Cooperative follows the practice of aggregating the cash assets of various funds to maximize cash management efficiency and returns. Various restrictions on deposits and investments are imposed by statutes. These restrictions are summarized below:

Deposits – The Cooperative's deposits are made in qualified public depositories as defined by SDCL 4-6A-1, 13-16-15, 13-16-15.1, and 13-16-18.1. Qualified depositories are required by SDCL 4-6A-3 to maintain at all times, segregated from their other assets, eligible collateral having a value equal to at least 100 percent of the public deposit accounts which exceed deposit insurance such as the FDIC and NCUA. In lieu of pledging eligible securities, a qualified public depository may furnish irrevocable standby letters of credit issued by federal home loan banks accompanied by written evidence of that bank's public debt rating which may not be less than "AA" or a qualified public depository may furnish a corporate surety bond of a corporation authorized to do business in South Dakota.

Investments – In general, SDCL 4-5-6 permits cooperative funds to be invested only in (a) securities of the United States and securities guaranteed by the United States Government either directly or indirectly; or (b) repurchase agreements fully collateralized by securities described in (a) above; or in shares of an open-end, no-load fund administered by an investment company whose investments are in securities described in (a) above and repurchase agreements described in (b) above. Also, SDCL 4-5-9 requires investments to be in the physical custody of the political subdivision or may be deposited in a safekeeping account with any bank or trust company designated by the political subdivision as its fiscal agent.

Credit Risk – State law limits eligible investments for the Cooperative, as discussed above. The Cooperative has no investment policy that would further limit its investment choices.

Custodial Credit Risk – Deposits – The risk that, in the event of a depository failure, the Cooperative’s deposits may not be returned to it. The Cooperative does not have a deposit policy for custodial credit risk.

Concentration of Credit Risk – The Cooperative places no limit on the amount that may be invested in any one issuer.

Interest Rate Risk – The Cooperative does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Assignment of Investment Income – State law allows income from deposits and investments to be credited to either the General Fund or the fund making the investment. The Cooperative’s policy is to credit all income from investments to the fund making the investment.

3. RECEIVABLES AND PAYABLES

Receivables and payables are not aggregated in these financial statements. The Cooperative expects all receivables to be collected within one year.

4. CHANGES IN CAPITAL ASSETS

A summary of changes in capital assets for the year ended June 30, 2015 is as follows:

	Balance 07/01/2014	Increases	Decreases	Balance 06/30/2015
Primary Government				
Governmental Activities:				
Capital Assets, Not Being Depreciated:				
Land	\$ 27,149.00	\$	\$	\$ 27,149.00
Capital Assets, Being Depreciated:				
Improvements	4,333.38			4,333.38
Buildings	560,625.47			560,625.47
Machinery and Equipment	578,178.30			578,178.30
Total Capital Assets, Being Depreciated	1,143,137.15	0.00	0.00	1,143,137.15
Less Accumulated Depreciation For:				
Improvements	(3,466.68)	(288.89)		(3,755.57)
Buildings	(154,422.02)	(11,765.03)		(166,187.05)
Machinery and Equipment	(334,087.07)	(61,533.96)		(395,621.03)
Total Accumulated Depreciation	(491,975.77)	(73,587.88)	0.00	(565,563.65)
Total Capital Assets, Being Depreciated, Net	651,161.38	(73,587.88)	0.00	577,573.50
Total Governmental Activity Capital Assets, Net	\$ 678,310.38	\$ (73,587.88)	\$ 0.00	\$ 604,722.50

Depreciation expense was charged to functions as follows:

Governmental Activities:	
Support Services	\$ (73,587.88)
Total Depreciation Expense – Governmental Activities	\$ (73,587.88)

5. LONG-TERM LIABILITIES

A summary of the changes in long-term liabilities for the year ended June 30, 2015 is as follows:

	Beginning Balance	Additions	Deletions	Ending Balance	Due Within One Year
Primary Government:					
Governmental Activities:					
Accrued Compensated Absences	\$ 78,880.54	\$ 38,565.61	\$ (33,855.92)	\$ 83,590.23	\$ 15,000.00
TOTAL PRIMARY GOVERNMENT	<u>\$ 78,880.54</u>	<u>\$ 38,565.61</u>	<u>\$ (33,855.92)</u>	<u>\$ 83,590.23</u>	<u>\$ 15,000.00</u>

Compensated absences for governmental activities typically have been liquidated from the General Fund.

Liabilities payable at June 30, 2015 are comprised of the following:

Governmental Activities:

Compensated Absences:

Vested Sick Leave Payable from the General Fund \$ 83,590.23

6. RESTRICTED NET POSITION

Restricted Net Position for the year ended June 30, 2015 was as follows:

Major Purposes:	Restricted By	
Pension Purposes	Law	<u>\$ 772,377.65</u>
Total Restricted Net Position		<u>\$ 772,377.65</u>

This balance is restricted due to statutory requirements.

7. PRIOR PERIOD ADJUSTMENTS

In prior periods, the Cooperative did not properly comply with indirect cost rate proposals for various federal grants which resulted in the Cooperative repaying a total of \$213,739.46 of prior year federal grant revenues.

In addition, the Cooperative overstated the amount reported as Accounts Receivable and did not report Accounts Payable or Contracts Payable. The beginning net position/fund balance has been restated to properly report these items.

The beginning net position/fund balance was restated to reflect the prior period loss due to misappropriation incurred by the Cooperative. This item is discussed further in Note 11.

In addition, the Cooperative implemented GASB Statement No. 68 *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27* and GASB Statement No. 71 *Pension Transition for Contributions Made Subsequent to the Measurement Date – An Amendment of GASB Statement No. 68*. As a result, beginning net position has been restated to reflect the accounting for pensions.

The summary of the restatements of the beginning net position/fund balance as of June 30, 2014 are as follows:

	Statement of Activities	Statement of Revenues, Expenditures and Changes in Fund Balances
Net Position/Fund Balance - July 1, 2014, as previously reported	\$ 3,610,168.10	\$ 3,010,738.26
Restatement for Return of Federal Grant Revenue	(213,739.46)	(213,739.46)
Restatement to remove effect of Prior Year Accounts Receivable Overstatement	387,887.29	387,887.29
Restatement to remove effect of Prior Year Accounts Payable Understatement	(694,818.73)	(694,818.73)
Restatement to remove effect of Prior Year Contracts Payable Understatement	(56,422.99)	(56,422.99)
Restatement to reflect the Prior Year Loss Due To Misappropriation	(839,256.40)	(839,256.40)
Restatement for Pension Accounting	561,052.14	
Net Position July 1, 2014, as restated	<u>\$ 2,754,869.95</u>	<u>\$ 1,594,387.97</u>

8. PENSION PLAN

Plan Information:

All employees, working more than 20 hours per week during the fiscal year, participate in the South Dakota Retirement System (SDRS), a cost sharing, multiple employer defined benefit pension plan administered by SDRS to provide retirement benefits for employees of the State of South Dakota and its political subdivisions. The SDRS provides retirement, disability, and survivors benefits. The right to receive retirement benefits vests after three years of credited service. Authority for establishing, administering and amending plan provisions are found in SDCL 3-12. The SDRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained at <http://www.sdrs.sd.gov/publications/> or by writing to the SDRS, P.O. Box 1098, Pierre, SD 57501-1098 or by calling (605) 773-3731.

Benefits Provided:

SDRS has three different classes of employees, Class A, Class B public safety and Class B judicial. Class A retirement benefits are determined as 1.7 percent prior to 2008 and 1.55 percent thereafter of the employee's final 3-year average compensation times the employee's years of service. Employees with 3 years of service are eligible to retire at age 55. Class B public safety benefits are determined as 2.4 percent for service prior to 2008 and 2.0 percent thereafter of employee final average compensation. Class B judicial benefits are determined as 3.733 percent for service prior to 2008 and 3.333 percent thereafter of employee final average compensation. All Class B employees with 3 years of service are eligible to retire at age 45. Employees are eligible for service-related disability benefits regardless of length of service. Three years of service is required for nonservice-related disability eligibility. Disability benefits are determined in the same manner as retirement benefits but are payable immediately without an actuarial reduction. Death benefits are a percent of the employee's final average salary.

The annual increase in the amount of the SDRS benefits payable on each July 1st is indexed to the consumer price index (CPI) based on SDRS funded status:

- If the SDRS market value funded ratio is 100% or more – 3.1% COLA

- If the SDRS market value funded ratio is 80.0% to 99.9%, index with the CPI
 - 90.0% to 99.9% funded — 2.1% minimum and 2.8% maximum COLA
 - 80.0% to 90.0% funded — 2.1% minimum and 2.4% maximum COLA
- If the SDRS market value funded ratio is less than 80% -- 2.1% COLA

All benefits except those depending on the Member's Accumulated Contributions are annually increased by the Cost-of-Living Adjustment.

Contributions:

Per SDCL 3-12, contribution requirements of the active employees and the participating employers are established and may be amended by the SDRS Board. Covered employees are required by state statute to contribute the following percentages of their salary to the plan; Class A Members, 6.0% of salary; Class B Judicial Members, 9.0% of salary; and Class B Public Safety Members, 8.0% of salary. State statute also requires the employer to contribute an amount equal to the employee's contribution. State statute also requires the employer to make an additional contribution in the amount of 6.2 percent for any compensation exceeding the maximum taxable amount for social security for general employees only. The Cooperative's share of contributions to the SDRS for the fiscal years ended June 30, 2015, 2014, and 2013 were \$162,817.60, \$149,208.61, and \$131,321.98, respectively, equal to the required contributions each year.

Pension Liabilities (Assets), Pension Expense (Revenue), and Deferred Outflows of Resources and Deferred Inflows of Resources to Pensions:

At June 30, 2014, SDRS is 107% funded and accordingly has a net pension asset. The proportionate shares of the components of the net pension asset of South Dakota Retirement System, for the Cooperative as of June 30, 2014 are as follows:

Proportionate share of net position restricted for pension benefits	\$ 15,494,677.61
Less proportionate share of total pension liability	<u>14,442,287.85</u>
Proportionate share of net pension liability (asset)	<u>\$ (1,052,389.76)</u>

At June 30 2015, the Cooperative reported a liability (asset) of \$(1,052,389.76) for its proportionate share of the net pension liability (asset). The net pension liability (asset) was measured as of June 30, 2014 and the total pension liability (asset) used to calculate the net pension liability (asset) was based on a projection of the Cooperative's share of contributions to the pension plan relative to the contributions of all participating entities. At June 30, 2014, the Cooperative's proportion was .14607210%.

For the year ended June 30, 2015, the Cooperative recognized pension expense (revenue) of \$(44,452.55). At June 30, 2015 the Cooperative reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows Of Resources</u>	<u>Deferred Inflows Of Resources</u>
Difference between expected and actual experience	\$ 89,046.40	\$
Changes in assumption	686,968.65	
Net Difference between projected and actual earnings on pension plan investments		1,218,844.74
Changes in proportion and difference between District contributions and proportionate share of contributions		
District contributions subsequent to the measurement date	<u>162,817.60</u>	
TOTAL	<u>\$ 938,832.65</u>	<u>\$ 1,218,844.74</u>

\$162,817.60 reported as deferred outflow of resources related to pensions resulting from Cooperative contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense (revenue) as follows:

<u>Year Ended June 30,</u>	
2015	\$ (83,624.27)
2016	(83,624.27)
2017	(83,624.27)
2018	<u>(191,956.86)</u>
TOTAL	<u>\$ (442,829.67)</u>

Actuarial Assumptions:

The total pension liability (asset) in the June 30, 2014 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25 percent
Salary Increases	5.83 percent at entry to 3.87 percent after 30 years of service
Investment Rate of Return	7.25 percent through 2016 and 7.50 percent thereafter, net of pension plan investment expense

Mortality rates were based on the RP-2000 Employee Mortality Table for males and females, as appropriate.

The actuarial assumptions used in the June 30, 2014 valuation were based on the results of an actuarial experience study for the period July 1, 2005 through June 30, 2010. The mortality assumptions were revised based on an extension of the experience study including mortality experience through June 30, 2013.

Investment portfolio management is the statutory responsibility of the South Dakota Investment Council (SDIC), which may utilize the services of external money managers for management of a portion of the portfolio. SDIC is governed by the Prudent Man Rule (i.e., the council should use the same degree of care as a prudent man). Current SDIC investment policies dictate limits on the

percentage of assets invested in various types of vehicles (equities, fixed income securities, real estate, cash, private equity, etc.). The long-term expected rate of return on pension plan investments was determined using a method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighing the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2014 (see the discussion of the pension plan's investment policy) are summarized in the following table using geometric means:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Global Equity	64.0%	4.7%
Fixed Income	26.0%	1.8%
Real Estate	8.0%	5.5%
Cash	<u>2.0%</u>	0.8%
Total	<u>100%</u>	

Discount Rate:

The discount rate used to measure the total pension liability (asset) was 7.25 percent through 2016 and 7.50% thereafter. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that matching employer contributions from will be made at rates equal to the member rate. Based on these assumptions, the pension plan's fiduciary net position was projected to be available to make all future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability (asset).

Sensitivity of liability (asset) to changes in the discount rate:

The following presents the Cooperative's proportionate share of net pension liability (asset) calculated using the discount rate of 7.25 percent through 2016 and 7.50 percent thereafter, as well as what the Cooperative's proportionate share of the net pension liability (asset) would be if it were calculated using a discount rate that is 1-percentage point lower (6.25/6.50%) or 1-percentage point higher (8.25/8.50%) than the current rate:

	<u>1% Decrease</u>	<u>Current Discount Rate</u>	<u>1% Increase</u>
Cooperative's proportionate share of the net pension liability (asset)	\$ 1,039,959.01	\$ (1,052,389.74)	\$ (2,758,918.54)

Pension Plan Fiduciary Net Position:

Detailed information about the plan's fiduciary net position is available in the separately issued SDRS financial report.

9. SUBSEQUENT EVENTS

During the April 14, 2016 Governing Board Meeting a resolution was proposed to terminate the Cooperative on June 30, 2017. The resolution was unanimously adopted by the Governing Board.

10. RELATED PARTY TRANSACTIONS

The Cooperative has an ongoing partnership with the American Indian Institute for Innovation (AIII). The following lists the employees and their titles at both organizations:

<u>Key Employee Name</u>	<u>Mid Central Educational Cooperative</u>	<u>American Indian Institute for Innovation</u>
Stacy Phelps	Outreach Coordinator	Chief Executive Officer
Scott Westerhuis	Business Manager	Chief Financial Officer
Nicole Westerhuis	Grants Manager	Employee

The Cooperative partnered with AIII to administer the Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) grant, assist in administering the Teacher Quality Partnership grant and the Wakan Gli grant and also provide other services. As noted above, Cooperative employees also held key positions with AIII. During fiscal year 2015, the Cooperative had \$1,196,462.35 in cash receipts from AIII and \$834,925.15 in cash disbursements to AIII.

The Cooperative also has an ongoing partnership with the Oceti Sakowin Education Consortium (OSEC). The following lists the employees and their titles at both organizations:

<u>Key Employee Name</u>	<u>Mid Central Educational Cooperative</u>	<u>Oceti Sakowin Education Consortium</u>
Nicole Westerhuis	Grants Manager	Business Manager

The Cooperative also partnered with OSEC to provide service to participating GEAR UP schools. As noted above, a Cooperative employee also held a key position with OSEC. During fiscal year 2015, the Cooperative had \$73,388.59 in cash disbursements to OSEC.

11. LOSS DUE TO MISAPPROPRIATION

The Cooperative has reflected in the financial statements a loss due to misappropriation after becoming aware of financial improprieties related to the former business manager and the related party transactions that occurred for a number of years. A summary of the loss due to misappropriation reflected in the financial statements is as follows:

	<u>Loss Due To Misappropriation Related To</u>		
	<u>Oceti Sakowin Education Consortium & Oceti Sakowin Distance Education Consortium</u>	<u>American Indian Institute for Innovation</u>	<u>Total Loss Due To Misappropriation</u>
Loss Due to Misappropriation Prior To July 1, 2014	\$ 619,153.88	\$ 220,102.52	\$ 839,256.40
Loss Due to Misappropriation July 1, 2014 through June 30, 2015		294,214.66	294,214.66
Loss Due to Misappropriation Subsequent to July 1, 2015		255,160.40	255,160.40
Total Loss Due to Misappropriation	<u>\$ 619,153.88</u>	<u>\$ 769,477.58</u>	<u>\$ 1,388,631.46</u>

12. RISK MANAGEMENT

The Cooperative is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During the period ended June 30, 2015, the Cooperative managed its risks as follows:

Employee Health Insurance:

The Cooperative purchases health insurance for its employees from a commercial insurance carrier. Settled claims resulting from these risks have not exceeded the liability coverage during the past three years.

Liability Insurance:

The Cooperative purchases liability insurance for risks related to torts; theft or damage to property; and errors and omissions of public officials from a commercial insurance carrier. Settled claims resulting from these risks have not exceeded the liability coverage during the past three years.

Worker's Compensation:

The Cooperative purchases liability insurance for worker's compensation from a commercial carrier. Settled claims resulting from these risks have not exceeded the liability coverage during the past three years.

Unemployment Benefits:

The Cooperative has elected to be self-insured and retain all risk for liabilities resulting from claims for unemployment benefits.

During the year ended June 30, 2015, three claims were filed for unemployment benefits. These claims resulted in the payment of benefits in the amount of \$15,311.95. At June 30, 2015, one claim had been filed and was outstanding. This claim resulted in the payment of unemployment benefits in the amount of \$3,121.57. It is anticipated that additional claims for unemployment benefits will be filed in the next fiscal year.

13. SIGNIFICANT CONTINGENCIES – LITIGATION

At June 30, 2015, the Cooperative was involved in several lawsuits. No determination can be made at this time regarding the potential outcome of these lawsuits. However, as discussed in the Risk Management note, the Cooperative has liability coverage for itself and its employees purchased from a commercial insurance carrier. Because of the unprecedented nature of the facts surrounding the actions and deaths of the Cooperative's former Business Manager and former Assistant Business Manager, it is not possible at this time to provide a reasoned and thoughtful evaluation of the likelihood of an unfavorable outcome and/or an estimate of the amount or range of potential loss. However, at this time, the Cooperative is confident that decisions in these lawsuits will be entered in the Cooperative's favor.

14. SIGNIFICANT CONTINGENCIES—FEDERALLY ASSISTED PROGRAMS—COMPLIANCE AUDITS

Testing for compliance with provisions of federal grants and contracts resulted in questioned costs totaling \$5,814,964.83. The ultimate resolution of the related compliance matters and the determination of the amounts of federal awards that must be repaid, if any, is up to the federal granting agency, and will be determined at a future date. The Cooperative has not made provision in the financial statements for any possible losses in connection herewith.

**REQUIRED SUPPLEMENTARY INFORMATION
MID CENTRAL EDUCATIONAL COOPERATIVE
BUDGETARY COMPARISON SCHEDULE - BUDGETARY BASIS
GENERAL FUND
For the Year Ended June 30, 2015**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
Revenue from Local Sources:				
Tuition and Fees:				
Student Tuition	\$ 508,761.56	\$ 508,761.56	\$ 409,665.89	\$ (99,095.67)
Earnings on Investments and Deposits	50,000.00	50,000.00	0.00	(50,000.00)
Other Revenue from Local Sources:				
Contributions and Donations	0.00	0.00	1,000.00	1,000.00
Services Provided Other LEAs	1,017,037.70	1,079,118.19	764,557.88	(314,560.31)
Other	1,939,446.73	2,199,446.73	1,387,200.79	(812,245.94)
Revenue from State Sources:				
Other State Revenue	100,000.00	100,000.00	971,040.85	871,040.85
Revenue from Federal Sources:				
Grants-in-Aid:				
Restricted Grants-in-Aid				
Received from Federal Government Through the State	5,713,666.00	5,753,668.00	4,260,805.01	(1,492,862.99)
Other Federal Revenue	1,209,680.00	1,436,124.63	980,117.99	(456,006.64)
Total Revenues	<u>10,538,591.99</u>	<u>11,127,119.11</u>	<u>8,774,388.41</u>	<u>(2,352,730.70)</u>
Expenditures:				
Instruction:				
Special Programs:				
Programs for Special Education	65,060.89	75,395.79	75,378.60	17.19
Other Special Programs	75,000.00	75,000.00	83,581.90	(8,581.90)
Support Services:				
Pupils:				
Guidance	0.00	2,080.49	1,870.11	210.38
Psychological	477,688.77	556,525.74	529,919.58	26,606.16
Speech Pathology	585,446.14	585,446.14	547,904.67	37,541.47
Audiology	132,274.58	172,276.58	172,939.76	(663.18)
Student Therapy Services	219,816.70	244,816.70	234,836.59	9,980.11
Support Services - Instructional Staff:				
Improvement of Instruction	760,000.00	980,000.00	979,009.41	990.59
Educational Media	127,050.00	127,050.00	90,253.33	36,796.67
Support Services - General Administration:				
Board of Education	188,250.00	188,250.00	150,638.83	37,611.17
Executive Administration	163,352.34	163,352.34	151,588.55	11,763.79
Support Services - School Administration:				
Other	7,623,104.35	7,828,548.98	5,336,866.21	2,491,682.77
Support Services - Business:				
Fiscal Services	221,489.73	221,489.73	121,784.33	99,705.40
Operation and Maintenance of Plant	160,700.00	160,900.00	75,801.74	85,098.26
Contingencies				
Amount Transferred	60,000.00	(29,371.87)		30,628.13
Total Expenditures	<u>10,859,233.50</u>	<u>11,411,760.62</u>	<u>8,552,373.61</u>	<u>2,859,387.01</u>
Excess of Revenues Over (Under)				
Expenditures	(320,641.51)	(284,641.51)	222,014.80	506,656.31
Extraordinary Items - Loss Due to Misappropriation				
	0.00	0.00	(294,214.66)	(294,214.66)
Net Change in Fund Balance	<u>(320,641.51)</u>	<u>(284,641.51)</u>	<u>(72,199.86)</u>	<u>212,441.65</u>
Fund Balance - Beginning				
	3,010,738.26	3,010,738.26	3,010,738.26	0.00
Adjustments:				
Refund of Federal Grant Revenues to State of South Dakota	0.00	0.00	(213,739.46)	(213,739.46)
Remove Effect of Prior Year Accounts Receivable Overstatement	0.00	0.00	387,887.29	387,887.29
Remove Effect of Prior Year Accounts Payable Understatement	0.00	0.00	(694,818.73)	(694,818.73)
Remove Effect of Prior year Contracts Payable Understatement	0.00	0.00	(56,422.99)	(56,422.99)
Prior Years Loss Due to Misappropriation	0.00	0.00	(839,256.40)	(839,256.40)
Adjust Fund Balance - Beginning	<u>3,010,738.26</u>	<u>3,010,738.26</u>	<u>1,594,387.97</u>	<u>(1,416,350.29)</u>
FUND BALANCE - ENDING	<u>\$ 2,690,096.75</u>	<u>\$ 2,726,096.75</u>	<u>\$ 1,522,188.11</u>	<u>\$ (1,203,908.64)</u>

MID CENTRAL EDUCATIONAL COOPERATIVE
NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
Schedules of Budgetary Comparisons for the General Fund

1. Budgets and Budgetary Accounting:

The Cooperative followed these procedures in establishing the budgetary data reflected in the schedules:

1. Prior to the first regular board meeting in May of each year the board causes to be prepared a proposed budget for the next fiscal year according to the budgetary standards prescribed by the Auditor General.
2. The proposed budget is considered by the board at the first regular meeting held in the month of May of each year.
3. The proposed budget is published for public review no later than July 15 each year.
4. Public hearings are held to solicit taxpayer input prior to the approval of the budget.
5. Before October 1 of each year, the board must approve the budget for the ensuing fiscal year for each fund, except fiduciary funds.
6. After adoption by the board, the operating budget is legally binding and actual expenditures of each fund cannot exceed the amounts budgeted, except as indicated in number 8.
7. A line item for contingencies may be included in the annual budget. Such a line item may not exceed 5 percent of the total cooperative budget and may be transferred by resolution of the board to any other budget category, except for capital outlay, that is deemed insufficient during the year. No amount of expenditures may be charged directly to the contingency line item in the budget.
8. If it is determined during the year that sufficient amounts have not been budgeted, state statute allows adoption of supplemental budgets when moneys are available to increase legal spending authority.
9. Unexpended appropriations lapse at year-end unless encumbered by resolution of the board.
10. Formal budgetary integration is employed as a management control device during the year for the General Fund.
11. Budgets for the General Fund are adopted on a basis consistent with generally accepted accounting principles (GAAP).

2. USGAAP/Budgetary Accounting Basis Differences:

The financial statements prepared in conformity with USGAAP present capital outlay expenditure information in a separate category of expenditures. Under the budgetary basis of accounting, capital outlay expenditures are reported within the function to which they relate.

**REQUIRED SUPPLEMENTARY INFORMATION
MID CENTRAL EDUCATIONAL COOPERATIVE
SCHEDULE OF THE COOPERATIVE'S CONTRIBUTIONS**

South Dakota Retirement System

*Last 10 Fiscal Years

		2015
Contractually required contribution	\$	162,818
Contributions in relation to the contractually required contribution	\$	162,818
Contribution deficiency (excess)	\$	0
District's covered-employee payroll	\$	2,713,627
Contributions as a percentage of covered-employee payroll		6.00%

*Until a full 10-year trend is compiled, the Cooperative will present information for those years for which information is available.

**REQUIRED SUPPLEMENTARY INFORMATION
MID CENTRAL EDUCATIONAL COOPERATIVE
SCHEDULE OF THE COOPERATIVE'S PROPORTIONATE SHARE OF
THE NET PENSION LIABILITY (ASSET)**

South Dakota Retirement System

*Last 10 Fiscal Years

	2015
District's proportion of the net pension liability (asset)	0.1460721%
District's proportionate share of net pension liability (asset)	\$ 1,052,390
District's covered-employee payroll	\$ 2,487,914
District's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll	42.30%
Plan fiduciary net position as a percentage of the total pension liability (asset)	107.3%

*The amounts presented for each fiscal year were determined as of the measurement date of the collective net pension liability (asset) which is 6/30 of previous fiscal year. Until a full 10-year trend is compiled, the Cooperative will present information for those years for which information is available.

MID CENTRAL EDUCATIONAL COOPERATIVE
NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
For the Year Ended June 30, 2015
Schedule of the Cooperative's Proportionate Share of the Net Pension Liability (Asset)
and Schedule of the Cooperative's Contributions

Changes of benefit terms:

No significant changes.

Changes of assumptions:

No significant changes.

SUPPLEMENTARY INFORMATION
MID CENTRAL EDUCATIONAL COOPERATIVE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended June 30, 2015

Federal Grantor/Pass-Through Grantor Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Passed Through to Subrecipients	Expenditures FY 2015
Special Education Cluster:				
US Department of Education - Pass Through Programs:				
SD Department of Education				
Special Education - Grants to States (Note 3)	84.027	15-611-048	\$	\$ 729,898.00
Special Education - Preschool Grants (Note 3)	84.173	15-619-043		<u>20,792.00</u>
Subtotal US Department of Education - Special Education Cluster				<u>750,690.00</u>
Other Programs:				
US Department of Education - Direct Programs:				
Carol M White Physical Education Program (Note 3)				
Teach American History Grant	84.215F	S215F140147		357,119.00
Teacher Quality Partnership Grants (Note 3)	84.215X	U215X100285		140,905.52
	84.336S	U3365090010		<u>566,196.14</u>
Subtotal US Department of Education - Direct Programs				<u>1,064,220.66</u>
Other Programs:				
US Department of Education - Pass Through Programs:				
SD Department of Education				
Career and Technical Education - Basic Grants to States	84.048A	PRP1-15-019		71,540.00
Special Education - Grants for Infants and Families	84.181A			18,974.64
Gaining Early Awareness and Readiness for Undergraduate Programs (Note 3)	84.334	P334S110022	670,841.29	2,881,129.40
English Language Acquisition State Grants	84.365	T3-15-05		73,710.00
Mathematics and Science Partnerships	84.366	T2B-15-03		68,077.00
College Access Challenge Grant Program (Note 3)	84.378	P378A140014		<u>483,622.75</u>
Subtotal US Department of Education - Pass Through Programs				<u>670,841.29</u>
Total US Department of Education			<u>\$ 670,841.29</u>	<u>\$ 5,411,964.45</u>

Note 1: Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the "Schedule") includes the federal award activity of the Cooperative under programs of the federal government for the year ended June 30, 2015. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Because the Schedule presents only a selected portion of the operations of the Cooperative, it is not intended to and does not present the financial position, changes in net position, or cash flows of the Cooperative.

Note 2: Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-133, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.

Note 3: Major Federal Financial Assistance Program

This represents a Major Federal Financial Assistance Program.

**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.

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.

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.