AUDIT REPORT
OF THE
EDUCATIONAL SERVICE UNIT NO. 9

SEPTEMBER 1, 2008 THROUGH AUGUST 31, 2009

Issued on May 7, 2010

EDUCATIONAL SERVICE UNIT NO. 9

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NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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EDUCATIONAL SERVICE UNIT NO. 9

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Educational Service Unit No. 9
Hastings, Nebraska:

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Educational Service Unit No. 9 (ESU 9), as of and for the year ended August 31, 2009, which collectively comprise ESU 9's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Educational Service Unit No. 9's management. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As described in Note 1, ESU 9 prepares its financial statements on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective assets and liabilities arising from cash transactions of the governmental activities, each major fund, and the aggregate remaining fund information of Educational Service Unit No. 9, as of August 31, 2009, and its respective revenue collected and expenses paid during the year then ended on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards,* we have also issued our report dated May 3, 2010, on our consideration of Educational Service Unit No. 9's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and 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 on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and Budgetary Comparison information on pages 3 through 7 and 24 through 26 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. Other supplementary information on pages 29 and 30 is included for additional analysis and is not required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required and other supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Educational Service Unit No. 9 basic financial statements. The accompanying supplementary information on pages 27 and 28 and schedule of expenditures of Federal awards on page 31 are presented for purposes of additional analysis. The accompanying supplementary information for the year ended August 31, 2008, was audited by another auditor whose January 12, 2009, report expressed an unqualified opinion on this information. The schedule of expenditures of Federal awards is required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Signed Original on File

May 3, 2010

Don Dunlap, CPA
Assistant Deputy Auditor

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of Educational Service Unit No. 9's (ESU 9) annual audit report presents our discussion and analysis of ESU 9's financial performance during the fiscal year that ended on August 31, 2009. Please read it in conjunction with ESU 9's financial statements, which follow this section.

OVERVIEW OF THE FINANCIAL STATEMENTS

The provisions of Statement No. 34 ("Statement 34") of the Governmental Accounting Standards Board, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments," established standards for external financial reporting for all state and local government entities, which includes government-wide financial statements, fund financial statements, and the classification of net assets into three components: (a) invested in capital assets, net of related debt; (b) restricted; and (c) unrestricted.

The annual report consists of five parts: (1) *Management's Discussion and Analysis* (this section); (2) *Basic Financial Statements – Cash Basis;* (3) *Required Supplementary Information;* (4) *Supplementary Information;* and (5) *Government Auditing Standards and OMB Circular A-133 Section.*

The accompanying basic financial statements have been prepared on the cash basis of accounting, in that revenues are not recorded until received, inventories are not recorded as disbursements until they are consumed and accounts payable and accrued expenses (primarily payroll withholdings) have not been recognized as liabilities. Accordingly the financial statements and supplemental schedules are not intended to present the financial position and results of operations in conformity with accounting principles generally accepted in the United States of America. The use of the cash basis of accounting is permissible under Title 92, Nebraska Administrative Code, Chapter 2 for units such as Educational Service Unit No. 9.

The statement of activities demonstrates the degree to which the direct disbursements of a given function or segment are offset by program receipts. Direct disbursements are those that are clearly identifiable with a specific function or segment. Program receipts include: (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment; and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported, instead, as general receipts.

Separate financial statements are provided for governmental funds and fiduciary funds, even though the latter are excluded from the government-wide financial statements.

Fiduciary funds report assets held in a trustee or agency capacity for others and; therefore, cannot be used to support ESU 9's own programs. ESU 9 has only one fiduciary fund - the Cafeteria Plan Fund.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data about the financial statements and ESU 9's commitments and contingencies, and long-term debt obligations that are not reported in the cash basis financial statements. The statements are followed by a section of *Required Supplementary Information* that further explains and supports the information in the financial statements.

FINANCIAL HIGHLIGHTS (Detailed Information Follows Later in this *Discussion and Analysis)*

- Governmental activities cash position including funds held by county treasurers at August 31, 2009, was $4,754,154 compared with $4,780,777 at August 31, 2008. This was a decrease of $26,623 or 0.6%.
- General Fund expenditures and transfers were $9,374,884 for the current fiscal year, which is a $249,064 (2.6%) decrease from the prior fiscal year.
- Federal program receipts were $1,332,554 for the current fiscal year, which is a $17,787 increase from the previous fiscal year.

FINANCIAL ANALYSIS OF ESU 9 AS A WHOLE

Governmental Activities

The largest single source of receipts for ESU 9 is special education. ESU 9's special education receipts recorded in the General Fund for 2007-2008 were $5,530,409 and for 2008-2009, it decreased by $1,031,184 to $4,499,225. Billing rates to school districts were reduced in 2008-2009 from the 2007-2008 rates.

The second largest source of revenue is generated by State funds. In 2007-2008, ESU 9's receipts from State funds were $1,123,671. In 2008-2009, it increased by $565,064 to $1,688,735.

The third largest source of receipts for ESU 9 is Federal grants. ESU 9's Federal grants recorded for 2007-2008 were $1,314,767. In 2008-2009, it increased by $17,787 to $1,332,554.

NET ASSETS AS OF AUGUST 31

	Governmental Activities	
	2009	**2008**
ASSETS		
Cash and Cash Equivalents	$ 4,606,084	$ 4,638,559
Funds held by County Treasurer	148,070	142,218
Total Assets	4,754,154	4,780,777
LIABILITIES	-	-

(Continued)

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

NET ASSETS AS OF AUGUST 31

	Governmental Activities	
	2009	**2008**
NET ASSETS		
Unrestricted	$ 4,754,154	$ 4,780,777
Total Net Assets	$ 4,754,154	$ 4,780,777

(Concluded)

CHANGES IN NET ASSETS FOR THE YEAR ENDED AUGUST 31

	Governmental Activities	
	2009	**2008**
RECEIPTS		
Program Receipts:		
Charges for Services	$ 5,389,718	$ 6,368,124
Operating Grants and Contributions	3,021,287	2,438,438
General Receipts:		
Taxes	740,867	694,114
Interest	160,318	224,102
Other Local Receipts	5,781	16,838
Total Receipts	$ 9,317,971	$ 9,741,616
DISBURSEMENTS:		
Governmental Activities:		
General and Special Instruction	$ 8,034,112	$ 8,130,581
Student Support Services	-	4,156
Support Services Staff:		
Staff Development	-	224,505
Production and Media Services	95,418	90,555
Governance and General Administration:		
Board of Control	42,460	37,235
General Administration	159,302	148,348
Support Services:		
Business Services	303,986	309,526
Building and Sites	29,799	23,469
Vehicle Acquisition and Maintenance	1,942	2,356

(Continued)

CHANGES IN NET ASSETS FOR THE YEAR ENDED AUGUST 31

	Governmental Activities	
	2009	**2008**
Maintenance and Operation of Buildings:		
Operation	40,193	51,292
Maintenance	12,107	7,019
Pupil Transportation:		
Special Education	112,300	104,960
Materials and Equipment Services	489,770	425,375
Equipment Purchases	19,710	10,342
Other	3,495	14,571
Total Disbursements	9,344,594	9,584,290
Increase (Decrease) in Net Assets	(26,623)	157,326
Net Assets - Beginning	4,780,777	4,623,451
Net Assets - Ending	$ 4,754,154	$ 4,780,777

(Concluded)

The following table shows the property tax rates, by fund, for fiscal years 2007-2008 and 2008-2009, including a calculation of the amount and percentage by which each levy changed. Note: levies are expressed in dollars and cents per $100 of valuation. For example, ESU 9's total property tax on a $100,000 property in 2008-2009 would be $15.36.

Tax Levy and Tax Receipts Comparison

Fiscal Year	**Tax Levy**	**Tax Receipts**
2007-2008	1.539201 Cents	$ 694,115
2008-2009	1.536530 Cents	$ 740,866

General Fund Budgetary Highlights

- Over the course of the 2008-2009 fiscal year, ESU 9's General Fund Cash Position increased by approximately $58,102. The following table provides a detailed picture of the change in cash position.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

	2008-2009 Budget	Year-End Actual	Difference
September 1, 2008 Actual Beginning Balance		**$ 4,647,558**	
Receipts:			
Property Taxes/Homestead	$ 737,164	740,866	$ 3,702
Other Local	6,523,013	5,548,846	(974,167)
State	1,562,349	1,688,735	126,386
Federal	1,465,588	1,332,554	(133,034)
Non Revenue	101,000	5,781	(95,219)
Total Receipts	**10,389,114**	**9,316,782**	**$ (1,072,332)**
Expenditures/Transfers	**10,398,766**	**9,374,884**	**$ 1,023,882**
Net Increase (Decrease)	**$ (9,652)**	**(58,102)**	
August 31, 2009 Ending Balance		**$ 4,589,456**	

CONTACTING ESU 9'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens and taxpayers a general overview of ESU 9's finances and to demonstrate ESU 9's accountability for the money with which it is entrusted. If you have questions about this report or need additional financial information, contact ESU 9's Director of Financial Services, 1117 East South Street, Hastings, Nebraska 68901. Telephone number is (402) 463-5611, fax number is (402) 463-9555, and website is http://www.esu9.org.

EDUCATIONAL SERVICE UNIT NO. 9

STATEMENT OF NET ASSETS - CASH BASIS
August 31, 2009

		Governmental Activities
ASSETS		
Cash and Cash Equivalents	$	4,606,084
Funds held by County Treasurer		148,070
Total Assets		4,754,154
LIABILITIES		-
NET ASSETS		
Unrestricted	$	4,754,154
Total Net Assets	$	4,754,154

The accompanying notes are an integral part of the financial statements.

EDUCATIONAL SERVICE UNIT NO. 9

STATEMENT OF ACTIVITIES - CASH BASIS
Fiscal Year Ended August 31, 2009

		Program Receipts			Net (Disbursement) Receipt and Changes in Net Assets
	Disbursements	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Total Governmental Activities
FUNCTIONS/PROGRAMS:					
Primary Government					
Governmental Activities:					
General and Special Instruction	$ 8,034,112	$ 5,389,718	$ 3,021,287	$ -	$ 376,893
Support Services Staff:					
Production and Media Services	95,418	-	-	-	(95,418)
Governance and General Administration:					
Board of Control	42,460	-	-	-	(42,460)
General Administration	159,302	-	-	-	(159,302)
Support Services:					
Business Services	303,986	-	-	-	(303,986)
Building and Sites	29,799	-	-	-	(29,799)
Vehicle Acquisition and Maintenance	1,942	-	-	-	(1,942)
Maintenance and Operation of Buildings:					
Operation	40,193	-	-	-	(40,193)
Maintenance	12,107	-	-	-	(12,107)
Pupil Transportation:					
Special Education	112,300	-	-	-	(112,300)
Materials and Equipment Services	489,770	-	-	-	(489,770)
Equipment Purchases	19,710	-	-	-	(19,710)
Other	3,495	-	-	-	(3,495)
Total Governmental Activities	$ 9,344,594	$ 5,389,718	$ 3,021,287	$ -	(933,589)
General Receipts:					
Taxes					740,867
Interest					160,318
Other Local Receipts					5,781
Total General Receipts					906,966
Change in Net Assets					(26,623)
Net Assets - Beginning					4,780,777
Net Assets - Ending					$ 4,754,154

The accompanying notes are an integral part of the financial statements.

EDUCATIONAL SERVICE UNIT NO. 9

STATEMENT OF ASSETS, LIABILITIES, AND FUND BALANCES - CASH BASIS
GOVERNMENTAL FUNDS
August 31, 2009

	General	Depreciation Fund	Total Governmental Funds
ASSETS:			
Cash and Investments	$ 4,441,386	$ 164,698	$ 4,606,084
Funds held by County Treasurer	148,070	-	148,070
TOTAL ASSETS	$ 4,589,456	$ 164,698	$ 4,754,154
LIABILITIES AND FUND BALANCE			
Liabilities	$ -	$ -	$ -
Fund Balances:			
Unreserved	4,589,456	164,698	4,754,154
Total Fund Balances	4,589,456	164,698	4,754,154
Total Liabilities and Fund Balances	$ 4,589,456	$ 164,698	$ 4,754,154

The accompanying notes are an integral part of the financial statements.

EDUCATIONAL SERVICE UNIT NO. 9

STATEMENT OF CASH RECEIPTS, DISBURSEMENTS, AND CHANGES IN FUND BALANCES - CASH BASIS GOVERNMENTAL FUNDS

Fiscal Year Ended August 31, 2009

	General	Depreciation	Total Governmental Funds
RECEIPTS:			
Local	$ 6,289,712	$ 1,189	$ 6,290,901
State	1,688,735	-	1,688,735
Federal	1,332,554	-	1,332,554
Total Receipts	9,311,001	1,189	9,312,190
DISBURSEMENTS:			
General Instruction	21,070	-	21,070
Special Education Programs	3,778,778	-	3,778,778
Support Services Staff:			
Production and Media Services	95,418	-	95,418
Governance and General Administration:			
Board of Control	42,460	-	42,460
General Administration	159,302	-	159,302
Support Services:			
Business Services	303,986	-	303,986
Building and Sites	29,799	-	29,799
Vehicle Acquisition and Maintenance	1,942	-	1,942
Maintenance and Operation of Buildings:			
Operation	40,193	-	40,193
Maintenance	12,107	-	12,107
Pupil Transportation:			
Special Education	112,300	-	112,300
Materials and Equipment Services	489,770	-	489,770
State Programs	1,706,824	-	1,706,824
Federal Programs	2,527,440	-	2,527,440
Equipment Purchases	-	19,710	19,710
Other	3,495	-	3,495
Total Disbursements	9,324,884	19,710	9,344,594
OTHER FINANCING SOURCES (USES):			
Interfund Transfers	(50,000)	50,000	-
Non-Revenue Receipts	5,781	-	5,781
Total Other Financing Sources (Uses)	(44,219)	50,000	5,781
Excess of Receipts Over (Under) Disbursements	(58,102)	31,479	(26,623)
Fund Balances - Beginning	4,647,558	133,219	4,780,777
Fund Balances - Ending	$ 4,589,456	$ 164,698	$ 4,754,154

The accompanying notes are an integral part of the financial statements.

EDUCATIONAL SERVICE UNIT NO. 9

STATEMENT OF FIDUCIARY NET ASSETS - CASH BASIS
FIDUCIARY FUND
August 31, 2009

	Cafeteria Plan Fund
ASSETS	
Cash and Investments	$ 9,199
Total Assets	9,199
LIABILITIES	-
NET ASSETS (Restricted)	$ 9,199

The accompanying notes are an integral part of the financial statements.

EDUCATIONAL SERVICE UNIT NO. 9

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS - CASH BASIS
FIDUCIARY FUND
Fiscal Year Ended August 31, 2009

		Cafeteria Plan Fund
ADDITIONS		
Participant withholdings	$	200,846
		200,846
DEDUCTIONS		
Payments to Participants		110,069
Payment to Vendors		86,138
Administrative Costs		3,397
Refunds to ESU		601
		200,205
CHANGE IN NET ASSETS		641
NET ASSETS - BEGINNING OF YEAR		8,558
NET ASSETS - END OF YEAR	$	9,199

The accompanying notes are an integral part of the financial statements.

1. Summary of Significant Accounting Policies

A. Organization

The Educational Service Unit No. 9 (ESU 9) operates under a board/administrator form of government. ESU 9 provides services to school districts in the following counties as identified by State law: Adams, Clay, Webster, Nuckolls, Hamilton, and that portion of Hall lying south of the Platte River.

B. Reporting Entity

ESU 9 is a governmental entity established under and governed by the laws of the State of Nebraska. In evaluating how to define ESU 9 for financial reporting purposes, all potential component units have been considered. The basic – but not the only – criteria for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations and accountability for fiscal matters. Based upon the above criteria, the accompanying combined financial statements include all funds for which ESU 9 has oversight responsibility.

A related organization, the ESU 9 Building Improvement Corporation has been considered and is discussed in detail in Note 2.

Basis of Accounting – ESU 9 prepares its financial statements on the cash basis, which is consistent with the Commissioner of Education and the Nebraska Department of Education requirements. Under the cash basis, revenues are recognized when collected rather than when earned, and expenses are recognized when paid rather than when incurred. Consequently, these financial statements are not intended to present financial information in accordance with generally accepted governmental accounting standards.

Basis of Presentation – On September 1, 2003, ESU 9 adopted the provisions of Statement No. 34 ("Statement 34") of the Government Accounting Standards Board "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments." Statement 34 established standards for external financial reporting for all state and local government entities, which includes government-wide financial statements, fund financial statements, and the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted.

1. Summary of Significant Accounting Policies (Continued)

Government-wide and Fund Financial Statements – The government-wide financial statements report information on all of the nonfiduciary activities of the primary government and any component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental receipts, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct disbursements of a given function or segment are offset by program receipts. Direct disbursements are those that are clearly identifiable with a specific function or segment. Program receipts include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program receipts are reported instead as general receipts.

Separate financial statements are provided for governmental funds and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements. The major funds for ESU 9 are the General Fund and Depreciation Fund.

Fiduciary funds report assets held in a trustee or agency capacity for others and; therefore, cannot be used to support ESU 9's own programs. The Cafeteria Plan is shown as a Fiduciary Fund.

Fund Types – The accounts of ESU 9 are organized on the basis of funds which are grouped into the following fund types:

Governmental Fund Types:

- **General Fund –** This fund is the operating fund of ESU 9. It is used to account for all financing resources except those required to be accounted for in other funds.

- **Depreciation Fund –** This fund accounts for revenues specifically maintained for future building and equipment purposes.

Fiduciary Fund Type:

- **Cafeteria Plan Fund –** This fund is a flow-through account for qualifying payroll deductions and reimbursements related to ESU 9's Cafeteria Plan.

1. Summary of Significant Accounting Policies (Continued)

Capital Assets – Under the cash receipts and disbursements basis of accounting, capital assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisitions are reflected as disbursements in governmental funds. GAAP requires capital assets, which would include property, plant, equipment, and infrastructure assets (e.g. roads, bridges, sidewalks, and similar items) to be reported in the applicable governmental activities columns in the government-wide financial statements.

Depreciation expenses on capital assets were not recorded on the cash basis financial statements. Under GAAP, depreciation expenses would be recorded in the Statement of Activities. The cost of normal maintenance and repairs that does not add to the value of the asset or extend asset life is not capitalized.

Property Taxes – The tax levies for all political subdivisions in each county are certified by the County Board on or before October 15. Real estate and personal property taxes are due and become an enforceable lien on property on December 31. The first half of real estate and personal property taxes becomes delinquent on May 1 and the second half becomes delinquent September 1 following the levy date. Delinquent taxes bear a statutory rate (currently 14%) of interest. Property taxes levied are recognized when received from each county.

Retirement System – ESU 9 participates in the Nebraska School Employees Retirement System retirement plan. The plan is funded by contributions from ESU 9 and eligible employees.

Compensated Absences – As a result of the use of the cash basis of accounting, liabilities related to accrued compensated absences are not recorded in the government-wide or fund financial statements. Expenditures/expenses related to compensated absences are recorded when paid.

Net Asset Classification

Government-Wide Statements:

Net Assets are displayed in two components:

a) Restricted net assets – Consists of net assets with constraints placed on the use either by 1) external groups such as creditors, grantors, contributors or laws and regulations of other governments, or 2) law through constitutional provisions or enabling legislation. ESU 9 has no restricted net assets.

b) Unrestricted net assets – All other net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Concluded)

It is ESU 9's policy to first use restricted net assets prior to the use of unrestricted net assets when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Fund Financial Statements:

Governmental fund equity is classified as fund balance. Fund balances are further classified as reserved or unreserved. Reservations of fund balances are established to identify the existence of assets that are not available for subsequent year appropriations or have been legally segregated for specific purposes. ESU 9 had no reservation of fund balance.

Investments – Investments are recorded at cost plus interest earned which approximates market value.

2. ESU 9 Building Improvement Corporation Entity/Lease Agreement

On July 6, 1994, the ESU 9 Building Improvement Corporation (the Corporation) was created as a nonprofit organization as defined and described in Internal Revenue Code Section 501 (c)(3). It has a separate set of board of directors from ESU 9.

Its purpose includes the purchase of educational facilities and property, both real and personal, including without limitation, buildings, building additions, equipment, supplies, materials and accessories necessary to assist in the educational purposes of Educational Service Unit No. 9, Hastings, Nebraska, and to borrow, encumber, make loans, lease, transfer, deed, and do all other things not prohibited by law in connection therewith.

Activity:

On July 21, 1994, the Corporation entered into a lease purchase agreement with ESU 9 for the completed construction of an addition to the existing service unit building. The term of the lease not to exceed 11 years from and after ESU 9 occupies the addition. Upon termination of the agreement, provided all lease payments have been made, ESU 9 shall have the option of purchasing the leased property for $1.00. The lease price was determined to be $190,500.

The initial term of the lease has expired. ESU 9 is currently continuing its lease payments under the initial terms of the original lease.

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. ESU 9 Building Improvement Corporation Entity/Lease Agreement (Concluded)

A summary of the Corporation's cash receipts and disbursements for the fiscal year ended August 31, 2009, is as follows:

Beginning balance		$ 1,759
Receipts:		
Lease payments received from ESU 9		17,539
Disbursements:		
Interest expense	$ 975	
Principal payments	18,187	
Total disbursements		(19,162)
ENDING BALANCE		$ 136

Sum of net assets/fund balance (cash basis) as of August 31, 2009:

Cash in Bank	$ 136
Total Assets	$ 136
Net Assets/Fund Balance	$ 136

On May 15, 1995, the Corporation signed a promissory note with Norwest Bank for $190,500 due May 31, 2010, with an annual tax-exempt rate equal to 70.0% of the low prime rate as adjusted annually on September 30 until maturity.

A schedule of long-term debt requirements of the Corporation based on the interest rate in effect at August 31, 2009, is as follows:

Year	Interest Rate	Principal	Interest	Total
2009-10	3.500%	$ 12,755	$ 185	$ 12,940

3. Property Tax Request

ESU 9 requested taxes for the year ended August 31, 2009, in the amount of $744,536 for the General Fund.

The ESU 9 tax levy is as follows:

Fiscal Year	Valuation Of Property	Tax Levy Per $100 Valuation
2008-2009	$ 4,845,547,574	.0153653

4. Cash and Investments

Deposits (cash and certificates of deposit) are carried at cost which approximates market value. At August 31, 2009, ESU 9's carrying amount of deposits was $89,802 for the General Fund, $164,698 for the Depreciation Fund, and $9,199 for the Fiduciary Fund. The bank balance for all funds totaled $267,910. The deposits of ESU 9 were covered by Federal Depository Insurance Corporation (FDIC) or secured by collateral held by ESU 9's agent in ESU 9's name. However, certain times during the year deposits for ESU 9's General Fund bank account were not fully covered by FDIC or secured by collateral.

State statute authorizes ESU 9's Board to invest funds in securities the nature of which individuals of prudence, discretion, and intelligence acquire or retain in dealing with property of others.

The Nebraska Liquid Asset Fund (NLAF) was established in March 1988 through the Interlocal Cooperation Act. NLAF was established to assist Nebraska school districts, educational service units, and technical community colleges with the investment of their available cash reserves. NLAF's activities are directed by a Board of Trustees, all of whom are representatives of Nebraska public agencies. The NLAF Board of Trustees contracts for services with professional service providers. The Board of Trustees approved the Investment Advisor making available to Participants a fixed income investment program. This program allows Participants to individually invest in securities issued by the United States Government or agencies or instrumentalities thereof, certificates of deposit (CDs) and other fixed income permitted by Nebraska law. ESU 9 has chosen to use this investment program and invest in CDs. The CDs available through the program are issued in denominations not to exceed the maximum amount insured by FDIC (face amount of the CDs plus accrued interest to maturity would not exceed the FDIC depository insurance limit of $250,000). These CDs are not held as part of the fund. On August 31, 2009, ESU 9 held $3,735,676 invested in CDs through this program. These CDs are valued at amortized cost, which is determined to approximate fair value. This involves valuing the CDs at original cost on the date of purchase and thereafter recording accrued interest until maturity. Participation in the investment trust is voluntary for its members. The objective of NLAF is to provide its owner members with a conservative and effective investment alternative tailored to the needs of its members. NLAF portfolio management generally follows established investment criteria developed by the Securities and Exchange Commission for money market funds designed to offer acceptable yield while maintaining liquidity. NLAF is not registered with the Securities and Exchange Commission as an investment company. ESU 9 had $811,821 invested with NLAF as of August 31, 2009.

4. Cash and Investments (Concluded)

NLAF's short-term investment portfolio consists of cash and short-term investments valued at amortized cost, which is determined to approximate fair value due to the short-term nature of the instruments. This involves valuing a portfolio security at its original cost on the date of purchase and thereafter amortizing any premium or discount on the straight-line basis to maturity. The amount of premium or discount amortized to income under the straight-line method does not differ materially from the amount which would be amortized to income under the interest method. Procedures are followed to maintain a constant net asset value of $1.00 per unit in NLAF.

5. Cafeteria Plan

ESU 9 provides for a qualifying "Cafeteria Plan" within the meaning of Section 125 of the Internal Revenue Code of 1986, as amended, and that the benefits which an employee elects to receive under the Plan be includable or excludable from the employee's income under Section 125(a) and other applicable sections of the Internal Revenue Code of 1986, as amended. The $9,199 due to employees at August 31, 2009, represents employee contributions to the Cafeteria Plan. These funds are held by ESU 9 until the proper claim is filed by the employee. If these funds are not claimed by the employee within 60 days after the end of the grace period (November 15 of each plan year), they become the property of ESU 9.

6. Retirement Plan

Plan Description. ESU 9, Hastings, Nebraska, contributes to the Nebraska School Employees Retirement System (NSERS), a cost-sharing multiple-employer defined benefit pension plan administered by the Nebraska Public Employees Retirement System (NPERS). NSERS provides retirement and disability benefits to plan members and beneficiaries. Neb. Rev. Stat. §§ 79-901 through 79-977.03 (Reissue 2008) – the School Employees Retirement Act – establishes benefit provisions. NPERS issues a publicly available financial report that includes financial statements and required supplementary information for NPERS. That report may be obtained by writing to NPERS, 1221 N Street, Suite 325, P.O. Box 94816, Lincoln, NE 68509-4816 or by calling 1-800-245-5712.

Funding Policy. Plan members are required to contribute 7.28% of their covered salary. ESU 9 is required to contribute 101% of the employee contribution. The contribution requirements of plan members and ESU 9 are established by Nebraska statutes. ESU 9's contributions to NSERS for the years ended August 31, 2007, 2008, and 2009 were $676,701, $637,870, and $672,058, respectively, equal to the required contributions for each year for plan members and ESU 9.

7. Transfers

Funds were transferred from the General Fund to the following accounts:

Depreciation Fund	$ 50,000

These are shown as transfers in the General Fund.

8. Film Contracts on Yearly Basis

ESU 9 enters into a number of agreements for the rental of films each year. These agreements fluctuate in total annually. The cost is based on a percentage of the purchase price of each film. The percentage charged is determined by each individual vendor. ESU 9 can choose to either add or delete individual film titles annually resulting in a new rental cost.

9. Major Revenues/Customers

Revenue for the year ended August 31, 2009, includes payments from the following sources:

	Amount	% of Total Revenues
Special Education	$ 3,232,708	35%
U.S. Government (various programs)	1,332,554	14%
County property taxes	740,866	8%
State of Nebraska	1,688,735	18%
Other Sources	2,316,138	25%
	$ 9,311,001	100%

10. Reconciliation with Annual Financial Report

The financial statement presentation has the following differences from the Annual Financial Report for the year ended August 31, 2009.

NOTES TO FINANCIAL STATEMENTS
(Continued)

10. <u>Reconciliation with Annual Financial Report</u> (Concluded)

	Amount per Annual Financial Report	Amount per Audit Report	Difference	
General Fund				
Revenue				
Local receipts	$ 6,314,885	$ 6,289,712	$ 25,173	*
State receipts	1,688,735	1,688,735	-	
Federal receipts	1,301,529	1,332,554	(31,025)	**
Non-revenue	30,116	5,781	24,335	
Total	$ 9,335,265	$ 9,316,782	$ 18,483	
Expenses				
General education	$ 21,070	$ 21,070	$ -	
Special Education	3,805,702	3,778,778	26,924	
Support Services Staff	95,418	95,418	-	
Governance and General Admin.	201,762	201,762	-	
Support Services	335,727	335,727	-	
Maintenance and Operation of Buildings	52,300	52,300	-	
Pupil Transportation	112,300	112,300	-	
Materials and Equipment	489,770	489,770	-	
State Programs	1,703,667	1,706,824	(3,157)	
Federal Programs	2,580,597	2,527,440	53,157	
Other	-	3,495	(3,495)	
Transfers	-	50,000	(50,000)	
Total	$ 9,398,313	$ 9,374,884	$ 23,429	

* Difference is due to the change in county treasurer balance of $5,852 and a Federal grant of $31,025 misclassified.

** Federal grant of $31,025 classified as local money.

11. <u>Cash at County Treasurer</u>

ESU 9 has yet to receive $825 in property taxes from Kearney County. This money is in-transit from Kearney County and has yet to be deposited into ESU 9's bank account. It has been included in the amount of funds held by Kearney County.

12. <u>Contingencies and Commitments</u>

Risk Management. ESU 9 is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors or omissions, injuries to employees, and natural disasters. ESU 9 has chosen to purchase insurance for:

A. **General Liability with the following limits –**
   - $2,000,000-General Aggregate Limit
   - $2,000,000-Products/Completed Operations Aggregate Limit
   - $1,000,000-Personal and Advertising Injury Limit (Any One Person or Organization)
   - $1,000,000-Each Occurrence Limit
   - $100,000-Damage to Premises Rented to you Limit (Any One Premises)
   - $5,000-Medical Expense Limit (Any One Person)

B. **Property-Building** – Various limits and coverage on each building.

C. **Crime and Fidelity Coverage** – Theft of money and securities on the premises-$10,000 limit, with a $500 deductible. Theft of money and securities outside the premises-$5,000 limit with a $500 deductible.

D. **Property-Equipment –** Various limits and coverage with a $500 deductible.

E. **Auto –** $1,000,000 liability and $500 deductible comprehensive coverage for each vehicle.

F. **Umbrella Policy** – $4,000,000 coverage with $10,000 retained limit.

G. **Medical professional Liability on one staff person** – Liability limits-$1,000,000 per claim with a policy aggregate of $3,000,000 and a deductible of $2,500 per claim.

H. **Errors and Omissions** – $5,000,000 policy aggregate with a $10,000 deductible for each wrongful act.

I. **Long Term Disability Insurance** – ESU 9 has two separate policies covering certified members and non-certified members. Members are not required to contribute a part of the premium for their insurance.

J. **Workers Compensation –** Coverage as required by Nebraska law.

Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three years.

EDUCATIONAL SERVICE UNIT NO. 9

REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE - BUDGET AND ACTUAL
GENERAL FUND CASH RECEIPTS ACCORDING TO SOURCE AND PURPOSE
Fiscal Year Ended August 31, 2009
With Comparative Amounts for 2008

	2009			
	Budget (Original/Final)	Actual Revenues	Variance with Final Budget Positive (Negative)	2008 Actual
RECEIPTS:				
Local:				
Property Tax	$ 737,164	$ 740,866	$ 3,702	$ 694,115
General Education	110,000	73,399	(36,601)	88,046
Special Education	3,362,613	3,232,708	(129,905)	3,650,480
Interest	120,000	159,128	39,128	220,742
Nurse	1,988	-	(1,988)	1,250
Film	100,000	105,470	5,470	101,226
Pre-school Special Education	2,155,544	1,266,517	(889,027)	1,879,929
Audio Visual	41,051	20,109	(20,942)	18,373
Co-op Purchases	381,092	384,267	3,175	301,181
Medicaid Payments	8,500	14,109	5,609	12,956
Inservice Fees	35,000	69,598	34,598	78,151
Other	207,225	223,541	16,316	236,532
Total Local Receipts	7,260,177	6,289,712	(970,465)	7,282,981
State:				
Special Education - School Age	100,486	81,701	(18,785)	81,925
Other	1,461,863	1,607,034	145,171	1,041,746
Total State Receipts	1,562,349	1,688,735	126,386	1,123,671
Federal:				
Title I	471,192	618,044	146,852	423,665
Other	994,396	714,510	(279,886)	891,102
Total Federal Receipts	1,465,588	1,332,554	(133,034)	1,314,767
Total Receipts	10,288,114	9,311,001	(977,113)	9,721,419
OTHER FINANCING SOURCES				
Other	101,000	5,781	(95,219)	16,837
Total Non-Revenue Receipts	101,000	5,781	(95,219)	16,837
GRAND TOTAL OF ALL RECEIPTS	$ 10,389,114	$ 9,316,782	$ (1,072,332)	$ 9,738,256

See Independent Auditor's Report.

EDUCATIONAL SERVICE UNIT NO. 9

REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE
BUDGET AND ACTUAL
GENERAL FUND
Fiscal Year Ended August 31, 2009

	Budget (Original/Final)	Actual	Variance with Final Budget Positive (Negative)
RECEIPTS			
Local	$ 7,260,177	$ 6,289,712	$ (970,465)
State	1,562,349	1,688,735	126,386
Federal	1,465,588	1,332,554	(133,034)
Total Receipts	10,288,114	9,311,001	(977,113)
DISBURSEMENTS			
General Instruction	34,000	21,070	12,930
Special Education Programs	4,106,028	3,778,778	327,250
Support Services Staff:			
Production and Media Services	95,895	95,418	477
Governance and General Administration:			
Board of Control	47,640	42,460	5,180
General Administration	155,248	159,302	(4,054)
Support Services:			
Business Services	392,340	303,986	88,354
Building and Sites	51,000	29,799	21,201
Vehicle Acquisition and Maintenance	3,550	1,942	1,608
Maintenance and Operation of Buildings:			
Operation	44,250	40,193	4,057
Maintenance	10,250	12,107	(1,857)
Pupil Transportation:			
Special Education	143,153	112,300	30,853
Materials and Equipment Services	469,945	489,770	(19,825)
State Programs	1,876,397	1,706,824	169,573
Federal Programs	2,890,070	2,527,440	362,630
Other	29,000	3,495	25,505
Total Disbursements	10,348,766	9,324,884	1,023,882
OTHER FINANCING SOURCES (USES)			
Interfund Transfers	(50,000)	(50,000)	-
Non-Revenue Receipts	101,000	5,781	(95,219)
Total Other Financing Sources (Uses)	51,000	(44,219)	(95,219)
Excess Receipts Over (Under) Disbursements	$ (9,652)	$ (58,102)	$ (48,450)

See Independent Auditor's Report.

BUDGETARY COMPARISON SCHEDULES

Budget

Budget Process and Property Taxes – ESU 9 follows these procedures in establishing the budgetary data reflected in the accompanying statements:

Public hearings are conducted at a public meeting to obtain taxpayer comments.

Prior to September 20, the budget is legally adopted by the Board through passage of a resolution. Total expenditures may not legally exceed total appropriations. Appropriations lapse at year end and any revisions require Board approval.

The property tax requirement resulting from the budget process is utilized by the County Assessors to establish the tax levy, which attaches as an enforceable lien on property as of December 31.

EDUCATIONAL SERVICE UNIT NO. 9

COMPARATIVE STATEMENT OF ASSETS, LIABILITIES, AND FUND BALANCE – ARISING FROM CASH TRANSACTIONS
GENERAL FUND
Fiscal Year Ended August 31, 2009
With Comparative Amounts for 2008

	2009	2008
ASSETS:		
Cash in bank and on hand	$ 4,441,386	$ 4,505,340
Funds held by County Treasurer	148,070	142,218
TOTAL ASSETS	$ 4,589,456	$ 4,647,558
LIABILITIES AND FUND BALANCES:		
LIABILITIES	$ -	$ -
FUND BALANCE	4,589,456	4,647,558
TOTAL LIABILITIES AND FUND BALANCE	$ 4,589,456	$ 4,647,558

EDUCATIONAL SERVICE UNIT NO. 9

COMPARATIVE STATEMENT OF CASH RECEIPTS, DISBURSEMENTS, AND CHANGES IN FUND BALANCE
GENERAL FUND

Fiscal Year Ended August 31, 2009
With Comparative Amounts for 2008

	2009	2008
RECEIPTS:		
Local	$ 6,289,712	$ 7,282,981
State	1,688,735	1,123,671
Federal	1,332,554	1,314,767
Total Receipts	9,311,001	9,721,419
DISBURSEMENTS:		
General Instruction	21,070	21,771
Special Education Programs	3,778,778	3,835,503
Student Support Services	-	4,156
Support Services Staff:		
Staff Development	-	224,505
Production and Media Services	95,418	90,555
Governance and General Administration:		
Board of Control	42,460	37,235
General Administration	159,302	148,348
Support Services:		
Business Services	303,986	309,526
Building and Sites	29,799	23,469
Vehicle Acquisition and Maintenance	1,942	2,356
Maintenance and Operation of Buildings:		
Operation	40,193	51,292
Maintenance	12,107	7,019
Pupil Transportation:		
Special Education	112,300	104,960
Materials and Equipment Services	489,770	425,375
State Programs	1,706,824	1,516,410
Federal Programs	2,527,440	2,756,897
Other	3,495	14,571
Total Disbursements	9,324,884	9,573,948
OTHER FINANCING SOURCES (USES):		
Interfund Transfers	(50,000)	(50,000)
Non-Revenue Receipts	5,781	16,837
Total Other Financing Sources (Uses)	(44,219)	(33,163)
Excess Receipts Over (Under) Disbursements	(58,102)	114,308
Fund Balance - Beginning	4,647,558	4,533,250
FUND BALANCE - ENDING	$ 4,589,456	$ 4,647,558

EDUCATIONAL SERVICE UNIT NO. 9

COUNTY TREASURER FUNDS - GENERAL FUND
Fiscal Year Ended August 31, 2009
(Unaudited)

	Adams	Clay	Fillmore	Franklin	Hall	Hamilton
BALANCES ON HAND						
September 1, 2008	$ 49,353	$ 26,979	$ 2,103	$ 1,179	$ 6,430	$ 34,666
REVENUES						
Tax Collections	272,725	111,797	9,563	6,234	35,906	147,939
Prorate Motor Vehicle	1,180	362	98	21	143	367
Homestead Exemption	7,745	1,254	25	144	401	2,287
Interest	1,514	365	15	29	81	341
Carline	939	824	38	-	-	482
Property Tax Credit	12,441	5,119	475	264	1,649	6,983
Other	30	-	12	-	-	-
Total Revenues	296,574	119,721	10,226	6,692	38,180	158,399
Total Funds Available	345,927	146,700	12,329	7,871	44,610	193,065
DISBURSEMENTS						
Remitted to ESU 9	300,151	117,686	9,822	6,273	36,936	151,118
County Treasurer Fee	2,742	1,134	96	64	380	1,506
Other	228	-	-	-	-	-
Total Disbursements	303,121	118,820	9,918	6,337	37,316	152,624
BALANCES ON HAND						
August 31, 2009	$ 42,806	$ 27,880	$ 2,411	$ 1,534	$ 7,294	$ 40,441

(Continued)

EDUCATIONAL SERVICE UNIT NO. 9

COUNTY TREASURER FUNDS - GENERAL FUND
Fiscal Year Ended August 31, 2009
(Unaudited)

	Kearney	Nuckolls	Thayer	Webster	York	Total
BALANCES ON HAND						
September 1, 2008	$ 824	$ 9,539	$ -	$ 10,979	$ 166	$ 142,218
REVENUES						
Tax Collections	4,207	48,863	31	55,627	1,267	694,159
Prorate Motor Vehicle	13	199	-	205	4	2,592
Homestead Exemption	25	1,064	-	1,060	-	14,005
Interest	8	245	-	227	5	2,830
Carline	11	87	-	170	5	2,556
Property Tax Credit	217	2,171	2	2,508	67	31,896
Other	-	-	-	62	-	104
Total Revenues	4,481	52,629	33	59,859	1,348	748,142
Total Funds Available	5,305	62,168	33	70,838	1,514	890,360
DISBURSEMENTS						
Remitted to ESU 9	3,568	50,205	33	57,985	1,237	735,014
County Treasurer Fee	42	502	-	569	13	7,048
Other	-	-	-	-	-	228
Total Disbursements	3,610	50,707	33	58,554	1,250	742,290
BALANCES ON HAND						
August 31, 2009	$ 1,695	$ 11,461	$ -	$ 12,284	$ 264	$ 148,070

(Concluded)

EDUCATIONAL SERVICE UNIT NO. 9

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended August 31, 2009

	Federal CFDA No.	Pass-Through Entity Identifying No.	Federal Disburse-ments
U.S. DEPARTMENT OF EDUCATION			
PASSED THROUGH NEBRASKA DEPARTMENT OF EDUCATION:			
Career and Technical Education - Basic Grants to States	84.048	08-09-000-0009-00	$ 57,364
Grants for State Assessments and Related Activities	84.369	00-0009-STAR08	7,804
Special Education - Grants to States	84.027	08-09-000-0009-00 00-0009-248-3B4-09 00-0009-248-2B9B-09 00-0009-248-2B11B-09 00-0009-248-2B19B-09	238,301
Special Education - Grants for Infants and Families	84.181	08-09-000-0009-00 00-0009-248-2B19C-09	13,250
Title I Grants to Local Educational Agencies	84.010	09-09-000-0009-00	469,604
Improving Teacher Quality State Grants	84.367	09-09-000-0009-00	108,540
Education Technology State Grants	84.318	09-09-000-0009-00 09-4985-01-09-00-0009	36,960
Safe and Drug-Free Schools and Communities - State Grants	84.186	09-09-000-0009-00	14,139
State Grants for Innovative Programs	84.298	09-09-000-0009-00	2,163
			$ 948,125
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
PASSED THROUGH NEBRASKA DEPARTMENT OF HEALTH & HUMAN SERVICES:			
Medical Assistance Program	93.778	Not Available	$ 90,372
Block Grants for Prevention and Treatment of Substance Abuse	93.959	Not Available	18,550
			$ 108,922
TOTAL			$ 1,057,047

See Notes to Schedule of Expenditures of Federal Awards.

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Fiscal Year Ended August 31, 2009

(1) General

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) presents the activity of all Federal awards programs of Educational Service Unit No. 9 (ESU 9).

(2) Summary of Significant Accounting Policies

(a) Reporting Entity

ESU 9's reporting entity is defined in Note 1.B to the financial statements. The accompanying Schedule includes the Federal awards programs administered by ESU 9 for the fiscal year ended August 31, 2009.

(b) Basis of Presentation

The accompanying Schedule presents total expenditures for each Federal awards program in accordance with Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Federal program titles are reported as presented in the Catalog of Federal Domestic Assistance (CFDA).

Federal Awards – Pursuant to OMB Circular A-133, Federal awards are defined as assistance provided by a Federal agency, either directly or indirectly, in the form of grants, contracts, cooperative agreements, loans, loan guarantees, property, interest subsidies, insurance, or direct appropriations. All Federal awards for ESU 9 were passed through from State agencies of the State of Nebraska.

Major Programs – In accordance with OMB Circular A-133, major programs are determined using a risk-based approach. Title I Grants to Local Educational Agencies CFDA #84.010 is the only major program of ESU 9.

(c) Basis of Accounting

The accompanying Schedule was prepared on the cash basis of accounting.

Matching Costs – The Schedule does not include matching expenditures from general revenues of ESU 9.

(3) Reconciliation Between Statements

The Schedule of Expenditures of Federal Awards on page 31 reports $1,057,047 in Federal expenditures. The Statement of Cash Receipts, Disbursements, and Changes in Fund Balances on page 11 reports $2,527,440 in Federal program disbursements. The difference of $1,470,393 is non-federal funds disbursements for the same purpose as the various Federal programs administered by ESU 9.

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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*

Board of Directors
Educational Service Unit No. 9
Hastings, Nebraska:

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Educational Service Unit No. 9, as of and for the year ended August 31, 2009, which collectively comprise Educational Service Unit No. 9's basic financial statements and have issued our report thereon dated May 3, 2010. Our report disclosed that, as described in Note 1 to the financial statements, ESU 9 prepares its financial statements on a basis of accounting that demonstrates compliance with the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Educational Service Unit No. 9's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Educational Service Unit No. 9's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Educational Service Unit No. 9's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Educational Service Unit No. 9's ability to initiate, authorize, record, process, or report financial data reliably in accordance with basis of accounting that demonstrates compliance with the cash basis of accounting such that there is more than a remote likelihood that a misstatement of Educational Service Unit No. 9's financial statements that is more than inconsequential will not be prevented or detected by Educational Service Unit No. 9's internal control. We consider the following deficiency described in the Schedule of Findings and Questioned Costs to be a significant deficiency in internal control over financial reporting: Finding #09-01.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Educational Service Unit No. 9’s internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Educational Service Unit No. 9'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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

We noted certain matters that we reported to the management of Educational Service Unit No. 9 in a separate letter.

Educational Service Unit No. 9’s response to the finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. We did not audit Educational Service Unit No. 9’s response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of the board of directors, management, and Federal awarding agencies, pass-through entities and is not intended to be and should not be used by anyone other than those specified parties. However, this report is a matter of public record and its distribution is not limited.

Signed Original on File

May 3, 2010

Don Dunlap, CPA
Assistant Deputy Auditor

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of Directors
Educational Service Unit No. 9
Hastings, Nebraska:

Compliance

We have audited the compliance of Educational Service Unit No. 9, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended August 31, 2009. Educational Service Unit No. 9's major Federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major Federal programs is the responsibility of Educational Service Unit No. 9's management. Our responsibility is to express an opinion on Educational Service Unit No. 9's compliance based on our audit.

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 Educational Service Unit No. 9'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. Our audit does not provide a legal determination of Educational Service Unit No. 9's compliance with those requirements.

In our opinion, Educational Service Unit No. 9 complied, in all material respects, with the requirements referred to above that are applicable to each of its major Federal programs for the year ended August 31, 2009.

The results of our auditing procedures disclosed an instance of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as applicable to

Title I Grants to Local Educational Agencies – CFDA #84.010 – Compliance Requirement – Allowable Costs/Cost Principles – Finding #09-02.

Internal Control Over Compliance

The management of Educational Service Unit No. 9 is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Educational Service Unit No. 9's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, 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 Educational Service Unit No. 9’s internal control over compliance.

A *control deficiency* in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a Federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a Federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a Federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a Federal program will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Educational Service Unit No. 9’s response to the finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. We did not audit Educational Service Unit No. 9’s response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of the board of directors, management, Federal awarding agencies, pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Signed Original on File

May 3, 2010

Don Dunlap, CPA
Assistant Deputy Auditor

EDUCATIONAL SERVICE UNIT NO. 9

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Fiscal Year Ended August 31, 2009

I. Summary of Auditors' Results:

Financial Statements

Type of auditor's report issued:	**Unqualified**			
Internal control over financial reporting:				
Material weakness (es) identified?	___	Yes	X	No
Significant Deficiency identified that is not considered to be a material weakness?	X	Yes	___	No
Noncompliance material to financial statements noted?	___	Yes	X	No

Federal Awards

Internal control over major programs:				
Material weaknesses identified?	___	Yes	X	No
Significant Deficiencies identified that are not considered to be material weaknesses?	___	Yes	X	None Reported
Type of auditor's report issued on compliance for major programs:	**Unqualified**			
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133 and are included in the schedule of findings and questioned costs in Part III:	X	Yes	___	No

Identification of major program:

CFDA Number	Name of Federal Program or Cluster
84.010	Title I Grants to Local Educational Agencies

Dollar threshold used to distinguish between type A and type B programs:	$300,000			
Auditee qualified as low-risk auditee:	X	Yes	___	No

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

II. Findings Relating to the Financial statements which are Required to be Reported in Accordance with *Government Auditing Standards*:

Finding #09-01

Segregation of Duties - Payroll

In our review of Educational Service Unit No. 9's (ESU 9) payroll procedures, we noted there was a lack of segregation of duties in the payroll process. The payroll clerk had the ability to add employees to payroll, process payroll, and distribute checks without a significant supervisory documented review. For the fiscal year ended August 31, 2009, ESU 9 had a budget of over $7,000,000 in personal service expenditures for 130 full-time equivalent employees.

A good internal control plan requires that one individual not have the ability to process a transaction from beginning to end.

When one person has the ability to process a transaction from beginning to end there is a greater risk that errors or irregularities may occur and go undetected.

We recommend ESU 9 segregate the duties of the payroll process to provide a proper segregation of duties so no one individual has the ability to handle the process from beginning to end. This process should include a strong documented supervisory review of the payroll register for each payroll cycle.

ESU 9's Response:

1. *ESU 9 has already implemented a procedure where the Human Resource director reviews the Payroll check register monthly and initials and dates the register. The Human Resource director performs this task because she is aware of all employees due to her involvement with all employee hires.*

2. *Jan Hughes runs a monthly pay doc report and gives a copy to the Director of Finance for approval. After approving the pay doc form is given to the payroll clerk for processing and filing. The director of finance then reviews and initials the payroll register to ensure that all pay docs have been entered according to the pay doc report.*

3. *The director of finance now approves all manual calculations of employees who are being terminated. The payroll clerk indicates final payment on the employee worksheet and the director of finance initials and dates the employee worksheet.*

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

III. Findings and Questioned Costs Related to Federal Awards:

Finding #09-02

Program: CFDA #84.010 – Title I Grants to Local Educational Agencies – Allowable ost Principles/Allowable Activities

Grant Number & Year: Project #09-09-000-0009-00, July 1, 2008 – September 30, 2009

Federal Grantor Agency: Department of Education

Pass-through Entity: Nebraska Department of Education

Criteria: A-87, Attachment B, section 8., h (4) states, "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) …" Section 8., h (5) states, "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, provided that:…(ii) At least quarterly, comparisons of actual costs to budgeted distributions based on the monthly activity reports are made. Costs charged to Federal awards to reflect adjustments made as a result of the activity actually performed may be recorded annually if the quarterly comparisons show the differences between budgeted and actual costs are less than ten percent…" Also, good internal control requires review and approval of payroll records.

Condition: During testing of payroll, it was noted that one employee's hours charged to Title I in fiscal year 2009 was based on budgeted hours not actual hours. Also, the employee did not sign the monthly Title I hour logs and the logs were not reviewed by a supervisor.

Questioned Costs: $9,353

Context: ESU 9 charged a budgeted 35% of the employee's fiscal year 2009 contracted salary plus benefits of $31,060 out of the total $88,741 to Title I. At fiscal year end 2009, ESU 9 compared the percentage of actual logged hours for the entire fiscal year 2009 to the budgeted amount charged, this comparison was not conducted quarterly as required by A-87, and no adjustment was made to charge only the employee's actual hours to the Title I grant as required by A-87. The employee logged a total of 330.75 hours for Title I in fiscal year 2009 and was contracted to work a total of 1,462.5 hours. Total logged hours were 1,361.75, which included 1,259 of billable hours and 102.75 hours of leave. The Auditor of Public Accounts (APA) could not calculate the actual allowable cost to Title I in fiscal year 2009 for this employee because 100.75 hours were not logged by the employee, so the total activity was not accounted for as required by A-87. The APA used the following calculations to determine known questioned costs: (1,361.75/1,462.5) x $88,741 = $82,629 of compensation which activity was logged, (330.75/1,259) x $82,629 = $21,707 of known actual costs, then $31,060 budgeted – $21,707 = $9,353 known questioned costs. Through inquiry of ESU 9, it was also noted, two other employees use budgeted not actual hours to charge to Title I.

Cause: ESU 9 was unaware of A-87 requirements above that affected Title I costs.

Effect: Without adequate procedures in place to charge actual hours worked to Title I, it causes noncompliance with A-87, increasing the risk of the costs charged to Title I not being allowable.

Recommendation: We recommend ESU 9 develop procedures to be in compliance with A-87, including; comparing actual hours to budgeted hours quarterly and determine if an adjustment is needed and to charge actual hours in accordance with A-87; having all employees who are required to prepare monthly personnel activity reports sign the report per A-87. Also recommend having a supervisor review the employees monthly logged hours and document their review.

Management Response: ESU 9 will no longer allocate budgeted hours to the Title I program.

Corrective Action Plan:

1. The Director of Finance will receive a copy of the employee's logs and compare it to hours input into 4D (ESU 9's software system that allocates employee's time to school districts). This will be done on an annual basis. At the end of the fiscal year, the Director of Finance will create a journal entry to adjust wage and benefits into the Title I programs.

2. Employee will sign log and log will be reviewed and initialed by supervisor.

Contact: Larry Fox

Anticipated Completion Date: #1- June 30, 2010; #2- July 2010

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

There were no prior audit findings.

NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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May 3, 2010

Board of Directors
Educational Service Unit No. 9

Dear Members:

We have audited the financial statements of Educational Service Unit No. 9 (ESU 9) for the year ended August 31, 2009, and have issued our report thereon dated May 3, 2010. In planning and performing our audit of the financial statements of ESU 9, in accordance with auditing standards generally accepted in the United States of America, we considered ESU 9's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of ESU 9's internal control. Accordingly, we do not express an opinion on the effectiveness of ESU 9's internal control.

During our audit, we noted certain matters involving internal control and other operational matters that are presented for your consideration. Draft copies of this letter were furnished to ESU 9 to provide them an opportunity to review the letter and to respond to the comments and recommendations included in this letter. ESU 9 declined to respond. These comments and recommendations are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

1. Administrator's Employment Contract

The employment contract agreement for fiscal year 2009 for the ESU 9 Administrator notes the Administrator received an annual salary of $124,000. He also received basic benefits which included retirement, health/dental insurance, and life insurance. In addition, the contract includes a section for "Other Benefits." This section, in part, states the "Administrator shall receive additional benefits as provided below:…b. Administrator shall have the flexibility of applying up to $6,000 toward civic dues, etc. Any sums in excess of the amount required to pay for the above fringe benefits may be diverted as the Administrator directs provided, however, that any funds so diverted for non tax-exempt benefits, or for salary, shall be subject to all statutory deductions." A similar benefit for civic dues was noted in the Administrator's contracts for fiscal years 2005 through 2008 as well; however, the benefit amount was $2,500 in years 2005 through 2007.

In addition, there is a separate section in the Administrator's contracts for fiscal years 2005 through 2009 which states, "…all membership dues or fees required of Administrator for membership in the Nebraska Council of School Administrators shall be borne by ESU 9. Membership dues or fees required of Administrator for membership in other professional associations may be borne by ESU 9 upon approval of the ESU 9 Board." There is not a limit on the amount of professional dues paid on behalf of the Administrator, per the contract.

For the five fiscal years noted (2005-2009), ESU 9 paid $20,084 in civic and professional dues for the Administrator in accordance with the above provisions of the Administrator's contracts. The following dues and fees were paid by ESU 9 on behalf of the Administrator:

	FY 2009	FY 2008	FY 2007	FY 2006	FY 2005	Total
Professional Dues:						
Nebraska Council of School Administrators (annual dues)	$ 718	$ 395	$ 310	$ 310	$ 300	$ 2,033
Nebraska School Masters Club (annual dues)	25	25	-	-	-	50
Chamber of Commerce (annual dues)	-	1,130	-	-	-	1,130
American Association of School Administrators (membership)	-	387	-	-	-	387
Hastings Rotary Club (student recognition)	-	45	-	-	-	45
ESU Administrators Association (operating fee)	-	-	120	20	20	160
Association of Educational Service Agencies (annual dues)	-	200	-	-	-	200
Total Professional Dues	$ 743	$ 2,182	$ 430	$ 330	$ 320	$ 4,005
Civic Dues:						
Lochland Country Club (annual dues)	$ 2,430	$ 2,820	$ 2,640	$ 2,460	$ 2,232	$ 12,582
Lochland Country Club (donation)	1,500	-	-	-	-	1,500
YMCA (membership)	482	467	-	-	-	949
United Way (donation)	200	200	-	-	-	400
Sam's Club (membership)	23	23	-	-	-	46
Association of Educational Service Agencies (golf tournament)	99	-	-	-	-	99
Hastings Elks Lodge (annual dues)	88	-	-	-	-	88
Hastings Rotary Club (annual dues)	-	225	190	-	-	415
Total Civic Dues	$ 4,822	$ 3,735	$ 2,830	$ 2,460	$ 2,232	$ 16,079
Total Professional and Civic Dues	$ 5,565	$ 5,917	$ 3,260	$ 2,790	$ 2,552	$ 20,084

We have two concerns with these payments made by ESU 9. First, we do not believe most of these payments are reasonable and necessary business expenses that should be paid by ESU 9. The only expenses that appear to be reasonable and necessary business expenses of ESU 9 are primarily the professional dues in the amount of $4,005. Meanwhile, the vast majority of the civic dues amount of $16,079 appears to be of a personal nature. Secondly, since these expenses were paid directly to the vendor by ESU 9, there were no State or Federal taxes withheld on the benefits. If a portion of these benefits were determined to be personal expenses and not business expenses they would be taxable benefits in accordance with the following Internal Revenue Service (IRS) guidance and regulations:

> The IRS has issued a "Taxable Fringe Benefit Guide" (January 2010). The relevant section related to **Entertainment and Recreational Organizations** is as follows: "Club dues and memberships are not allowed as business deductions. If an employer provides these benefits to an employee, they are taxable to the employee and subject to withholding for income tax, social security and Medicare. The payment of club dues by the employer is a taxable fringe benefit.

> No business deduction is allowed for club dues. If an employer pays or reimburses an employee for club dues, the amount is taxable to the employee and subject to income tax withholding, social security and Medicare taxes." This section is referenced to *IRC* § *274(a)(3)* (see below).
>
> IRS regulation 26 U.S.C. § 274(a)(3) (January 5, 2009) states, "no deduction shall be allowed under this chapter for amounts paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose."

When personal benefits are paid by a political subdivision, there are fewer dollars available to fund their programs. In addition, if personal benefits are paid and appropriate State and Federal taxes are not withheld, the ESU may not be in compliance with State and Federal tax laws.

> We recommend the Board review the Administrator's contract and determine if the above types of expenditures should be made by ESU 9. In addition, we recommend the Board obtain professional assistance to determine if the above benefits are taxable or not.

2. <u>Billings for Special Education Services</u>

Per Special Education Contract, Term 5. states, "The Servicing Agency agrees to bill the District for the actual cost of special education services rendered and to make any adjustments caused by prior overpayments or underpayments." Term 6. states, "The Servicing Agency agrees to provide the District with the final billing, a complete reconciliation of the actual costs of special education services rendered and the actual rate for the cost of services. The final billing to the District shall serve as a final reconciliation of the amount of payment previously agreed upon in item two of this contract."

Good internal control requires rates that provide a significant portion of overall revenues to be adequately monitored by the Board of Directors (Board), including approval of rates.

ESU 9 provides Special Education Services to 14 school districts. Services include approximately 16 different types of programs that can be offered. Examples of programs offered include providing paraprofessionals, speech pathologists, audiology specialists, and providing several types of specialists at designated center based classrooms. All programs under Special Education Services charge a separate rate when billed to school districts. The Board gives authority for ESU 9 management to contract with school districts for Special Education Services; however, procedures are not in place for the Board to formally review and approve rates used to bill school districts for Special Education Services throughout the fiscal year or for the ESU 9 Administrator to approve the calculated final rates used for Special Education Services. The only formal approval of the rates is a Board signature that is stamped by an ESU 9 employee on each school contract. The rates charged to school districts throughout the fiscal year are initially set based on ESU 9 budgeted costs and budgeted hours for each program. The school districts agree to these rates when they sign their contract. All school districts agree to the same rates as all other school districts under ESU 9. At the end of the fiscal year, the Finance Director calculates final rates based on costs incurred for each program divided by the actual amount of hours served for the program. Included in the final rates are administrative costs that are also not approved by the Board. In fiscal year 2009, revenue from Special Education Services billings accounted for 48% of ESU 9's total revenue of $9,311,001.

Per the contract with school districts, the final billing at the end of the fiscal year should be based on actual costs adjusting for overpayments and underpayments based on the rates charged during the year. Through discussion with the ESU 9 Administrator, ESU 9 has an informal policy which gives credits to schools for overpayments but does not collect amounts owed for underpayments. For example, if a school district's actual costs were lower than their budgeted costs (resulting in an overpayment to ESU 9), the excess would be paid (credited) back to the school district; however, if a school district's actual costs were higher than budgeted (resulting in an underpayment), the shortage would not be paid (billed) to the school district. Per the ESU 9 Administrator, the policy was in place before he started approximately ten years ago, and he continued to follow the policy. This policy is not formally approved by the Board. We tested 1 of 16 rates billed to school districts for Special Education Services; determination of rates would be performed in a similar manner. We noted the following concerning billings for Special Education Services:

A. During testing of a fiscal year 2009 Special Education Services billing (a $128,493 credit for overpayment to a school district from a final 2007-2008 billing), the center base final rate calculated was not calculated based on actual costs per the contract with the school district, but calculated based on actual costs divided by actual hours less 3,590 hours, causing the rate to be $38.44 instead of the actual rate of $34.77. If the actual rate was used to calculate the final invoicing, the credit to the school district would have been $173,306. Per discussion with the ESU 9 Finance Director, this rate was adjusted because the credit to school districts would have impacted ESU 9's cash flow to much if the rate had not been adjusted.

    1) Credits for overpayments were given to 9 school districts in addition to the one noted above, for a total of $262,670 using the adjusted rate. If the actual rate was used, the 9 other school districts would have received a credit for a total of $340,689.

    2) Total amount not billed to school districts for underpayments based on final rates calculated by ESU 9 for 2007-2008 billings was $136,931, and if the program rate mentioned above of $34.77 was charged, the amount would have been $120,080.

B. During review of the 2009 billings it was also noted that ESU 9 budgeted rates lower than what they expected the final actual rates to be in order to decrease the amount billed to school districts. This decision was made as a way to lower ESU 9's cash balance which was $4,754,154, which is 51% of expenditures in fiscal year 2009. Per the ESU 9 Administrator, this decision was informally communicated to the Board at a budget meeting, but was not formally authorized.

    1) For fiscal year 2009, by lowering rates ESU 9 undercharged school districts by $628,053 compared to the final actual rate calculated by ESU 9.

Without procedures in place to charge school districts consistently, some school districts are paying budgeted costs, while others are paying actual costs. By not billing all actual costs to school districts, ESU 9 would not be in compliance with the contracts. Also, without the Board's development of procedures to bill school districts appropriately and without reviewing and approving rates charged, it increases the risk of noncompliance with the contracts.

> We recommend ESU 9 charge rates to all school districts based on actual costs to agree with the contract, including giving credits for overpayments and charging for underpayments when the final billing is sent out to the school districts. Also, we recommend the Board take a more active role in monitoring the rates charged to school districts by approving the initial rates during the budgeting process. Finally, we recommend the Board develop policies and procedures for ESU 9's management to use in order to be in compliance with Special Education contracts, including requiring the ESU 9 Administrator to formally review and approve the final rates used to reach the actual costs.

3. Payroll

For the fiscal year ended August 31, 2009, ESU 9 had a budget of over $7,000,000 in personal service expenditures for 130 full-time equivalent employees. In our review of ESU 9's payroll procedures and transactions we noted the following:

A. Federal I-9 forms which are required to be retained by Federal law were destroyed in the summer of 2009 because of a misunderstanding of instructions on the I-9 form.

B. There were eight employees authorized by management to work 39 hours but were paid for 40 hours. Per discussion with ESU 9's staff, this had occurred for approximately four to five years for six employees and approximately one year for two employees. This practice was discontinued in April 2009.

C. Leave documents prior to January 2009 were not available as they had been destroyed in accordance with an ESU 9 informal policy. The informal policy was to maintain binders of the following information for one year: Leave reports signed by the employee and approved by a supervisor at the end of each week (completed for any employee who used leave that week) and leave request forms approved by a supervisor if leave was requested in advance.

D. One employee tested received a 20 mile mileage stipend for travel from her last assignment to home every day. Mileage stipends are set up in ESU 9's payroll system and paid for employees who have a regular first or last assignment. For the pay period tested, this stipend resulted in an overpayment of 70 miles that were not actually traveled. Twenty miles were paid for a day in which the employee used sick leave and 50 miles were overpaid as the employee's last assignment was closer to her home than the stipend number of miles. Total overpayment for the pay period was $40.95 (70 miles x $0.585/mile).

Through discussion with ESU 9's staff, their policy was not to make any adjustments to the stipend amounts unless there was a significant variance. They determined a significant variance to occur when an employee was absent for two weeks or longer. This is an unwritten informal policy and thus not approved by the Board. For the employee tested above, this policy would mean an overpayment of 200 miles or more, or $117 for one pay period, would have to occur in order to be considered significant for adjustment. Staff also indicated there were 30 employees that had mileage stipends added to their paychecks over 10 months during fiscal year 2009. Other employees were also paid mileage but their mileage was based on mileage logs, thus actual miles driven.

E. Through discussion with staff it was noted that any final pay calculations for terminated employees would be performed manually with no supervisory review completed on the calculation.

F. During review of employee access to the payroll system (4D), it was noted one employee had access to a certain function of the 4D system who had not used the system since August 2006. It appears this employee's access is not needed and should therefore be removed.

A good internal control plan requires that: Federal I-9 forms be retained, per Federal law, for three years after the date of hire or one year after the date employment ends, whichever is later; employees be paid only for hours worked; a documented review be performed for any manual payroll calculations performed; and employee access to the payroll system should be given only to those employees whose duties require access. ESU 9's Records Retention Policy indicates "Any forms used to request time off for vacation, illness, civil leave, or any other reason" should be disposed of "after verification of time cards/sheets, provided audit has been completed." In addition, a policy, formal or informal, should not be adopted to pay for expenses not incurred.

Federal penalties may occur when I-9 forms are not maintained in accordance with Federal law; when employees are paid for hours not worked, they are receiving compensation not earned; when records are not kept in accordance with record retention policies, ESU 9 is not in compliance with those policies and certain activities of ESU 9 may not have records to support that activity; when a mileage stipend is set up and paid for mileage not incurred, ESU 9 is paying an employee a stipend that was not earned; when there is no review of manual payroll calculations, there is an increased risk that errors could occur; and when employees have access to the payroll system when their duties do not require access, there is a greater risk of irregularities occurring.

> We recommend I-9 forms destroyed be completed again for all employees; employees be paid only for hours worked; ESU 9 retain records in accordance with their record retention policies; mileage stipends not be paid for mileage not incurred; a supervisory review be performed and documented on manual payroll calculations; and employee access to the payroll system be removed if it is no longer required to perform their duties.

4. Expenditures

In our review of the ESU 9 expenditure process and testing of transactions, we noted the following:

Travel Expenditures-18 Documents Reviewed:

A. As part of the duties of the ESU 9 employees, they are paid mileage in accordance with Board policy for miles driven on a daily basis between school districts. Our review noted there was an employee reviewing the mileage logs, but this review was not documented. In addition, this review was not performed by an employee who is the direct supervisor of the employees who are driving the miles. Although this employee may have a general knowledge of the miles that employees would be driving, she would not have the same knowledge as the employees' direct supervisors. A good internal control plan would include a documented supervisory review of all mileage logs.

B. An employee was underpaid $29 for mileage driven because of a clerical error. Mileage was not included on the claim form even though destinations for that day were included. A good internal control plan would include procedures to ensure correct mileage payments are made.

C. The per diem meal amount was requested and received by one employee for meals provided by the conference the employee attended. The amount reimbursed to the employee for these meals was $19. The meal per diem should not be requested and reimbursed when the meal is provided by the conference per ESU 9's Administrative Policy #21.

D. Lunch and dinner were paid for an employee for a one-day trip without overnight travel. ESU 9's Administrative Policy #21 does not allow meals to be reimbursed unless there is an overnight stay.

E. There was one instance noted where an employee was reimbursed $144 for lodging without a receipt and another instance where a hotel bill of $99 was paid without a receipt. Amounts reimbursed should be paid upon receiving original receipts only.

F. In two instances taxes were paid by ESU 9 for lodging in Nebraska. ESU 9 is tax exempt from paying taxes in Nebraska and thus ESU 9 should not pay tax.

G. The ESU 9 Administrator's travel claim forms were not approved by a second individual with knowledge of his travel. A good internal control plan would include a documented review and approval of the Administrator's travel claims.

Other Expenditure Transactions-13 Documents Reviewed:

H. There were 4 of 6 applicable documents in which there was no documentation on the vendor invoices or shipping documents to indicate that goods or services were received. ESU 9 does not have a policy in place to routinely perform this procedure. A good internal control plan would include documentation on the invoices or shipping documents to indicate that goods or services have been received by an individual knowledgeable of the transaction and thus providing evidence that goods or services were actually received.

I. ESU 9 paid Hastings Public Schools $15,898 for rent, but there was no written contract which outlined the agreement between the two parties for this payment. It was also noted that ESU 9 underpaid Hastings Public Schools $1,130 based on the amount invoiced due to a mathematical error. A good internal control plan would ensure a written contract be negotiated between parties for significant services obtained and invoices be reviewed to ensure the proper amount is paid.

When procedures and processes are not in place to ensure travel expenditures are approved, policies are not followed, payments are made without original receipts, taxes are paid when not required; there is a greater risk of fraud, abuse, or errors occurring and going undetected. When there are no written contracts for significant services obtained and invoices are not verified as to accuracy before payment is made, there is a greater risk of services being paid for and not obtained or incorrect payments being made.

We recommend the following:

1. ESU 9 strengthen controls over mileage paid to employees and a supervisory review be performed and documented on travel logs by a supervisor that has knowledge of the mileage the employee has driven.
2. Meals be reimbursed only in accordance with ESU 9's policies and the underpayment of $29 be made to the employee.
3. All expenditures be paid only upon receiving an original receipt.
4. The Administrator's travel claim forms be approved by an individual knowledgeable of his travel.
5. An individual with knowledge of the transactions should document on the original vendor invoices or shipping documents that goods and services have been received before payment is made to the vendor.
6. All invoices be verified as to accuracy before payment is made, and the $1,130 underpayment to Hastings Public Schools be verified and, if determined to be accurate, be corrected.

5. <u>Receipts</u>

In our review of internal controls over receipts and testing of receipts we noted the following:

A. Receipts were only recorded in the accounting system once a month.
B. Checks received were not restrictively endorsed until the deposit was made.
C. One person recorded all receipt activity into the accounting system, but there was no supervisory review of transactions to ensure all receipts were recorded accurately.
D. One individual had access to the billing system and opened the mail to make an initial list of monies received.
E. During review of a billing it was noted that 0.6 FTE of an employee was charged to a school district for Clay County Learning Center, which was not part of the contract.

A good internal control plan would include controls and procedures to: record receipts in the accounting system in a timely manner, restrictively endorse checks immediately upon receipt, perform a supervisory review of receipt activity to what was recorded, limit access to systems only for individuals who require it, and include all agreed upon terms with a party in the contract.

When receipts are not recorded in a timely manner, checks are not restrictively endorsed upon receipt, a supervisory review of receipts received is not compared to accounting system transactions, and access to a billing system is given to individuals who do not need access; there is greater risk of errors or irregularities occurring and going undetected. Also, without all agreed upon terms with a party included in the contract, it increases the risk of disputes on future billings.

> We recommend receipts be recorded in a timely manner, checks be restrictively endorsed upon receipt, a supervisory review be performed on receipt activity, individuals with access to the billing system be removed, if needed have two individuals open the mail, and all agreed upon terms with a party be included in the contract.

6. <u>Capital Assets</u>

Internal controls and procedures to account for ESU 9 capital assets were not adequate to ensure accountability over those assets. As of March 2010, the capital asset records included 349 items. The capitalization policy for ESU 9 was to capitalize all assets over $1,000. We noted during our review that ESU 9 did have a recently developed capital asset computer system to track their capital assets and also had policies to account for and control their capital assets - updated in January 2010. However, many of those policies were not yet implemented, or in some cases could be improved upon. In addition, we noted the capital asset records were not accurate or complete. The following was noted:

A. The policies require a form to be completed by an authorized supervisor for the transfer and disposal of capital assets. This form has only been recently developed. The form is then sent to the Accounts Payable Clerk (APC) who is responsible to make the change to the capital asset records. Based on our discussion with the APC, this form has not yet been used for these purposes. Thus, there was little documentation of assets being transferred or documentation of assets which were disposed. Per discussion with the Finance Director and APC, there were many older capital assets (many of them computers) still on the capital asset records which were disposed of with little or no documentation to support the disposition of the capital asset.

B. The policies require the following: *"A Fixed Asset print out will be provided to each supervisor for their department area at the end of each school year. The supervisors will be responsible for confirming that the current list is accurate and up to date by verifying the list to tagged assets within their department. Each supervisor will work closely with the APC to verify the accuracy of the Fixed Assets listing for ESU 9. All discrepancies will be brought to the attention of the APC for correction. The APC is responsible for maintaining proper written documentation of all corrections and adjustments to the Fixed Assets during this process."* Our review noted there had not been a physical inventory of ESU 9's capital assets for many years. No documentation was provided to indicate when the last inventory had been taken.

C. The policies require the following: *"When it has been determined that a Fixed Asset has been lost or stolen the Director of Finance must be notified immediately. The Director of Finance will be responsible for doing an internal investigation working with the Department Directors for whom the fixed asset belonged. The Director of Finance will notify the insurance company and sheriff's department if needed."* Since an inventory had not been taken for many years there was no evidence this policy was followed. The policies did not include written documentation by management and the Board for the removal of any missing asset from the capital asset records.

D. There was a lack of segregation of duties over capital assets. The APC had the ability to add capital assets to the capital asset records, remove capital assets from the records, and perform all other duties in maintaining the capital asset records. Per discussion with staff there was no supervisory review of the system records to ensure all capital assets that should be added were added and only authorized disposal of capital assets were removed from the capital asset records.

E. Capital asset additions were not being added to the capital asset records in a timely manner. During our testing we selected six capital assets from the office of ESU 9 and noted three of those items had not yet been added to the capital asset listing. One of these items had not been tagged, although the tag numbers had been assigned. We also selected six capital assets purchased during the fiscal year ended August 31, 2009, to determine if they had been added to the capital asset listing. We noted two of these six items had not yet been added to the capital asset records. However, for all of the above items not found on the capital asset records, we noted the APC had identified and maintained records to get these items added to the capital asset records. The APA also noted the APC files contained records of other items that also had not been added to the capital asset records as of March 12, 2010.

F. There seemed to be no central location or one person given the responsibility to ensure proper disposal of capital assets. The surplus process appeared to be handled by each department. A more centralized process would help to ensure a proper accounting of all surplus property.

G. For the fiscal year ended August 31, 2009, ESU 9 received Title I (Grants to Local Educational Agencies – CFDA 84.010) and Title II Part D (Education Technology State Grants – CFDA 84.318) Federal grant funds passed through from the Nebraska Department of Education (NDE) and expended $20,750 in Title I funds and $31,025 in Title II Part D funds for computer equipment. In the case of these purchases, ESU 9 functioned as a fiscal agent between NDE and a school district for the Title I equipment and the Nebraska Education Technology Association (NETA) for the Title II Part D funds. The equipment was ordered by and shipped directly to the school district and NETA. Upon receiving the invoices from these entities, ESU 9 paid the vendors for this equipment. Per discussion with ESU 9 staff, this equipment belongs to the school district and NETA and ESU 9 is simply the fiscal agent handling the funds between these two entities and NDE. They have no further responsibility to account for this equipment even though the equipment was paid out of ESU 9's Federal funds as they believe the school district and NETA own this equipment.

In review of the grant award for the Title I and Title II Part D in the **Terms and Conditions of Award** section we noted the following: "Records will be maintained for equipment acquired and the equipment will remain under the administrative control of the grantee." The grantee is ESU 9. In addition, per discussion with NDE Title I and Title II Part D staff they believe ESU 9 does have some on-going responsibility to account for this equipment as they are the grantee. However, beyond this we were unable to determine what administrative control means and we were unable to obtain documentation showing who owns this equipment and who and how this equipment should be accounted for.

A good internal control plan would include policies and procedures to ensure a proper accounting of all capital assets.

When policies, internal controls, and procedures over capital assets are not adequate there is greater risk capital assets will be lost or stolen. In addition, without a clear understanding of who owns equipment and how equipment should be accounted for, there is a greater risk equipment will not be properly accounted for.

We recommend the following:

1. ESU 9's capital asset policies be implemented and followed.
2. There be a supervisory review of system records to ensure all capital assets that should be added are being added and only authorized disposal of capital assets are properly removed from the capital asset records. ESU 9 should consider developing reports in the system that would identify all changes to the capital asset records to accomplish this review and this review should be periodically performed and documented.
3. A complete physical inventory of all capital assets be performed annually as required by Board policy and all items that cannot be found be investigated and reported to the Board for their approval of items to be taken off the system. This documentation should be maintained.
4. Addition to and removal of assets from the capital asset records should be performed timely.
5. ESU 9 work with the State and Federal Departments of Education to determine a process by which equipment purchased as a fiscal agent is properly accounted for after the purchase and until it is properly disposed of.

7. Cash and Investment Procedures

In our review of cash and investment procedures for ESU 9, we noted the following:

A. There was no documented supervisory review of bank reconciliations prepared by the accounting clerk. A good internal control plan over cash would include a supervisory review of bank reconciliations.

B. The Hastings State Bank account was uncollateralized for several days during the fiscal year ended August 31, 2009. Neb. Rev. Stat. § 77-2395(1) (Reissue 2009) requires bank deposits over the FDIC insurance to be secured with additional pledged collateral to cover at least 102% of the amount on deposit. The Hastings State Bank account had $250,000 of FDIC insurance and as of March 1, 2010, had approximately $30,000 in face value of pledged collateral. However, staff did not monitor or have knowledge of the market value of this pledged collateral. Market value of the pledged collateral should be monitored and known as it is the amount of the actual protection in case of bank failure. This pledged collateral amount varied during the year but the face amount of the collateral never covered ESU 9's deposit in case of bank failure. The bank balance during the fiscal year ended August 31, 2009, was often between $300,000 to $500,000 and peeked at over $700,000. Even considering the varied amounts of collateral during the fiscal year ended August 31, 2009, ESU 9's Hastings State Bank account was significantly uncollateralized. This resulted in ESU 9's cash deposits of several hundreds of thousands of dollars for several days during the year being put at risk of loss if Hastings State Bank had failed.

C. The Board had no written investment policies regarding investment in the Nebraska Liquid Asset Fund. The Board invested millions of dollars in this fund. A good internal control plan would include written investment policies to help ensure investments made by management are made in accordance with Board requirements.

When there is no documented supervisory review of bank reconciliations there is a greater risk of errors or irregularities to occur and go undetected; when bank deposits are not collateralized as required by State Statute there is a greater risk of loss of ESU 9 assets due to bank failure and ESU 9 is not in compliance with State Statute; and when there is no written investment policies there is greater risk investments will be made by management which are not made in accordance with Board requirements.

> We recommend a documented supervisory review of bank reconciliations be performed and that procedures be established to ensure all bank accounts are collateralized in accordance with Neb. Rev. Stat. § 77-2395(1) (Reissue 2009). In addition, written investment policies should be developed to help ensure investments will be made in accordance with Board requirements.

8. Cafeteria Plan

The Statement of Changes in Fiduciary Net Assets for the Cafeteria Plan was misstated as only a portion of the additions and deductions were included.

GASB Statement No. 34, Section 109, states "The statement of changes in fiduciary net assets should include information about the additions to, deductions from, and net increase (or decrease) for the year in net assets for each fiduciary fund type." In addition, good business practice indicates that **all** addition and deduction activity for a plan should be included on the financial statements.

There are five components of ESU 9's Cafeteria Plan: 1) Administrative Fee, 2) AFLAC, 3) Group Health, 4) Medical Expenses, and 5) Dependent Care. The AFLAC and Group Health components are paid out directly to the vendor by ESU 9 and; therefore, are never deposited into the Cafeteria Plan bank account. In addition, the Admin Fee is paid out to McDermott & Miller as they administer the plan, so that component is not deposited either. As only Medical Expenses and Dependent Care portions are deposited, only those amounts were initially included on the financial statement. However, as the other components are still a part of the plan, the APA believes all the activity should have been recorded.

Total plan additions and plan deductions were both understated by $88,718.

> We recommended an adjustment be made to the financial statement and management agreed. In addition, we recommend ESU 9 include all activity for the cafeteria plan on the Statement of Changes in Fiduciary Net Assets in the future.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore, may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of ESU 9's organization gained during our work to make comments and suggestions that we hope will be useful to you.

This communication is intended solely for the information and use of management, the ESU 9 Board, and others within the organization and is not intended to be and should not be used by anyone other than specified parties. However, this letter is a matter of public record and its distribution is not limited.

Sincerely,

Signed Original on File

Don Dunlap, CPA
Assistant Deputy Auditor