AUDIT REPORT
OF THE
EDUCATIONAL SERVICE UNIT NO. 18

SEPTEMBER 1, 2015 THROUGH AUGUST 31, 2016

Issued on November 30, 2016

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KEY OFFICIALS AND ENTITY CONTACT INFORMATION

Educational Service Unit No. 18 Board Members

Name	Title	Term Ending
Lanny Boswell	Board President	May 2017
Matt Schulte	Board Vice President	May 2019
Kathy Danek	Board Member	May 2017
Connie Duncan	Board Member	May 2019
Barbara A. Baier	Board Member	May 2017
Annie Mumgaard	Board Member	May 2019
Don Mayhew	Board Member	May 2017

Educational Service Unit No. 18 Management

Name	Title
Elizabeth Standish	Administrator

Educational Service Unit No. 18
5905 O Street
Lincoln, NE 68510
http://home.lps.org/esu18/

SUMMARY OF COMMENTS

During our audit of the Educational Service Unit No. 18 (ESU No. 18), we noted certain matters involving the internal control over financial reporting and other operational matters that are presented here.

1. ***Lack of Internal Controls:*** There was a lack of segregation of duties over expenditures, payroll, and receipts for ESU No. 18.

2. ***Contract Issue:*** ESU No. 18 did not have a contract on file for one payment tested totaling $115,000. The vendor was paid a total of $223,632 during the fiscal year tested.

3. ***Payroll Issues:*** ESU No. 18 overpaid one employee by $180 and lacked Board approval or supporting documentation for a $50 stipend paid to a second individual.

More detailed information on the above items is provided hereinafter. It should be noted this report is critical in nature, containing only our comments and recommendations on the areas noted for improvement.

Draft copies of this report were furnished to ESU No. 18 to provide its management with an opportunity to review and to respond to the comments and recommendations contained herein. All formal responses received have been incorporated into this report. A response that indicates corrective action has been taken was not verified at this time, but it will be verified in the next audit.

COMMENTS AND RECOMMENDATIONS

1. Lack of Internal Controls

Good internal control requires an adequate segregation of duties to ensure no one individual is able to perpetrate and to conceal errors or irregularities. Good internal control also requires procedures to ensure cash accounts are adequately safeguarded, and disbursements are reviewed and approved prior to payment.

Without an adequate segregation of duties, there is an increased risk for loss or misuse of funds.

Expenditures
During our review of ESU No. 18's accounting system access, we noted four employees had Super User access. This allowed those individuals to change their access in the system with no secondary review or approval. Therefore, the four Super Users could give themselves access to process an expenditure transaction in the system from beginning to end with no compensating controls in place to identify the improper payment. Furthermore, one of the individuals was also a signor on the bank account.

ESU No. 18's expenditures totaled approximately $11.8 million during the fiscal year tested.

Payroll
During testing of ESU No. 18's payroll, we noted six individuals had payroll access that allowed them to perform all functions of payroll in the accounting system. Those individuals were able to process payroll, set up new employees in the system, make changes to wages, deductions, etc. Each of the six individuals was assigned a "group" of employees for which they processed and reviewed the payroll each month. One of the six payroll processors was a member of her own employee "group," which permitted her to process her own pay; and there was no secondary review of her work to ensure that she had processed her pay properly.

ESU No. 18's payroll and benefits totaled approximately $6.7 million during the fiscal year tested.

Receipts
During our review of the receipt process for ESU No. 18, we noted a lack of segregation of duties. There was no record or log of money received when the mail was opened, and there were no compensating procedures that would identify if all monies received were properly receipted and deposited.

During the fiscal year tested, $12,970 in cash receipts was deposited by ESU No. 18.

> We recommend ESU No. 18 establish an adequate segregation of duties or implement compensating procedures to ensure no one individual is able to perpetrate or to conceal errors or irregularities.

ESU No. 18 Response:

Expenditures: In the area of segregation of duties within our accounting system, LPS has limited functionality as the system is 30 years old. Super-users do not have the ability to create or print a check. Two signatures are required on all checks. Super-users could set up a direct deposit. ESU No. 18 has initiated the process of reviewing the roles and access of super-users to maximize all opportunities for role-based access security in our current system. In addition, ESU No. 18 is in the process of considering a new system.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Lack of Internal Controls (Concluded)

Payroll: ESU No. 18 modified the access of payroll employees. Four employees no longer have access to process a payroll or set up new employees. In addition, the payroll manager reviews for accuracy the payroll for the employee who processes their own payroll.

Receipts: A compensation procedure has been established to include four separate people for the receipt and deposit process. One opens the mail, a second creates a log, a third makes the deposit, and a fourth checks to make sure that all items logged are in the deposit.

2. Contract Issue

During testing of one payment for $115,000, we noted ESU No. 18 did not have a contract on file. The purchase was for equipment to upgrade its electronic storage capacity. The purchase was made from a contract that was initially bid in 2011; however, that contract was destroyed in the 2011 district office fire. ESU No. 18 had not attempted to obtain a copy of the contract from the vendor or to renew that agreement. During the audit, however, ESU No. 18 contacted the vendor, who also did not have a copy of the contract on file. The total amount paid to the vendor during fiscal year 2016 was $223,632.

Good internal controls require adequate policies and procedures to ensure contracts for goods and services are on file. When contracts for significant purchases are not on file, there is an increased risk ESU No. 18 will not receive agreed-upon pricing or discounts.

> We recommend ESU No. 18 implement policies and procedures to ensure contracts for goods and services are on file to support payments made.

ESU No. 18 Response: A vendor was selected in 2011 for electronic storage. ESU No. 18 obtains electronic storage through a sales quote and subsequent purchase order process. The purchase order establishes the product specifications including associated services and agreed upon prices to acquire the product desired. ESU No. 18 will review the purchase order language to ensure appropriate contracts or arrangements are in place.

3. Payroll Issues

During testing of payroll, we selected eight employees and tested one paycheck for each. ESU No. 18 had approximately 81 employees during the fiscal year tested. We noted the following issues:

- One employee was overpaid $180. The individual's timesheet reflected 84 hours worked; however, the employee was paid for 87.5 hours. The overpayment occurred due to an error in the system that allowed the employee to report a half day of work (3.5 hours) and also clock in for 3.5 hours during the same time frame. ESU No. 18 was unaware of the system error until the APA identified it during the audit.

COMMENTS AND RECOMMENDATIONS
(Concluded)

3. <u>Payroll Issues</u> (Concluded)

- One employee was paid a $50 stipend for attending a training session. The rate was not approved by the Board, and there was no supporting documentation for how the rate was determined. According to ESU No. 18, any such supporting documentation would have been destroyed in the 2011 district office fire.

Good internal controls require adequate policies and procedures to ensure hours paid agree to employees' timesheets, and rates paid are properly approved by the Board. When documentation is not maintained, and reviews are not adequate to identify improper payments, there is an increased risk for loss or misuse funds.

> We recommend ESU No. 18 implement policies and procedures to ensure hours and rates paid agree to supporting documentation. Furthermore, we recommend stipend rates be approved by the Board.

ESU No. 18 Response: The ESU No. 18 time and attendance software does not provide a method to prevent the double counting of clocked and reported hours. ESU No. 18 implemented an additional report and verification process that will generate an error in the payroll run process. This additional step in the process will identify similar errors in the future prior to running payroll.

ESU No. 18 established a process through Human Resources in September of 2016 to review stipend amounts each month before payroll is run. Staff in Human Resources makes sure all rates paid are rates consistent with existing agreements and practices.

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EDUCATIONAL SERVICE UNIT NO. 18

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Educational Service Unit No. 18
Lincoln, Nebraska

Report on the Financial Statements
We have audited the accompanying modified cash basis financial statements of the governmental activities of the Educational Service Unit No. 18 (ESU No. 18), as of and for the year ended August 31, 2016, and the related notes to the financial statements, which collectively comprise ESU No. 18's basic financial statements, as listed in the Table of Contents.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with the modified cash basis of described in Note A; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ESU No. 18's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to previously present fairly, in all material respects, the respective modified cash basis financial position of the governmental activities of ESU No. 18, as of August 31, 2016, and the respective changes in modified cash basis financial position thereof for the year then ended in accordance with the modified cash basis of accounting described in Note A.

Basis of Accounting

We draw attention to Note A of the financial statements, which describes the basis of accounting. The financial statements are prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Other Information

The Schedule of General Fund Receipts, Expenditures and Fund Balance – Budget and Actual – Modified Cash Basis, Notes to Other Information, and Schedule of General Fund Expenditures has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 22, 2016, on our consideration of ESU No. 18's internal control over financial reporting and on 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, not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ESU No. 18's internal control over financial reporting and compliance.

Pat Reding

November 22, 2016

Pat Reding, CPA
Assistant Deputy Auditor

EDUCATIONAL SERVICE UNIT NO. 18

STATEMENT OF NET POSITION - MODIFIED CASH BASIS

AUGUST 31, 2016

		Governmental Activities
ASSETS:		
Investments held by Lincoln Public Schools	$	4,365,043
LIABILITIES:		
Accrued expenses and encumbrances		1,006,451
NET POSITION:		
Unrestricted	$	3,358,592

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

EDUCATIONAL SERVICE UNIT NO. 18

STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS

FOR THE YEAR ENDED AUGUST 31, 2016

		Program Receipts		
Functions/Programs	Expenditures	Charges for Services	Operating Grants and Contributions	Net (Expenditures)/ Receipt and Changes in Net Position
Primary government:				
Governmental activities:				
Instruction	$ 1,777,202	$ 846,826	$ 1,440,738	$ 510,362
Support services	6,353,656	5,481,556		(872,100)
General administration	142,509			(142,509)
Co-op services	3,497,745			(3,497,745)
Total governmental activities	$ 11,771,112	$ 6,328,382	$ 1,440,738	(4,001,992)
	General receipts:			
	Taxes:			
	Property			2,796,723
	Pro rate motor vehicle			7,836
	Other			1,849
	Total Taxes			2,806,408
	State Aid			1,962,452
	Total general receipts			4,768,860
	Change in net position			766,868
	Net position - beginning of year			2,591,724
	Net position - ending of year			$ 3,358,592

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

NOTES TO THE FINANCIAL STATEMENTS

For the Fiscal Year Ended August 31, 2016

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization – On November 28, 1972, the Lincoln Educational Service Unit, a tax-supported governmental organization, was formed to provide supplementary educational services to Lancaster County School District 001 – Lincoln Public Schools (the School District). It was later renamed as the Educational Service Unit No. 18 of the State of Nebraska (ESU No. 18) by statute. The ESU No. 18, a component unit of Lancaster County School District 001 – Lincoln Public Schools as defined by the Governmental Accounting Standards Board, is controlled by the same Board of Education as is elected for the School District and is supported by property taxes of up to 1.5 cents per one hundred dollars of valuation. The ESU No. 18 is a tax-exempt political subdivision of the State of Nebraska under Nebraska Statute §79-1202.

Reporting Entity – The financial statements of the ESU No. 18 include all significant separately administered organizations for which the ESU No. 18 is financially accountable. Financial accountability is determined on the basis of selection of governing authority, imposition of will, a financial benefit/burden relationship, and/or fiscal dependency. The ESU No. 18's financial statements are included in the School District's financial statements as a blended component unit and have no component units included in these financial statements.

Basis of Presentation – The ESU No. 18 prepares its financial statements based on 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 establishes standards for external financial reporting for all state and local government entities, which includes government-wide financial statements and fund financial statements. Fund financial statements are not presented as part of these financial statements due to the ESU No. 18 only having one fund which would report essentially the same information as the government-wide financial statements. However, on fund financial statements, the fund balance is reported in five classifications based primarily on the extent to which the ESU No. 18 is bound to observe constraints imposed upon the use of the resources. The classifications are nonspendable, restricted, committed, assigned and unassigned. As of August 31, 2016, the entire fund balance is considered unassigned. Unassigned are those funds not identified as restricted, committed, or assigned for a specific purpose by the ESU No. 18.

Basis of Accounting – The accompanying statements have been prepared on the modified cash basis of accounting. Under the cash basis of accounting, revenues are recognized when collected rather than when earned and expenses are recognized when paid rather than incurred. While a primarily cash basis methodology is used, the ESU No. 18 does utilize certain characteristics of accrual accounting in their accounting policies to more accurately depict the cash position of the ESU No. 18. Specifically, payroll-related accrued expenses and operating encumbrances for specific purchase orders are recorded as liabilities at the end of the fiscal year.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The year-end potential liabilities not recorded include:

- Potential liabilities based on blanket purchase orders in any of the ESU No. 18's funds, as these ongoing purchase orders do not represent a specific dollar-amount liability for the ESU No. 18; and

- Unencumbered accounts payable; deferred revenues; notes; bonds and capital lease obligations; compensated absences and pension liabilities.

Accordingly, the financial statements and schedules are not intended to present the financial position and results of operation in conformity with accounting principles generally accepted in the United States of America.

General Fund – This fund finances the educational services rendered by the ESU No. 18 and is used to account for all financial resources except those required or determined to be accounted for in another fund. Currently, the ESU No. 18 maintains no other funds.

Budgetary Data – The ESU No. 18 Board (the Board) follows these procedures in establishing the budgetary data reflected in the accompanying financial statements:

1. Prior to September 1, the Board proposes a budget on the modified cash basis of accounting for the fiscal year commencing September 1. The operating budget includes proposed expenditures and the means of financing them.

2. Hearings are conducted at a public meeting to obtain public comments.

3. Prior to September 20, the budget is legally adopted by the Board and submitted to the Office of the Auditor of Public Accounts and to the County Clerk.

4. Once approved by the Board, total expenditures cannot legally exceed total appropriations for the ESU No. 18 as a whole without holding a public budget hearing and obtaining approval from the Board. No amendments to the legally adopted budget were made for the year ended August 31, 2016.

5. Appropriations lapse at the end of the fiscal year.

Property Taxes – The tax levies for all political subdivisions in Lancaster County (the 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 April 1 and the second half becomes delinquent August 1 following the levy date. Delinquent taxes bear a statutory rate (currently 14%) of interest. Property taxes are recognized when received from Lancaster County. Accordingly, unremitted taxes of $182,388 at August 31, 2016 collected by the County have not been reflected in the ESU No. 18's financial statements.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Concluded)

The 2015 property tax valuation for the ESU No. 18 was $19,028,682,944. A tax levy of $0.015 per $100 of valuation was adopted to obtain a property tax assessment of $2,854,302 for the 2015-2016 budget year.

Cash held by Lincoln Public Schools – The ESU No. 18 does not maintain a separate bank account, but instead operates as part of a pooled cash account and investments with the School District. The ESU No. 18's share of cash and investments are recognized as a cash equivalent of the financial statement. The amount held by the School District consists of $4,365,043 of investments at August 31, 2016.

Interlocal Agreements – The School District and the ESU No. 18 have entered into agreements whereby each entity provides certain services on behalf of the other. The ESU No. 18 provides certain technology and instructional media services to the School District. During the fiscal year ended August 31, 2016, the School District reimbursed the ESU No. 18, $5,481,556, which is reported as Support Service program receipts on the Statement of Activities. Furthermore, the School District provides instructional media services, instructional and administrative technology services, and staff development services to the ESU No. 18. During the fiscal year ended August 31, 2016, the ESU No. 18 reimbursed the School District $3,497,745, for these services, shown as Co-op Service expenditures on the Statement of Activities.

Compensated Absences – Vacation benefits are recorded when paid. The liability for accumulated unpaid vacation benefits of ESU No. 18 amounting to approximately $362,563 at August 31, 2016, has not been accrued for in the financial statements in accordance with the basis of accounting disclosed above.

Sick and annual leave are also recorded when paid. Under the Option A Annual Leave Plan, certificated employees who separate from ESU No. 18 following twenty years of employment receive $16.50 per hour for each hour of accumulated annual (sick) leave. Under the Option B Annual Leave Plan certificated employees who separate from the ESU No. 18 following ten years of employment receive $16.50 per hour for each hour of accumulated annual (sick) leave. Other employee groups receive a range from four to twenty-two dollars per accumulated hour of sick or annual leave after ten to twenty years of employment.

The liability for sick and annual leave has not been determined, but management believes that annual payments for these benefits will not have a material financial impact on the accompanying financial statements and has not been accrued for in the financial statements in accordance with the basis of accounting disclosed above.

B. INVESTMENTS

For financial reporting purposes, the ESU No. 18's investments are carried at cost, which approximates fair value. As of August 31, 2016, the cost and fair value of the ESU No. 18's investments was $4,365,043.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

B. INVESTMENTS (Concluded)

The ESU No. 18 has not adopted a fair value measurements policy, but is providing the following information to enhance the understanding of its investments. A fair value policy establishes a framework for measuring fair value and expanded disclosures about fair value measurements. If adopted, the policy applies to all assets and liabilities that are measured and reported on a fair value basis. This enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values.

Assets and liabilities are classified into one of the following categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.
Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.
Level 3: Unobservable inputs that are not corroborated by market data.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following table presents financial instruments at cost and fair value utilizing the above hierarchy as of August 31, 2016:

	Cost	Fair Value Level 2
Short-term Federal Investment Trust	$ 4,365,043	$ 4,365,043

Risks – The ESU No. 18 attempts to mitigate the following types of deposit and investment risks through compliance with the State Statutes referred to above. The three types of deposit and investment risks are the following:

- Custodial Credit Risk – for deposits and investments, custodial credit risk is the risk that in the event of the failure of a bank or other counterparty, the ESU No. 18 will not be able to recover the value of its deposits or investments or collateral securities in the possession of a third-party.

- Credit Risk – for deposits and investments, credit risk is the risk that a bank or other counterparty defaults on its principal and/or interest payments owed to the ESU No. 18.

- Interest Rate Risk – for deposits and investments, interest rate risk is the risk that the value of deposits and investments will decrease as a result of a rise in interest rates.

The ESU No. 18's investment policy does not restrict investment maturities. The ESU No. 18 minimizes its interest rate risk by structuring its investment portfolio so that securities mature to meet the ESU No. 18's cash needs, which is accomplished in part by investing primarily in short-term investments or in investment vehicles that allow for monthly cash draws.

C. PENSION PLANS

The employees of ESU No. 18 are covered by the following pension plan:

The ESU No. 18 contributes to the Nebraska School Employees Retirement System, a cost–sharing multiple-employer defined benefit pension plan administered by the Nebraska Public Employees Retirement System (NPERS). NPERS provides retirement and disability benefits to plan members and beneficiaries. The School Employees Retirement Act establishes benefit provisions.

In 1945, the Nebraska Legislature enacted the law establishing a retirement plan for school employees of the State. During the NPERS fiscal year ended June 30, 2015, there were 266 participating school districts. These were the districts that had contributions during the fiscal year. All regular public school employees in Nebraska, other than those who have their own retirement plans (Class V school districts, Nebraska State Colleges, University of Nebraska, Community Colleges), are members of the plan.

Normal retirement is at age 65. The monthly benefit is equal to the greater of the following: 1) the sum of a savings annuity, which is the actuarial equivalent of the member's accumulated contributions and a service annuity equal to $3.50 per year of service; or 2) the average of the three 12-month periods of service as a school employee in which such compensation was the greatest, multiplied by total years of creditable service, multiplied by a formula factor of two percent, and an actuarial factor based on age.

For an employee who became a member on or after July 1, 2013, the monthly benefit is equal to the greater of the following: 1) the sum of a savings annuity, which is the actuarial equivalent of the member's accumulated contributions and a service annuity equal to $3.50 per year of service; or 2) the average of the five 12-month periods of service as a school employee in which such compensation was the greatest, multiplied by total years of creditable service, multiplied by a formula factor of two percent, and an actuarial factor based on age.

Benefit calculations vary with early retirement. Employees' benefits are vested after five years of plan participation or when termination occurs at age 65 or later.

For employees who became members prior to July 1, 2013, the benefit paid to a retired member or beneficiary receives an annual cost of living adjustment, which is increased by the lesser of the percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers or two and one-half percent. The current benefit paid to a retired member or beneficiary is adjusted so that the purchasing power of the benefit being paid is not less than 75 percent of the purchasing power of the initial benefit.

For employees who became members on or after July 1, 2013, the benefit paid to a retired member or beneficiary receives an annual cost-of-living adjustment, which is increased by the lesser of the percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers or one percent.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

C. PENSION PLANS (Continued)

For the ESU No. 18's year ended August 31, 2016, the ESU No. 18's total payroll for all employees was $5,206,417. Total covered payroll was $5,187,902. Covered payroll refers to all compensation paid by the ESU No. 18 to active employees covered by the Plan.

Contributions

The State's contribution is based on an annual actuarial valuation. In addition, the State contributes an amount equal to two percent of the compensation of all members. This contribution is considered a nonemployer contribution since employees are not employees of the State. The employee contribution was equal to 9.78 percent from July 1, 2014, to June 30, 2015, (and from July 1, 2015, through August 31, 2015). The ESU No. 18 (employer) contribution is 101 percent of the employee contribution. The ESU No. 18's contribution to the Plan for its year ended August 31, 2016 was $504,846.

Pension Liabilities

At June 30, 2015, the ESU No. 18 had a liability of $2,493,051 for its proportionate share of the net pension liability. (This liability is not recorded in the accompanying modified cash basis financial statements.) The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined using an actuarial valuation as of that date. The NPERS School Plan was 89.88% funded as of June 30, 2015 based on actuarial calculations comparing total pension liability to the plan fiduciary net position. The ESU No. 18's proportion of the net pension liability was based on a projection of the ESU No. 18's long-term share of contributions to the pension plan relative to the projected contributions of all participating entities, actuarially determined. At June 30, 2015, the ESU No. 18's proportion was 0.22891% which was an increase/(decrease) of (0.00181%) from its proportion measured as of June 30, 2014.

Under Nebraska Statute 79-966.01, if the actuarially required contribution rate exceeds the rate of all contributions required by the School Employees Retirement Act by ESU No. 18, the added contributions, if any, are required to be paid by the State of Nebraska. Accordingly, ESU No. 18 is not responsible for any portion of this liability beyond its current annual funding requirements. Thus the future liability, if any, related to the unfunded benefits will not have a material financial impact on the accompanying financial statements and has not been accrued for in the financial statements in accordance with the basis of accounting disclosed above.

For the year ended June 30, 2015, the ESU No. 18's allocated pension income was $49,396.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

C. PENSION PLANS (Continued)

Actuarial Assumptions

The total pension liability in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25%
Investment rate of return, net of investment expense and including inflation	8.0%
Projected salary increases, including inflation	4.0%-9.0%
Cost-of-living adjustments (COLA)	2.50% with a floor benefit equal to 75% purchasing power of original benefit*

* 1% and no floor benefit for members joining on or after July 1, 2013.

The School Plan's pre-retirement mortality rates were based on the 1994 Group Annuity Mortality Table, projected to 2015 using scale AA, set back one year (sex distinct with 55 percent of male rates for males and 40 percent of female rates for females).

The School Plan's post-retirement rates were based on the 1994 Group Annuity Mortality Table, projected to 2015 using Scale AA, set-back one year (sex distinct).

The School Plan's disability mortality rates were based on the 1983 Railroad Retirement Board Disabled Annuitants Mortality (unisex).

The actuarial assumptions used in the July 1, 2015, valuations for the School plan is based on the results of the most recent actuarial experience study, which covered the five year period ending June 30, 2011. The experience study report is dated August 20, 2012.

The long-term expected real rate of return on pension plan investments was based upon the expected long-term investment returns provided by a consultant of the Nebraska Investment Council, who is responsible for investing the pension plan assets. The return assumptions were developed using a building-block method in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of geometric real rates of return for each major asset class included in the pension plans' target asset allocation as of first quarter 2016, (see the discussion of the pension plan's investment policy) are summarized in the following table:

C. PENSION PLANS (Continued)

Asset Class	Target Allocation	Long-term Expected Real Rate of Return
U.S. Stocks	29.0%	4.4%
Non-U.S. Stocks	13.5%	5.2%
Global Stocks	15.0%	4.8%
Fixed Income	30.0%	2.1%
Real Estate	7.5%	4.4%
Private Equity	5.0%	6.7%
Total	100%	

Discount Rate

The discount rate used to measure the Total Pension Liability at both June 30, 2014, and June 30, 2015, was 8 percent. The discount rate is reviewed as part of the actuarial experience study, which was last performed for the period July 1, 2006, through June 30, 2011. The actuarial experience study is reviewed by the NPERS Board, which must vote to change the discount rate.

The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and contributions from employers and nonemployers will be made at the contractually required rates, actuarially determined. Based on those assumptions, the pension plans' fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payment to determine the total pension liability. The projected future benefit payment for all current plan members were projected through 2114.

Sensitivity of the ESU No. 18's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the ESU No. 18's proportionate share of the net pension liability calculated using the discount rate of 8.0 percent, as well as what the ESU No. 18's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (7.0 percent) or 1-percentage-point higher (9.0 percent) than the current rate:

	Discount Rate	ESU's proportionate Share of net pension liability
1% decrease	7.0%	$ 5,660,624
Current discount rate	8.0%	$ 2,493,051
1% increase	9.0%	$ (141,018)

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

C. PENSION PLANS (Concluded)

Plan Fiduciary Net Position

Detailed information about the Plan's fiduciary net position is available in the separately issued Nebraska Public Employees Retirement Systems Plan financial report. NPERS issues a publicly available financial report that includes financial statements and required supplementary information for NPERS. That report may be obtained by writing the NPERS, P.O. Box 94816, Lincoln, NE 68509-4816, by calling 1-800-245-5712 or via the internet at http:/ /www.auditors.nebraska.gov/ APA_ Reports.

D. COMMITMENTS AND CONTINGENCIES

Self-Insurance – The ESU No. 18 uses a blend of self-insurance and commercial insurance to manage its financial risk. The ESU No. 18 is covered under the School District's self-insurance program. The School District's primary areas of risk are covered as follows:

- Workers' Compensation – benefits, medical expenses, evaluation expenses, legal fees, and other administrative costs are self-insured up to a maximum retention of $500,000 per incident. Excess liabilities are commercially insured in accordance with the Nebraska Workers' Compensation laws.

- Unemployment Compensation – the School District is a "self-insured employer" under regulations promulgated by the Nebraska Department of Labor, and utilizes a third-party administrator to monitor quarterly reimbursements to the Department of Labor.

- Real and Personal Property, Basic Liability, Motor Vehicle Liability, and Errors and Omissions – the School District utilizes a "protected self-insurance" program whereby losses are self-insured up to a maximum retention of $250,000 per incident. Excess liabilities are self-insured, with the excess liability covered by various commercial insurers.

- Flood Insurance – the School District is commercially insured for losses due to floods.

- Employee Death Benefit – active-employee death benefits are payable pursuant to the School District's various employment agreements, ranging from $5,000 to $20,000 per individual, are self-insured.

The ESU No. 18 or School District did not pay any settlement amounts which exceeded its insurance coverages or amounts that exceeded its budget estimates for self-insured risks for the years ending August 31, 2016, 2015, or 2014.

NOTES TO THE FINANCIAL STATEMENTS
(Concluded)

D. COMMITMENTS AND CONTINGENCIES (Concluded)

Federal Award Programs – The ESU No. 18 receives funds under various federal and state programs and such assistance is to be expended in accordance with the provisions of the various grants. Compliance with the grants is subject to audit by various government agencies which may impose sanctions in the event of non-compliance. Management believes that they have complied with all aspects of the various grant provisions and the results of adjustments, if any, relating to such audits would not have any material financial impact.

EDUCATIONAL SERVICE UNIT NO. 18

SCHEDULE OF GENERAL FUND RECEIPTS, EXPENDITURES, AND FUND BALANCE - BUDGET AND ACTUAL - MODIFIED CASH BASIS

FOR THE YEAR ENDED AUGUST 31, 2016

	Budget (Original and Final)	Actual
FUND BALANCE, beginning of year	$ 2,497,023	$ 2,591,724
Receipts:		
Local sources:		
Local property taxes	2,826,042	2,597,152
Tuition receipts for classes	7,000	8,130
Contracted services	934,750	838,696
Other	26,750	1,849
	3,794,542	3,445,827
State sources:		
State aid	1,962,452	1,962,452
Homestead exemption	-	74,216
Property tax credit	-	125,355
Pro-rata motor vehicle	7,500	7,836
	1,969,952	2,169,859
Federal sources	1,830,250	1,440,738
Inter-local agreement - Lincoln Public Schools	5,627,700	5,481,556
Total receipts	13,222,444	12,537,980
Total available resources	15,719,467	15,129,704
EXPENDITURES:		
Operational expenditures:		
Instruction (non-special education)	969,160	871,763
Instruction (special education)	1,830,250	905,439
Support services and programs to schools	6,552,390	6,353,656
General administration	156,290	142,509
Co-op contracts and services	3,616,990	3,497,745
Total expenditures	13,125,080	11,771,112
FUND BALANCE, end of year	$ 2,594,387	$ 3,358,592

NOTES TO OTHER INFORMATION

For the Fiscal Year Ended August 31, 2016

BUDGETARY COMPARISON SCHEDULE

The ESU No. 18 prepares its budget for the Governmental Funds on the modified cash basis of accounting. This basis is consistent with the basis of accounting used in presenting the basic financial statements. Under this method of accounting, all unexpended appropriations lapse at the end of the budget year.

The term “Budgetary Fund Balance” used in these supplementary schedules is synonymous with the terms “Fund Balance – Modified Cash Basis” used in the basic financial statements.

EDUCATIONAL SERVICE UNIT NO. 18

SCHEDULE OF GENERAL FUND EXPENDITURES - MODIFIED CASH BASIS

FOR THE YEAR ENDED AUGUST 31, 2016

INSTRUCTION (NON-SPECIAL EDUCATION):	
Salaries:	
Professional staff	$ 541,342
Technical staff	28,079
Clerical staff	88,624
Employee benefits	187,942
Purchased services	1,914
Supplies and materials	19,365
Other	4,497
	871,763
INSTRUCTION (SPECIAL EDUCATION):	
Salaries:	
Professional staff	57,960
Technical staff	558,535
Clerical staff	21,174
Employee benefits	212,566
Contracted services	15,384
Supplies and materials	25,325
Other	14,495
	905,439
SUPPORT SERVICES AND PROGRAMS TO SCHOOLS:	
Salaries:	
Professional staff	907,504
Technical staff	2,281,682
Clerical staff	156,318
Employee benefits	1,059,882
Purchased services	759,407
Supplies and materials	877,881
Furniture and equipment	240,975
Other	70,007
	6,353,656
GENERAL ADMINISTRATION:	
Salaries:	
Administrative staff	100,680
Employee benefits	21,938
Purchased services	13,291
Supplies and materials	-
Other	6,600
	142,509
CO-OP CONTRACTS:	
District staff development	1,132,027
Computer technology	1,884,181
Assessment services	303,742
Media contracted services	177,795
	3,497,745
Total Expenditures	$ 11,771,112

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EDUCATIONAL SERVICE UNIT NO. 18

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*

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Educational Service Unit No. 18
Lincoln, Nebraska

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the governmental activities of the Educational Service Unit No. 18 (ESU No. 18), as of and for the year ended August 31, 2016, and the related notes to the financial statements, which collectively comprise ESU No. 18's basic financial statements, and have issued our report thereon dated November 22, 2016. The report notes the financial statements were prepared on a modified cash basis of accounting.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered ESU No. 18's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ESU No. 18's internal control. Accordingly, we do not express an opinion on the effectiveness of ESU No. 18's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of ESU No. 18's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control that we consider to be significant deficiencies, as described in the Comments Section of the report: Comment Number 1 (Lack of Internal Controls).

Compliance and Other Matters

As part of obtaining reasonable assurance about whether ESU No. 18'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*.

Additional items

We also noted certain additional items that we reported to the management of ESU No. 18 in the Comments Section of this report as Comment Number 2 (Contract Issue) and Comment Number 3 (Payroll Issues).

ESU No. 18's Response to Findings

ESU No. 18's responses to the findings identified in our audit are described in the Comments Section of the report. ESU No. 18's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them. Where no response is indicated, the ESU No. 18 declined to respond.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, not to provide an opinion on the effectiveness of ESU No. 18's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ESU No. 18's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Pat Reding

November 22, 2016 Pat Reding, CPA
Assistant Deputy Auditor