STATE OF NEW MEXICO
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RECEIVED
OCT 31 2014
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HANNA SKANDERA
SECRETARY OF EDUCATION

SUSANA MARTINEZ
GOVERNOR

Hector Balderas
State Auditor
2540 Camino Edward Ortiz, Suite A
Santa Fe, NM 87507

October 30, 2014

State Auditor Balderas,

I am in receipt of your October 29, 2014, letter. I am disappointed that it seems like you are trying to take advantage of this situation for what I can only assume is an attempt to make headlines before your upcoming election. Here are the facts:

PED has worked directly with OSA to outline the scope and selection of a forensic accountant. PED submitted a draft scope of work to your Chief of Staff, Evan Blackstone on October 7, 2014. Mr. Blackstone acknowledged receipt of the scope of work at the October 8, 2014 meeting you mentioned. At that meeting, PED, through its General Counsel, raised the issue of forensic accounting. Your staff agreed that this work should proceed as an emergency procurement rather than going through a competitive procurement. PED's General Counsel specifically raised the question of *who* the forensic accountant should be and OSA, PED and the Southwest Learning Center Schools all agreed upon an accountant, who is a recognized expert in the field. Your staff also agreed that PED should work with the accountant to develop an appropriate scope of work. Your staff directed PED to meet with the State Controller to determine whether an emergency procurement could proceed. PED met with the State Controller *the same day* and informed your staff that PED could proceed accordingly. PED also informed your staff that the accountant *who your staff agreed upon* was unavailable to discuss her engagement until October 23, 2014. PED raised this issue and asked if this was unacceptable to your office. Your staff indicated that this was not a problem. PED's General Counsel met with the selected accountant last week and has been working closely with her to refine the scope of work *which your office has had since October 7, 2014*. Both PED and the forensic accountant have spent considerable time and effort coordinating the considerable work required to conduct forensic accounting of the schools' finances. PED must also determine the cost of the work required, and how the department or schools will pay for the work.

I find it extremely troubling that you chose to copy Amy Carter, Audit Manager at Moss Adams. Ms. Carter was the financial auditor responsible for conducting the audits of the Southwest Learning Center Schools last fiscal year. In fact, she has been responsible for auditing the schools for some time, and even audited the schools when they were still chartered by the Albuquerque Public Schools. There is no reason for you to copy Moss Adams in your communications regarding the Southwest Learning Center Schools and undoubtedly the evidence uncovered by a forensic accounting must be examined to determine whether Moss Adams knew or should have known about the allegations recently uncovered by the FBI.

Also, to be clear, PED has been working closely with the Southwest Learning Center Schools through their counsel, Mark Baker. PED and the schools have worked diligently to uncover instances of fraud, waste and abuse, which

were in turn reported to the FBI *and your office*. It is unclear what work, if any, your office has done since PED took over the Boards of Finance of the schools to uncover fraud, waste and abuse. Rather, it seems like you have repackaged what the schools reported to you and paint the picture of delay and emergency despite the fact that your office has specifically agreed with the approach and timeline outlined.

PED's concern is ensuring that the students at these schools are not adversely affected by the swirling allegations and controversy regarding the schools while ensuring that public money is protected. PED will proceed with its work to engage the forensic accountant your office has already agreed upon. We will continue to work with her to develop an appropriate scope of work as your office has previously directed. PED hopes that we all can work together to ensure that our state's students receive the best education possible and that the adults in charge of our schools are held accountable.

Regards,

Hipolito Aguilar
Deputy Secretary, Finance and Operations

Cc: Carolyn Shearman, Chair, Public Education Commission
David Abbey, Director, Legislative Finance Committee
Frances Maestas, Director, Legislative Education Study Committee
Amy Carter, Audit Manager, Moss Adams
Dan Hill, General Counsel, Public Education Department

State of New Mexico
OFFICE OF THE STATE AUDITOR

Hector H. Balderas
State Auditor

Carla C. Martinez
Deputy State Auditor

October 29, 2014

Via U.S. Mail

Secretary-Designate Hanna Skandera
Public Education Department
300 Don Gaspar Avenue
Santa Fe, NM 87501

Re: Updated Risk Review Regarding SSLC and SAMS – Notice of Noncompliance with 22-8-39 (B) NMSA 1978 – Additional Measures Required to Address Risks of Fraud, Waste and Abuse

Dear Secretary-Designate Skandera:

On August 5, 2014, the Office of the State Auditor (OSA) issued a comprehensive risk review related to the financial affairs of Southwest Secondary Learning Center (SSLC), and Southwest Aeronautics, Mathematics and Science Academy (SAMS), which are state-chartered charter schools under the oversight of the New Mexico Public Education Commission (PEC) and the Public Education Department (PED). Overall, our review identified numerous risks, internal control deficiencies and potential violations of law related to certain financial affairs of the charter schools. This letter serves an update to my office's August 5, 2014 risk review, advises you of additional risks we have identified related to the schools' financial affairs, and informs you of certain expectations I have that directly pertain to measures PED must immediately take to address the risks of waste, fraud and abuse.

As you are well aware, during the course of the OSA's extensive review which took place over many months, my auditors and investigators identified and assessed certain risks that we determined were appropriate to refer to the Federal Bureau of Investigation (FBI), which raided the SSLC on July 31, 2014. Following the OSA's risk review, Dr. Glasrud submitted his resignation as the schools' Head Administrator on August 14, 2014, and on August 22, 2014, the FBI also raided the private residence of Dr. Glasrud. On August 28, 2014, the OSA was copied on a letter sent by PED to the charter schools' Governing Council, informing its members that pursuant to its oversight authority, PED would immediately take over as the acting board of finance for the schools. Pursuant to Section 22-8-39(B) NMSA 1978, when PED suspends a

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charter school from acting as board of finance, the Department "shall immediately have an audit made of all funds under the control of the local school board or governing body of a state-chartered charter school acting as a board of finance." In sum, 60 days have now elapsed since PED's suspension of the schools boards of finance, 90 days have passed since you received the OSA's risk review, and even more time has expired since PED learned of the FBI's criminal investigation. To date, PED has not executed, nor has my office reviewed, a contract for a forensic audit that would address significant risks of fraud, waste and abuse at the schools.

Further delays in conducting forensic audit work adversely impacts the schools, its students, and the confidence of oversight agencies and the public in the schools' financial operations. My office has moved expeditiously to support comprehensive audits of the schools' operations in light of the identified risks and the State Auditor's duty to thoroughly audit and examine the financial affairs and transactions of all government agencies that receive or expend public monies. On August 29, 2014, the OSA sent a letter to the schools' fiscal year 2014 independent auditor in which we requested certain information regarding the statuses of the schools' fiscal year 2014 financial audits. We informed the audit firm to include the items of concern noted in the OSA's August 5, 2014 risk review in the firm's planning and performance of the annual financial audit of the schools. On September 3, 2014, PED staff and OSA staff held a conference call regarding PED's plans to conduct a forensic audit of the schools. During the call, PED's Deputy Secretary of Finance and Operations, Hipolito "Paul" Aguilar, informed the OSA's Chief of Staff, Evan Blackstone, that PED intended to publish an RFP for the forensic audit within two weeks and that PED would send the OSA a draft audit scope to review. Additionally, the OSA received PED's September 3, 2014 letter, once again advising of its takeover, and detailing its plan to conduct both an ethics investigation and a "thorough forensic audit of financial transactions." The OSA responded with a follow-up letter which acknowledged PED's decision to take control of the schools' finances, and advised PED on how to move forward in order to properly and timely procure audit services to review "all funds under the control of [the schools'] governing body", as provided in Section 22-8-39 NMSA 1978.

After weeks of failing to receive a proposed scope for the forensic audit from PED, my staff immediately called for meeting between representatives of OSA, Moss Adams, LLP, the schools, and PED, for October 8, 2014 in order to discuss in further detail the upcoming forensic audit work, and ensure that adequate progress was being made toward the procurement and engagement of such services. At the conclusion of the meeting, it was our understanding that PED would pursue an emergency procurement for the purpose of quickly hiring an expert forensic auditor. Since that time, PED staff made representations to our office that a proposed scope and contract for the forensic audit would be forthcoming. Most recently, my staff was given assurances that we would receive the scope by last Friday, October 24, 2014. However, we are still awaiting that scope and we have not received any response to our inquiries made to PED staff for an update.

Given these developments, please be advised of the measures PED must immediately take to fulfill its responsibilities as an oversight agency and the current board of finance of the

charter schools with regard to audit requirements. The timely completion of a forensic audit of the schools' funds is critical to eliminate the risk of financial mismanagement and preserve the educational opportunities provided to the student bodies.

1) The Forensic Audit Must Address Risks Identified in the OSA's August 5, 2014 Risk Review and the Ongoing Criminal Investigation

The forensic audit should necessarily include robust risk assessments and aggressive test work that accounts for the violations of law identified by the risk review as well as the ongoing federal criminal investigation. First, the scope of the forensic audit must be adequately tailored to include test work related to SSLC's and SAMS's procurement of aircraft and services for the schools' aviation program. Fundamental to the problems identified in the August 5, 2014 risk review was the direct conflict of interest between Dr. Glasrud's personal financial interest in Diamond Aviation and his broad and influential authority as Head Administrator for SSLC and SAMS. As co-owner of Diamond Aviation, Dr. Glasrud was being paid significant sums of public funds under contracts between Diamond Aviation and the charter schools. Yet, as Head Administrator for those schools, Dr. Glasrud maintained actual control over the schools' employees and operations, including the procurement processes. We found serious deficiencies in these procurement processes related to the schools' repeated hiring of Diamond Aviation over multiple fiscal years. In many cases, the schools failed to follow a transparent, competitive bidding process when hiring Diamond Aviation and it remains unclear what role Dr. Glasrud may have directly or indirectly played in various aspects of SSLC's and SAMS's procurement of his company. In various instances, the procurement process appeared to have been manipulated to give Diamond Aviation an unfair advantage over other potential bidders. Dr. Glasrud participated directly in contract negotiations and we reviewed certain instances in which there was no evidence of proper disclosures of Dr. Glasrud's conflict of interest and the Governing Councils of SSLC and SAMS "waived" Dr. Glasrud's participation in the procurement process only after the school awarded contracts to Diamond Aviation. We were also unable to determine whether the aircraft were used solely for the purposes stated in the aircraft leases, and we are concerned that the aircrafts may have been misappropriated for personal use. The forensic audit must deal directly with these troubling questions.

The OSA also identified certain risks related to the lease of building space to SSLC and SAMS by Dr. Glasrud's private business. Based on our review, it was unclear if the lease is a necessity and whether the approval of expenditures is in the best interest of the taxpayers. The risk review also described certain risks we identified related to the charter schools' governance and employee salaries and contracts. We found that the SSLC Governing Council did not appear to properly notice and openly vote on the execution of numerous employment contracts for the Head Administrator, which violates New Mexico administrative rules. We found particularly high base salaries, generous accruals of annual leave days, and several issues and inconsistencies in what is documented in the employee contracts versus what was explained to the OSA during our risk review site visit. Additionally, during the course of the OSA's review, auditors and

investigators identified and assessed certain risks that we determined were appropriate to refer to the Federal Bureau of Investigation (FBI), which raided the SSLC on July 31, 2014.

In the risk review, I strongly recommend that state oversight agencies take steps to ensure that the governing authorities and management of the charter schools remain accountable and implement and adhere to robust policies and procedures that protect New Mexico's significant financial investment in education. Specifically, I recommended that the PED and the Public Education Commission (PEC) should take appropriate oversight actions within their statutory and regulatory authorities to ensure the risks outlined in risk review are addressed in the best interest of taxpayers. It is critical that the financial affairs and transactions of our schools be wholly transparent to the public and oversight agencies. New Mexicans should be confident that its school districts and charter schools, and their governing bodies and management, strictly adhere to state laws that protect the integrity of the procurement process, require proper and timely disclosures of conflicts of interest, and prohibit unlawful profiteering by public officials and employees.

2) The Forensic Audit Must Address Additional Risks Identified by the OSA Related to Fraud, Waste and Abuse

Since the issuance of my initial risk review, additional areas of risk have been identified which further illuminate the need for an immediate forensic audit. I am markedly concerned about the potential misuse of revenue generated by the questionable lease of a building by the schools, and about the distinct possibility of the existence of fictitious vendors with which the schools contracted and paid for goods and services. Further, based on information gathered, there is a high level of risk associated with the possibility that certain school employees and officials were unlawfully profiting from transactions brokered through the schools.

In light of these risks, it is important to outline the following specific objectives that should be included in the scope of the upcoming audit test work:

- Determine whether payments were made to any employee(s) of any of the charter schools for services that were never provided;
- Determine what payments were made by each of the charter schools, and verify whether goods and services invoiced for were actually provided;
- Verify whether or not Dr. Glasrud or any other school employee or official unlawfully profited as a result of any transactions related to contractor services or transactions related to their position as an employee;
- Review procurement compliance and compliance with state and federal tax law for all employees and contractors;
- Review oversight practices and procedures at the Public Education Department over the charter schools, including but not limited to the budget approval process and the approval and distribution of capital outlay funds;

- Review all school credit card expenditures to determine whether any were made for personal or non-school related purposes;
- Verify whether or not any official school records related to contractors or employees were fraudulently created and/or manipulated;
- Identify and conduct necessary test work to determine whether or not any manipulation or exploitation of the schools' accounting system occurred, and evaluate any associated risks;
- Identify and review any ancillary school programs to determine whether or not Dr. Glasrud or any other school employee or official unlawfully profited as a result of their existence or function.

3) PED Must Meet Contract Submission Deadline for the Forensic Audit

Based on the unfolding events detailed in this letter, it is imperative that PED submit a contract for a forensic audit to OSA for review and approval no later than November 5, 2014. If by that date PED fails to submit a contract for approval, the OSA will be forced to designate for a special audit engagement pursuant to the Audit Rule, Section 2.2.2.15 (B) NMAC, which provides that "The State Auditor may designate an agency for special audit, performance audit, or attestation engagement regarding an agency's financial affairs and transactions, to be conducted by an IPA approved by the State Auditor."

The completion of this audit test work in a timely and thorough manner is of paramount importance; any further delay in its completion will be harmful to the schools' recovery. It is vital that public confidence in the schools is restored and that they are able to operate independently and efficiently, as soon as possible. I appreciate your attention to these important matters and I look forward to receiving the intended scope for the impending forensic audit for our review and approval.

Respectfully,

Hector H. Balderas, Esq., CFE
New Mexico State Auditor

cc: Carolyn Shearman, Chair, Public Education Commission
David Abbey, Director, Legislative Finance Committee
Frances Maestas, Director, Legislative Education Study Committee
Paul Aguilar, Deputy Secretary of Finance and Operations, PED
Amy Carter, Audit Manager, Moss Adams