



State of New Mexico
OFFICE OF THE STATE AUDITOR

Hector H. Balderas
State Auditor

Carla C. Martinez
Deputy State Auditor

December 22, 2014

Via Email and U.S. Mail

Hipolito Aguilar, Deputy Secretary of Finance and Operations
New Mexico Public Education Department
300 Don Gaspar
Santa Fe, NM 87501

RECEIVED

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LESC

Dear Deputy Secretary Aguilar:

On December 10th, 2014, our office received your letter of December 8th, 2014 in which you enclosed the contract between the Public Education Department (PED) and Wagner Valuation and Financial Forensics, LLC (WVFF) in connection with your Department's fiscal agent obligation to "immediately have an audit made" of the Southwest Learning Center charter schools pursuant to Section 22-8-29(B) NMSA 1978. After carefully reviewing your letter and the contract with WVFF, it is imperative to make a few points very clear to you.

In violation of state regulation and contrary to your prior assurances, PED executed the forensic engagement contract with WVFF without the State Auditor's review and approval as required by the Audit Rule, specifically 2.2.2.15(E)(2) NMAC. In the past, your Department ignored red flags, audit findings, and was unwilling to crack down on Dr. Scott Glasrud's unlawful profiteering that has harmed the charter schools and their students. Now, in the face of revelations that Dr. Glasrud potentially embezzled millions in public education dollars, PED's recent actions exhibit a continuous pattern of evasiveness designed to mislead stakeholders and circumvent scrutiny for its own oversight failures. Unfortunately, your December 8th letter perpetuates this conduct by twisting facts and dishonestly justifying your efforts to sideline the State Auditor's independent review of the forensic investigation's scope devised under the direction of PED.

As evidenced in the voluminous correspondence between our offices on this matter, State Auditor Balderas sent unambiguous directives to Secretary-Designate Hanna Skandera on October 29th, December 2nd, and December 4th, 2014 to submit the contract to our office for review and approval pursuant to state regulation. It is now apparent that PED scrambled to execute the forensic engagement contract *after* receiving the last of these numerous notifications informing you that the State Auditor must approve the contract before work commences. Secretary-Designate Skandera signed the contract on December 4th, and PED's General Counsel Dan Hill fully executed the contract by his signature on December 5th, 2014. What's more troubling, PED's spokesman had publicly stated just two days earlier that the contract was

"finalized" and "was in place as of last week" – a representation that we now know was patently false.

Adding to PED's rebuke, you now attempt to explain away your Department's unlawful actions by disingenuously positing that PED decided to forgo the State Auditor's review and approval because neither I nor the State Auditor's staff ever "provided any feedback" to you on a proposed scope of work. Moreover, you mistakenly assert that our office granted PED an exemption from the Audit Rule's requirements. Without recounting the extensive discussion which occurred during the October 8th, 2014 meeting, which you declined to attend, our offices agreed that the forensic audit's scope of work should not be developed solely by a PED attorney and issued via a request for proposals. Although an Assistant General Counsel at PED had emailed a draft scope of work to me the day before our meeting, we decided that the best course of action was for PED to seek Ms. Judith Wagner's expertise in developing a proposed scope of work, which PED would then provide to our office for review. Further, neither I nor anyone else from our office gave PED authorization to eschew Audit Rule procedures. In short, the State Auditor's review and approval of contracts under the Audit Act (Section 12-6-1 NMSA 1978 et seq.) and the Audit Rule is required, regardless of the particular procurement methods an agency may choose to pursue.

The fact that your Department refused to provide our office the proposed scope of work you developed with Ms. Wagner after October 8th, 2014 is well documented, but the reasons why you deliberately shut the State Auditor out of the required process are left to speculation. The good faith aim of our regulatory efforts has always been to remedy your Department's delay in "immediately" auditing the charter schools as required by Section 22-8-29(B) NMSA 1978, and ensure that you strictly follow Audit Rule procedures which provide for an independent review of the forensic engagement's scope of work. Your opinion that these requirements are "needless bureaucratic machinations" and "non-existent, bureaucratic nits" sends the wrong message to the schools, students and parents who have themselves been victimized by unlawful acts.

It remains this office's position that PED violated the Audit Rule's requirements in executing a contract for a forensic engagement with WVFF without the prior review and approval of the State Auditor. In our view, your Department's noncompliance as fiscal agent for the charter schools continues to delay the proper completion and submission of an immediate financial accounting of the charter schools pursuant to Section 22-8-29(B) NMSA 1978. Therefore, PED will remain designated "at-risk" by the Office of the State Auditor until your Department takes adequate corrective action to remedy this violation.

Moving forward, PED must demonstrate a sincere willingness to respect the rule of law and be accountable for its actions. The credibility and integrity of your Department in responding to this crisis hangs in the balance. As a first step, PED should allow the State Auditor to lawfully review and approve WVFF's forensic engagement scope of work and contract. I hope that you will work with the incoming State Auditor to achieve compliance and ensure the forensic engagement, which currently lies under the direction of PED's General Counsel, is independently assessed in this regard. Finally, as part of our administration's transition briefings with State Auditor-Elect Tim Keller, we will timely notify him and his incoming General Counsel of PED's December 9, 2014 request for records related to the forensic engagement.

Respectfully,

Evan C. Blackstone for

Evan C. Blackstone
Chief of Staff

cc: Susana Martinez, Governor of New Mexico
Hanna Skandera, Secretary-Designate, PED
Carolyn Shearman, Chair, Public Education Commission
David Abbey, Director, Legislative Finance Committee
Frances Maestas, Director, Legislative Education Study Committee
Dan Hill, General Counsel, PED



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PUBLIC EDUCATION DEPARTMENT
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SANTA FE, NEW MEXICO 87501-2786
Telephone (505) 827-5800
www.ped.state.nm.us

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DEC 10 2014

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HANNA SKANDERA
SECRETARY OF EDUCATION

SUSANA MARTINEZ
GOVERNOR

December 8, 2014

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

Dear State Auditor Balderas:

I am writing in response to your December 2, 2014 letter placing the Public Education Department (PED) on "at-risk status" "as further incentive for PED to submit the forensic scope and audit contract" and your December 4, 2014 letter requesting the forensic audit scope of work and contract. I summarily reject the accusations you make in both letters about PED's actions regarding the circumstances surrounding the Southwest charter schools situation.

PED has acted with the appropriate professionalism and urgency that this situation deserves and in compliance of all state law and regulations. Here are the facts:

- PED has already engaged a forensic accounting firm that is widely regarded as being at the top of the industry, both in New Mexico and nationally. I have enclosed the State Comptroller's approval of the emergency procurement of forensic accounting work related to the Southwest Learning Center schools. I have also enclosed a copy of the contract with Wagner Valuation & Financial Forensics, LLC (WVFF). The emergency procurement was approved November 19, 2014 by the State Comptroller, which authorized work to commence on that date, allowing PED staff to meet with Ms. Judith Wagner, the principal of WVFF, to finalize the contract and begin to provide WVFF with the records necessary for the forensic accounting work.
- Your Chief of Staff, Evan Blackstone, was provided a scope of work for this contract with a request for feedback on October 7, 2014. See enclosed email. As noted in your December 2nd letter, PED met with your office, Moss Adams, and representatives of the SLC schools on

October 8, 2014. Your office called that meeting primarily to discuss the FY 14 financial audit of the SLC schools, and issues surrounding the SLC schools' ability to sign management representation letters. Mr. Blackstone acknowledged, at the meeting, receiving the proposed scope of work from PED.

- At the same in-person meeting on October 8, 2014, after Moss Adams left the meeting, PED and the SLC schools raised the issue of forensic accounting work. PED proposed in this meeting that 1) rather than following the procedures set forth in the Audit Rule that you cite in your December 4th letter, this situation warranted an emergency procurement, and 2) Ms. Wagner be engaged due to her experience and reputation. All parties, including your office, agreed that both proposals were the best course of action. It was PED's understanding that your office had spoken with Ms. Wagner before the meeting to discuss the possibility of her engagement to work on this matter. It is not surprising that you agreed with PED's proposal to engage WVFF as WVFF is a highly regarded forensic accounting firm. Ms. Wagner was appointed as the trustee in the Doug Vaughan Ponzi scheme bankruptcy matter, and was instrumental in uncovering the fraud, waste and abuse associated with the Bernalillo County Metropolitan Courthouse construction, which lead to eight individuals pleading guilty to a \$4.3 million scheme to steal money from the construction of the Metropolitan Courthouse.

- Neither Mr. Blackstone nor anyone else from your office has provided any feedback or comment to PED's proposed scope of work with WVFF. Rather than waiting for a response from your office, PED worked with WVFF to refine the scope of work to outline the work necessary to uncover and document inappropriate or fraudulent activity in the schools' financial records. Ms. Wagner's experience and reputation puts her in high demand, and PED informed your office during the October 8th meeting and confirmed the same in the following days that she was engaged in other matters and could not immediately begin work in this matter. Your office voiced no concerns to engaging WVFF once her schedule allowed. PED negotiated the terms of the contract, both to determine the cost of the forensic accounting work and to ensure that the work would meet the agency's objectives and timelines relevant to the ongoing federal criminal investigation in the matter. PED used all appropriate and necessary diligence in ensuring that the engagement would meet the necessary objectives and would be an efficient use of public funds. Given the magnitude of this undertaking, it was crucial that this was done correctly up front to determine the best plan of action, to avoid issues or duplication of work down the line.

- Moss Adams notified PED on November 25, 2014, that they were terminating our contract based on the impairment of their independence in carrying out their contractual obligations to PED. Moss Adams copied you on that letter. You point out in your letters that it is the responsibility of the party terminating the contract to notify your office of the termination. As such, this responsibility rests with Moss Adams, and they have provided you with notice.

Your letters make a number of other accusations, casting aspersions at PED and its leadership. I will not address those claims in this letter. There is a pending federal criminal investigation into

the allegations of improper and illegal actions of SLC employees. Until the relevant investigations are concluded and any action is taken by the U.S. Attorney's Office, it would be inappropriate to discuss the allegations.

PED has acted professionally and thoughtfully throughout this process. Moreover, adding to the existing frenzy of media speculation regarding what occurred at the schools and what the FBI is investigating will only distract from the important work of determining the extent of any wrongdoing while protecting public funds and ensuring that the schools' students are not adversely affected by this situation. PED will work to prevent a situation like this from happening again, and PED is working with all due diligence, speed, and the necessary partners to determine why existing controls, both at the department, state, and local levels, did not uncover the alleged actions.

While your office has been quick to take credit for uncovering this situation, the fact remains that you had access to the same information as PED and the general public throughout. Only after a tip did the "revelations of potential criminal activity" come to light and did your office take action to refer that tip to law enforcement, nearly identical to the way your office responded to the situation in Jemez Mountain Valley school district where \$3.4 million was embezzled from the district for over a decade. In that case, this fraudulent activity came to light only after a tip was brought to law enforcement after the District's superintendent discovered that the District's business manager was embezzling public funds. In short, your office has taken action only after tips such as these surfaced. While it is vital that we protect the interests of the schools' students and assist any appropriate action to rectify past deeds, the State Auditor's office must move beyond a strategy for uncovering fraud, waste, and abuse that relies on tips to come in to uncover wrongdoing.

PED has begun work with WVFF and will make whatever records requested by the firm available. The SLC schools have fully cooperated in this process and have similarly agreed to make records available to WVFF. PED staff and staff and counsel for the SLC schools have spent considerable time and effort gathering documents and information in this matter, and such information has been provided to your office and federal law enforcement. PED will also make Ms. Wagner available to the FBI and U.S. Attorney's Office to the extent her work is relevant or of any use to the ongoing federal criminal investigation or any resulting litigation.

Under separate cover PED is requesting that your office make its records available to Ms. Wagner, as those records will be important to her forensic accounting work. Previously your office has represented that it will make such records available, and I trust that you are genuine in your "intention to work with [PED] to achieve the best outcome for the schools and its students" and will comply fully with our requests for OSA records.

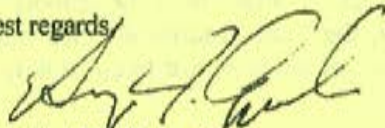
PED is actively engaged with WVFF and others to determine the extent of any wrongdoing, and to take any appropriate action to prevent such occurrences in the future. I hope that your office,

in its current and future leadership, will go beyond taking credit or applauding the after-the-fact clean-up of these situations, and will go to the heart of the matter—preventing fraud before it occurs and uncovering fraud at its inception rather than waiting for a Good Samaritan to bring the facts to your doorstep.

Your office has had a proposed scope of work for the forensic auditor for nearly three months and has not responded. Additionally, your office agreed with the approach proposed by PED in early October to use the emergency procurement process and engage with WVFF, but now you draw on needless bureaucratic machinations in an attempt to shoehorn this ongoing investigation into an indictment of PED, distancing yourself from your office's audits of PED and the schools.

PED's focus remains on the interests of the schools' students and assisting the continued criminal investigation into the matter. PED will continue to work with WVFF, the SLC schools, federal law enforcement, and others to gather and analyze the evidence, and I expect that once all the evidence has been gathered, any wrongdoers will be held accountable for any misuse of public funds. My hope is that your office will join us, rather than spending its time drafting letters picking at non-existent, bureaucratic nits. As the conditions you identified for placing PED on "at-risk status" are non-existent or have been satisfied, please reverse your decision and remove PED from the listing of at-risk agencies.

Best regards



Hipolito "Paul" Aguilar
Deputy Secretary, Finance and Operations

Enclosures: Email-PED Forensic Audit SOW
Emergency procurement for forensic accounting
Wagner evaluation and financial forensics contract

cc: Hanna Skandera, Secretary of Education
Dan Hill, General Counsel
Carolyn Shearman, Chair, Public Education Commission
David Abbey, Director, Legislative Finance Committee
Frances Maestas, Director, Legislative Education Study Committee

Lusk, Jennie, PED

From: Lusk, Jennie, PED
Sent: Tuesday, October 07, 2014 10:13 AM
To: 'Evan.Blackstone@osa.state.nm.us'
Subject: PED Forensic Audit SOW
Attachments: PED Forensic Audit SOW.docx

Hey, Evan. I'm working on the PED forensic audit RfP. Our scope was just sent to P. Kippert to make sure it's PSC only from his point of view. I'm sending the scope to you here, along with the technical requirements that will follow in the RfP, for your approval.

Please let me know what, if anything, needs revisions from your point of view.

I've spoken with Patrick Stewart from your staff and understand that I will need to use a special audit contract for the RfP sample contract. He is sending me a good template, but if you have something new/different to suggest, please let me know.

All best!

J

Jennie Lusk

Assistant General Counsel

Public Education Department

300 Don Gaspar

Santa Fe, NM 87501

(505) 827-6641

Jennie.lusk@state.nm.us



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HANNA SKANDERA
SECRETARY OF EDUCATION

SUSANA MARTINEZ
GOVERNOR

November 19, 2014

Ricky A. Bejarano, CPA
Director/State Controller
State of New Mexico
Department of Finance and Administration
Financial Control Division
407 Galisteo Street
Bataan Memorial Building, Room 166
Santa Fe, NM 87501

Re: Emergency Procurement for Forensic Accounting

Dear Mr. Bejarano,

Pursuant to NMSA 1978, §13-1-127, the Public Education Department has determined that an emergency condition exists which cannot be met through the normal procurement method.

Preservation or Protection of Property

On August 28, 2014 the Department assumed responsibility as board of finance for four state charter schools in Albuquerque: Southwest Intermediate, Southwest Primary, Southwest Secondary, and Southwest Aeronautics, Mathematics & Science Academy.

The Schools have fallen victim to fraudulent activities by their former Head Administrator. The activity in question dates back several years that cannot be determined by the Department the severity or the exact time frame the fraud has transpired. Prior to the Department accepting board of finance responsibility and subsequent to that, the records at the schools have been in disarray. The procurement code is not and has not been complied with, the general ledger is not being maintained on a daily basis, there are suspicious general ledger activities, suspicious individuals who have general ledger access, bank reconciliations are not being performed, and liabilities have not been accrued for at year end. The Department is questioning the schools solvency and whether the schools are able to provide a functioning educational facility for the students currently attending them.

The schools are currently under the investigation of the FBI. The Department and the schools have been asked to provide documentation, however due to the general ledger not being maintained adequately, the information could not be accurate and complete. The Department and the schools would like to be able to comply with all requests by all parties.

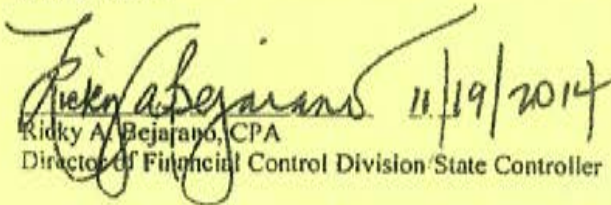
In order to preserve and protect the finances of the schools, determine the schools solvency, and maintain operational educational centers for the students, the Department is requesting approval by the Department of Finance and Administration to enter into a professional service agreement with a certified forensic auditor under an emergency procurement.

Best regards,



Hipolito "Papa" Aguilar
Deputy Secretary, Finance & Operations
New Mexico Public Education Department

APPROVED:



11/19/2014

Ricky A. Bejarano, CPA
Director of Financial Control Division/State Controller

STATE OF NEW MEXICO

**PUBLIC EDUCATION DEPARTMENT
PROFESSIONAL SERVICES CONTRACT #15-924-P527-00300**

THIS AGREEMENT is made and entered into by and between the State of New Mexico, **PUBLIC EDUCATION DEPARTMENT (PED)**, hereinafter referred to as the "Agency," and **WAGNER VALUATION AND FINANCIAL FORENSICS, LLC**, hereinafter referred to as the "Contractor," and is effective as of the date set forth below upon which it is executed by the parties.

IT IS AGREED BETWEEN THE PARTIES:

1. Scope of Work.

WAGNER VALUATION AND FINANCIAL FORENSICS, LLC is engaged to perform a forensic accounting investigation as directed by the General Counsel New Mexico Public Education Department. This contract is not a contract to perform audit or attest services. WAGNER VALUATION AND FINANCIAL FORENSICS, LLC is not engaged to perform an audit as defined by 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 or an audit under the New Mexico Audit Act. Accordingly WAGNER VALUATION AND FINANCIAL FORENSICS, LLC will not express an opinion on the financial statements of PED or any of its component units (including charter schools). Further, WAGNER VALUATION AND FINANCIAL FORENSICS, LLC is not engaged to perform any compliance or performance audit of PED or any of its component units under OMB A-133 or any other framework. WAGNER VALUATION AND FINANCIAL FORENSICS, LLC is being engaged as a non-testifying consultant in anticipation of potential litigation and/or criminal proceedings related to the financial operations of the four Southwest Learning Center schools (School or Schools) and the actions of current and former School personnel.

The Contractor shall perform the work outlined in Exhibit A.

2. Compensation.

A. The Agency shall pay to the Contractor in full payment for services satisfactorily performed at the rate of \$290.00 dollars per hour for Judith Wagner, \$125.00 per hour for Certified Fraud Examiners (CFE's), \$75.00 per hour for approved paraprofessionals, and incidental expenses approved by the Agency, such compensation not to exceed \$280,000.00, excluding gross receipts tax. The New Mexico gross receipts tax levied on the amounts payable under this Agreement totaling \$19,600.00 shall be paid by the Agency to the Contractor. **The total amount payable to the Contractor under this Agreement, including gross receipts tax and expenses, shall not exceed (\$299,600.00).** This amount is a maximum and not a guarantee that the work assigned to be performed by Contractor under this Agreement shall equal the amount stated herein. The parties do not intend for the Contractor to continue to provide services without compensation when the total compensation amount is reached. Contractor is responsible for notifying the Agency when the services provided

under this Agreement reach the total compensation amount. In no event will the Contractor be paid for services provided in excess of the total compensation amount without this Agreement being amended in writing prior to those services in excess of the total compensation amount being provided.

B. Payment is subject to availability of funds pursuant to the Appropriations Paragraph set forth below and to any negotiations between the parties from year to year pursuant to Paragraph 1, Scope of Work. All invoices MUST BE received by the Agency no later than fifteen (15) days after the termination of the Fiscal Year in which the services were delivered. Invoices received after such date WILL NOT BE PAID.

C. Contractor must submit a detailed statement accounting for all services performed and expenses incurred. If the Agency finds that the services are not acceptable, within thirty days after the date of receipt of written notice from the Contractor that payment is requested, it shall provide the Contractor a letter of exception explaining the defect or objection to the services, and outlining steps the Contractor may take to provide remedial action. Upon certification by the Agency that the services have been received and accepted, payment shall be tendered to the Contractor within thirty days after the date of acceptance. If payment is made by mail, the payment shall be deemed tendered on the date it is postmarked. However, the agency shall not incur late charges, interest, or penalties for failure to make payment within the time specified herein.

3. Term.

This Agreement shall terminate on **June 30, 2015**, unless terminated pursuant to paragraph 4 (Termination), or paragraph 5 (Appropriations). In accordance with NMSA 1978, § 13-1-150, no contract term for a professional services contract, including extensions and renewals, shall exceed four years, except as set forth in NMSA 1978, § 13-1-150.

4. Termination.

A. Grounds. The Agency may terminate this Agreement for convenience or cause. The Contractor may only terminate this Agreement based upon the Agency's uncured, material breach of this Agreement.

B. Notice: Agency Opportunity to Cure.

1. Except as otherwise provided in Paragraph (4)(B)(3), the Agency shall give Contractor written notice of termination at least thirty (30) days prior to the intended date of termination.

2. Contractor shall give Agency written notice of termination at least thirty (30) days prior to the intended date of termination, which notice shall (i) identify all the Agency's material breaches of this Agreement upon which the termination is based and (ii) state what the Agency must do to cure such material breaches. Contractor's notice of termination shall only be effective (i) if the Agency does not cure all material breaches within the thirty (30) day notice period or (ii) in the case of material breaches that cannot be cured within thirty (30) days, the Agency does not, within the thirty (30) day notice period, notify the Contractor of its intent to cure and begin with due diligence to cure the material breach.

3. Notwithstanding the foregoing, this Agreement may be terminated

immediately upon written notice to the Contractor (i) if the Contractor becomes unable to perform the services contracted for, as determined by the Agency; (ii) if, during the term of this Agreement, the Contractor is suspended or debarred by the State Purchasing Agent; or (iii) the Agreement is terminated pursuant to Paragraph 5, "Appropriations", of this Agreement.

C. Liability. Except as otherwise expressly allowed or provided under this Agreement, the Agency's sole liability upon termination shall be to pay for acceptable work performed prior to the Contractor's receipt or issuance of a notice of termination; provided, however, that a notice of termination shall not nullify or otherwise affect either party's liability for pre-termination defaults under or breaches of this Agreement. The Contractor shall submit an invoice for such work within thirty (30) days of receiving or sending the notice of termination. THIS PROVISION IS NOT EXCLUSIVE AND DOES NOT WAIVE THE AGENCY'S OTHER LEGAL RIGHTS AND REMEDIES CAUSED BY THE CONTRACTOR'S DEFAULT/BREACH OF THIS AGREEMENT.

D. Termination Management. Immediately upon receipt by either the Agency or the Contractor of notice of termination of this Agreement, the Contractor shall: 1) not incur any further obligations for salaries, services or any other expenditure of funds under this Agreement without written approval of the Agency; 2) comply with all directives issued by the Agency in the notice of termination as to the performance of work under this Agreement; and 3) take such action as the Agency shall direct for the protection, preservation, retention or transfer of all property titled to the Agency and records generated under this Agreement. Any non-expendable personal property or equipment provided to or purchased by the Contractor with contract funds shall become property of the Agency upon termination and shall be submitted to the agency as soon as practicable.

5. Appropriations.

The terms of this Agreement are contingent upon sufficient appropriations and authorization being made by the Legislature of New Mexico for the performance of this Agreement. If sufficient appropriations and authorization are not made by the Legislature, this Agreement shall terminate immediately upon written notice being given by the Agency to the Contractor. The Agency's decision as to whether sufficient appropriations are available shall be accepted by the Contractor and shall be final. If the Agency proposes an amendment to the Agreement to unilaterally reduce funding, the Contractor shall have the option to terminate the Agreement or to agree to the reduced funding, within thirty (30) days of receipt of the proposed amendment.

6. Status of Contractor.

The Contractor and its agents and employees are independent contractors performing professional services for the Agency and are not employees of the State of New Mexico. The Contractor and its agents and employees shall not accrue leave, retirement, insurance, bonding, use of state vehicles, or any other benefits afforded to employees of the State of New Mexico as a result of this Agreement. The Contractor acknowledges that all sums received hereunder are reportable by the Contractor for tax purposes, including without limitation, self-employment and business income tax. The Contractor agrees not to purport to bind the State of New Mexico unless the Contractor has express written authority to do so, and then only within the strict limits of that authority.

7. **Assignment.**

The Contractor shall not assign or transfer any interest in this Agreement or assign any claims for money due or to become due under this Agreement without the prior written approval of the Agency.

8. **Subcontracting.**

The Contractor shall not subcontract any portion of the services to be performed under this Agreement without the prior written approval of the Agency. No such subcontract shall relieve the primary Contractor from its obligations and liabilities under this Agreement, nor shall any subcontract obligate direct payment from the Procuring Agency.

9. **Release.**

Final payment of the amounts due under this Agreement shall operate as a release of the Agency, its officers and employees, and the State of New Mexico from all liabilities, claims and obligations whatsoever arising from or under this Agreement.

10. **Confidentiality.**

Any confidential information provided to or developed by the Contractor in the performance of this Agreement shall be kept confidential and shall not be made available to any individual or organization by the Contractor without the prior written approval of the Agency.

11. **Product of Service -- Copyright.**

All materials developed or acquired by the Contractor under this Agreement shall become the property of the State of New Mexico and shall be delivered to the Agency no later than the termination date of this Agreement. Nothing developed or produced, in whole or in part, by the Contractor under this Agreement shall be the subject of an application for copyright or other claim of ownership by or on behalf of the Contractor.

12. **Conflict of Interest; Governmental Conduct Act.**

A. The Contractor represents and warrants that it presently has no interest and, during the term of this Agreement, shall not acquire any interest, direct or indirect, which would conflict in any manner or degree with the performance or services required under the Agreement.

B. The Contractor further represents and warrants that it has complied with, and, during the term of this Agreement, will continue to comply with, and that this Agreement complies with all applicable provisions of the Governmental Conduct Act, Chapter 10, Article 16 NMSA 1978. Without in anyway limiting the generality of the foregoing, the Contractor specifically represents and warrants that:

1) in accordance with NMSA 1978, § 10-16-4.3, the Contractor does not employ, has not employed, and will not employ during the term of this Agreement any Agency employee while such employee was or is employed by the Agency and participating directly or indirectly in the Agency's contracting process;

2) this Agreement complies with NMSA 1978, § 10-16-7(A) because (i) the Contractor is not a public officer or employee of the State; (ii) the Contractor is not a member of the family of a public officer or employee of the State; (iii) the Contractor is not a business in which a public officer or employee or the family of a public officer or

employee has a substantial interest; or (iv) if the Contractor is a public officer or employee of the State, a member of the family of a public officer or employee of the State, or a business in which a public officer or employee of the State or the family of a public officer or employee of the State has a substantial interest, public notice was given as required by NMSA 1978, § 10-16-7(A) and this Agreement was awarded pursuant to a competitive process;

3) in accordance with NMSA 1978, § 10-16-8(A), (i) the Contractor is not, and has not been represented by, a person who has been a public officer or employee of the State within the preceding year and whose official act directly resulted in this Agreement and (ii) the Contractor is not, and has not been assisted in any way regarding this transaction by, a former public officer or employee of the State whose official act, while in State employment, directly resulted in the Agency's making this Agreement;

4) this Agreement complies with NMSA 1978, § 10-16-9(A) because (i) the Contractor is not a legislator; (ii) the Contractor is not a member of a legislator's family; (iii) the Contractor is not a business in which a legislator or a legislator's family has a substantial interest; or (iv) if the Contractor is a legislator, a member of a legislator's family, or a business in which a legislator or a legislator's family has a substantial interest, disclosure has been made as required by NMSA 1978, § 10-16-7(A), this Agreement is not a sole source or small purchase contract, and this Agreement was awarded in accordance with the provisions of the Procurement Code;

5) in accordance with NMSA 1978, § 10-16-13, the Contractor has not directly participated in the preparation of specifications, qualifications or evaluation criteria for this Agreement or any procurement related to this Agreement; and

6) in accordance with NMSA 1978, § 10-16-3 and § 10-16-13.3, the Contractor has not contributed, and during the term of this Agreement shall not contribute, anything of value to a public officer or employee of the Agency.

C. Contractor's representations and warranties in Paragraphs A and B of this Article 12 are material representations of fact upon which the Agency relied when this Agreement was entered into by the parties. Contractor shall provide immediate written notice to the Agency if, at any time during the term of this Agreement, Contractor learns that Contractor's representations and warranties in Paragraphs A and B of this Article 12 were erroneous on the effective date of this Agreement or have become erroneous by reason of new or changed circumstances. If it is later determined that Contractor's representations and warranties in Paragraphs A and B of this Article 12 were erroneous on the effective date of this Agreement or have become erroneous by reason of new or changed circumstances, in addition to other remedies available to the Agency and notwithstanding anything in the Agreement to the contrary, the Agency may immediately terminate the Agreement.

D. All terms defined in the Governmental Conduct Act have the same meaning in this Article 12(B).

13. Amendment.

A. This Agreement shall not be altered, changed or amended except by instrument in writing executed by the parties hereto and all other required signatories.

B. If the Agency proposes an amendment to the Agreement to unilaterally reduce funding due to budget or other considerations, the Contractor shall, within thirty (30) days of receipt of the proposed Amendment, have the option to terminate the Agreement, pursuant to the termination provisions as set forth in Article 4 herein, or to agree to the reduced funding.

14. Merger.

This Agreement incorporates all the Agreements, covenants and understandings between the parties hereto concerning the subject matter hereof, and all such covenants, Agreements and understandings have been merged into this written Agreement. No prior Agreement or understanding, oral or otherwise, of the parties or their agents shall be valid or enforceable unless embodied in this Agreement.

15. Penalties for violation of law.

The Procurement Code, NMSA 1978 §§ 13-1-28 through 13-1-199, imposes civil and criminal penalties for its violation. In addition, the New Mexico criminal statutes impose felony penalties for illegal bribes, gratuities and kickbacks.

16. Equal Opportunity Compliance.

The Contractor agrees to abide by all federal and state laws and rules and regulations, and executive orders of the Governor of the State of New Mexico, pertaining to equal employment opportunity. In accordance with all such laws of the State of New Mexico, the Contractor assures that no person in the United States shall, on the grounds of race, religion, color, national origin, ancestry, sex, age, physical or mental handicap, or serious medical condition, spousal affiliation, sexual orientation or gender identity, be excluded from employment with or participation in, be denied the benefits of, or be otherwise subjected to discrimination under any program or activity performed under this Agreement. If Contractor is found not to be in compliance with these requirements during the life of this Agreement, Contractor agrees to take appropriate steps to correct these deficiencies.

17. Applicable Law.

The laws of the State of New Mexico shall govern this Agreement, without giving effect to its choice of law provisions. Venue shall be proper only in a New Mexico court of competent jurisdiction in accordance with NMSA 1978, § 38-3-1 (G). By execution of this Agreement, Contractor acknowledges and agrees to the jurisdiction of the courts of the State of New Mexico over any and all lawsuits arising under or out of any term of this Agreement.

18. Workers Compensation.

The Contractor agrees to comply with state laws and rules applicable to workers compensation benefits for its employees. If the Contractor fails to comply with the Workers Compensation Act and applicable rules when required to do so, this Agreement may be terminated by the Agency.

19. Records and Financial Audit.

The Contractor shall maintain detailed time and expenditure records that indicate the date, time, nature and cost of services rendered during the Agreement's term and effect and retain them for a period of three (3) years from the date of final payment under this Agreement.

The records shall be subject to inspection by the Agency, the Department of Finance and Administration and the State Auditor. The Agency shall have the right to audit billings both before and after payment. Payment under this Agreement shall not foreclose the right of the Agency to recover excessive or illegal payments

20. Indemnification.

The Contractor shall defend, indemnify and hold harmless the Agency and the State of New Mexico from all actions, proceeding, claims, demands, costs, damages, attorneys' fees and all other liabilities and expenses of any kind from any source which may arise out of the performance of this Agreement, caused by the negligent act or failure to act of the Contractor, its officers, employees, servants, subcontractors or agents, or if caused by the actions of any client of the Contractor resulting in injury or damage to persons or property during the time when the Contractor or any officer, agent, employee, servant or subcontractor thereof has or is performing services pursuant to this Agreement. In the event that any action, suit or proceeding related to the services performed by the Contractor or any officer, agent, employee, servant or subcontractor under this Agreement is brought against the Contractor, the Contractor shall, as soon as practicable but no later than two (2) days after it receives notice thereof, notify the legal counsel of the Agency and the Risk Management Division of the New Mexico General Services Department by certified mail.

21. New Mexico Employees Health Coverage.

A. If Contractor has, or grows to, six (6) or more employees who work, or who are expected to work, an average of at least 20 hours per week over a six (6) month period during the term of the contract, Contractor certifies, by signing this agreement, to have in place, and agree to maintain for the term of the contract, health insurance for those employees and offer that health insurance to those employees if the expected annual value in the aggregate of any and all contracts between Contractor and the State exceed \$250,000 dollars.

B. Contractor agrees to maintain a record of the number of employees who have (a) accepted health insurance; (b) declined health insurance due to other health insurance coverage already in place; or (c) declined health insurance for other reasons. These records are subject to review and audit by a representative of the state.

C. Contractor agrees to advise all employees of the availability of State publicly financed health care coverage programs by providing each employee with, as a minimum, the following web site link to additional information: <http://insurenwnewmexico.state.nm.us/>.

22. Employee Pay Equity Reporting.

Contractor agrees if it has ten (10) or more New Mexico employees OR eight (8) or more employees in the same job classification, at any time during the term of this contract, to complete and submit the PE10-249 form on the annual anniversary of the initial report submittal for contracts up to one (1) year in duration. If contractor has (250) or more employees contractor must complete and submit the PE250 form on the annual anniversary of the initial report submittal for contracts up to one (1) year in duration. For contracts that extend beyond one (1) calendar year, or are extended beyond one (1) calendar year, contractor also agrees to complete and submit the PE10-249 or PE250 form, whichever is applicable, within thirty (30) days of the

annual contract anniversary date of the initial submittal date or, if more than 180 days has elapsed since submittal of the last report, at the completion of the contract, whichever comes first. Should contractor not meet the size requirement for reporting at contract award but subsequently grows such that they meet or exceed the size requirement for reporting, contractor agrees to provide the required report within ninety (90 days) of meeting or exceeding the size requirement. That submittal date shall serve as the basis for submittals required thereafter. Contractor also agrees to levy this requirement on any subcontractor(s) performing more than 10% of the dollar value of this contract if said subcontractor(s) meets, or grows to meet, the stated employee size thresholds during the term of the contract. Contractor further agrees that, should one or more subcontractor not meet the size requirement for reporting at contract award but subsequently grows such that they meet or exceed the size requirement for reporting, contractor will submit the required report, for each such subcontractor, within ninety (90 days) of that subcontractor meeting or exceeding the size requirement. Subsequent report submittals, on behalf of each such subcontractor, shall be due on the annual anniversary of the initial report submittal. Contractor shall submit the required form(s) to the State Purchasing Division of the General Services Department, and other departments as may be determined, on behalf of the applicable subcontractor(s) in accordance with the schedule contained in this paragraph. Contractor acknowledges that this subcontractor requirement applies even though contractor itself may not meet the size requirement for reporting and be required to report itself.

Notwithstanding the foregoing, if this Contract was procured pursuant to a solicitation, and if Contractor has already submitted the required report accompanying their response to such solicitation, the report does not need to be re-submitted with this Agreement.

23. Invalid Term or Condition.

If any term or condition of this Agreement shall be held invalid or unenforceable, the remainder of this Agreement shall not be affected and shall be valid and enforceable.

24. Enforcement of Agreement.

A party's failure to require strict performance of any provision of this Agreement shall not waive or diminish that party's right thereafter to demand strict compliance with that or any other provision. No waiver by a party of any of its rights under this Agreement shall be effective unless express and in writing, and no effective waiver by a party of any of its rights shall be effective to waive any other rights.

25. Notices.

Any notice required to be given to either party by this Agreement shall be in writing and shall be delivered in person, by courier service or by U.S. mail, either first class or certified, return receipt requested, postage prepaid, as follows:

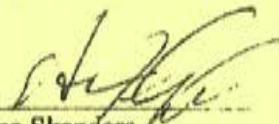
To the Agency:
Dan Hill
General Counsel
300 Don Gaspar, Room 211
Santa Fe, NM 87501
daniel.hill@state.nm.us

To the Contractor:
Judith A. Wagner CPA/ABV, CFF, CVA
Wagner Valuation & Financial Forensics, LLC
jwagner@wvfcpa.com
5600 Eubank NE Suite 150
Albuquerque, NM 87111
PO Box 95110
Albuquerque, NM 87199


26. Authority.

If Contractor is other than a natural person, the individual(s) signing this Agreement on behalf of Contractor represents and warrants that he or she has the power and authority to bind Contractor, and that no further action, resolution, or approval from Contractor is necessary to enter into a binding contract.

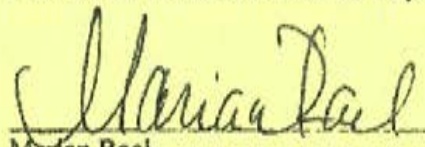
IN WITNESS WHEREOF, the parties have executed this Agreement as of the date of signature by all parties below.

By: 
Hanna Skandera
Secretary of Education,
New Mexico Public Education Department

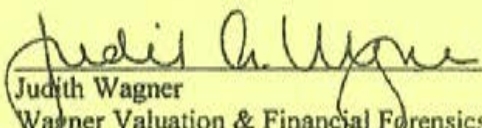
Date: 12/4/14

By: 
Dan Hill
General Counsel,
New Mexico Public Education Department

Date: 12/5/14

By: 
Marian Rael
Chief Financial Officer,
New Mexico Public Education Department

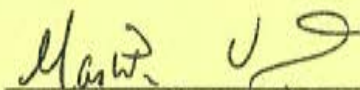
Date: 12.4.14

By: 
Judith Wagner
Wagner Valuation & Financial Forensics, LLC

Date: 11/25/2014

The records of the Taxation and Revenue Department reflect that the Contractor is registered with the Taxation and Revenue Department of the State of New Mexico to pay gross receipts and compensating taxes.

ID Number: 03-086275-00-2

By: 
Taxation and Revenue Department

Date: 12/4/14

EXHIBIT A: SCOPE OF WORK

1. Conduct an initial Risk Assessment to include:
 - a. Review of August 5, 2014 Comprehensive Risk Review (CRR) issued by the Office of the State Auditor (OSA)
 - i. Review CRR
 - ii. Review OSA workpapers in support of the CRR
 - iii. Interview OSA staff
 - b. Review of October 29, 2014 Updated Risk Review (URR) issued by the State Auditor
 - i. Review URR
 - ii. Review OSA workpapers in support of the URR
 - iii. Interview OSA staff
 - c. Review of School Audit Reports for the state fiscal years (SFY) 2006 through 2013
 - i. Identification, review and classification of risks identified in audit findings
 - ii. Review of IPA Moss Adams' workpapers for the relevant years
 - iii. Review of Moss Adams's or other IPA's documentation of any *completed* interim field work for SFY 2014
 - iv. Interview Moss Adams or other IPA staff
 - d. Interview law enforcement to identify risks, to the extent legally allowable
 - e. Interview PED staff charged with oversight of the Schools and/or the Audits for the relevant period
 - f. Interview APS Business Management staff charged with oversight of the Schools and/or the Audits for the relevant period
 - g. Interview School representatives
 - h. Conduct independent research and develop database of relevant and / or related parties or entities and identify potential conflicts of interest between the Schools and those parties or entities
 - i. Review of any reports and interview of any software consultants retained to identify risks and vulnerabilities in the inherent structure of the Schools' accounting software.
 - j. Catalog and classify fraud, waste or abuse risks identified in the initial Risk Assessment
 - k. Document understanding of system of internal controls in place, if any, to mitigate occurrences of control circumvention and an evaluation of the strength of internal controls.
2. Conduct an initial assessment of the integrity of the electronic accounting records of the Schools to include:
 - i. Review of user manuals
 - ii. Review of user controls
 - iii. Review of documented policies and procedures relating to control of access and user authorizations
 - iv. Identification of audit trails inherent in the accounting system

- v. Inventory and timeline of all users and their level of authorization and access to the general ledger and sub-modules
 - vi. Judgmentally testing the electronic general ledger, cash receipts, cash disbursements and payroll modules for all relevant periods through:
 - 1. Comparison to contemporaneously prepared hard copy records provided to third parties to include Moss Adams, PED, APS, Board Members and others
 - 2. Other books and records generated and maintained by the Schools in the ordinary course of business
 - 3. Review of journal entries or other anomalies for the period 2006 through October 2014
 - 4. Cash testing described below
 - vii. Identifying risk of and documentation of actual occurrences of manipulation or exploitation of the accounting system, including alteration of recorded transactions
3. Conduct 100% testing of cash transactions through the application of forensic accounting methodologies, with judgmental review of associated documentation and controls, for the period July 1, 2011 through October 31, 2014 for the purpose of:
- a. Assisting PED in establishing and quantifying the Schools' cash position as of October 31, 2014
 - b. Though the application of forensic accounting methodologies, investigating specific risks identified in the CRR, ORR, and Audits and through interviews to include:
 - i. Examination of the revenue cycle for proper revenue recognition and internal controls.
 - ii. Examination of available documentation of disbursements to Dr. Glasrud, his family, and related entities including, but not limited to Southwest Educational Consultants, Inc and any of its DBA's
 - iii. Identification of fictitious or sham vendors
 - iv. Identification of ghost (fictitious) employees
 - v. Comparison of payments to employees to contracts and other contemporaneously prepared documentation evidencing provision of services.
 - vi. Review of school records to determine if records relating to contractors or employees were falsified and/or manipulated
 - vii. Evaluation of aviation program activities and transactions including plane maintenance, fuel purchases, hanger rental fees and other aviation-related expenditures.
 - viii. Review school credit card expenditures to investigate whether any were made for personal or non-school related purposes

¹ To the extent available. If records remain in the possession of law enforcement, this step may be delayed, or coordination with law enforcement allowing review of records in their possession may be necessary, if legally allowable,

- c. Documenting and quantifying transactions identified as payments to related parties, parties with an identified conflict of interest, sham fictitious vendors or employees, payments for goods or services not delivered.
 - d. Documenting and quantifying transaction not properly authorized and/or transactions conducted in a manner inconsistent with applicable procurement or funding laws, regulations, or restrictions as identified by PED General Counsel.
4. Conduct fact-finding investigations related to potential revenue improprieties.
 - a. Evaluation of school revenue sources taking into consideration all types of payments and deposits, authorization controls, necessary documentation, cash receipts controls and procedures for such transactions including related party transactions, conflict of interests, segregation of duties and reconciliation controls.
 - b. Identification and review of ancillary school programs to determine whether or not Dr. Glasrud or any other school employee diverted revenue or assets to personally benefit from the programs as a result of their existence or function
 - c. Evaluation of records that would provide evidence of existence and assist in the quantification of unrecorded and/or diverted revenue from extended learning, activities or aeronautic fees.
5. Testing of cycles for cash (all forms of cash transactions); credit card transactions, external revenue sources and extended learning program fees.
6. Evaluation of accounts payable transactions including employee contracts, vendor contracts, employee travel and payment for assets in propriety of regular school business.
7. Evaluation of procurement compliance with charter school programs and federal programs to include, where possible, tracing of specific grants or appropriations to specific programs or purchases of services, goods and/or equipment, with particular focus on related party transactions
8. Evaluation of compliance with state and federal tax law in relation to payments to employees and contractors
9. Evaluation of risks, internal control deficiencies and transactions inconsistent with applicable law in relation to the procurement of aircraft or services for the Schools' aviation programs.
10. Review capital or fixed asset inventories and capital outlay appropriation reviews prepared by Moss Adams, the Schools or PED with comparison to the general ledger and judgmental sample of purchases to determine the existence of the capital asset.
11. Periodically meeting with PED General Counsel to report initial findings, concerns, and limiting conditions.
12. Coordination with the ongoing federal criminal investigation, and other investigations, at the direction of PED
13. Preparation of a final report at the direction of PED General Counsel to include detailing the results of the comprehensive investigation and findings, including analysis and reporting on the financial data and evidence which shall include a recommendation of additional internal controls to mitigate future occurrences of fraudulent conduct.
14. Document recommendations for improvements where needed, including controls in place at all levels of management and operations including Board of Director roles and

responsibilities and including an examination of whether existing controls were either insufficient to detect improprieties or were not being utilized in such a manner to detect the improprieties.

15. Conduct follow-up review, analysis and interviews to document the manner in which the identified risks or vulnerabilities have been addressed by the Schools and those charged with oversight.
16. Timing and completion of work identified within this Scope of Work is dependent upon the availability of relevant documents and the availability of key OSA, IPA, School or PED staff. Certain steps within this Scope of Work may not be performed as a result of those limitations. Contractor will document limiting conditions including missing or unavailable records and limitations relating to interviews that precluded the performance of work identified within this Scope of Work.



State of New Mexico
OFFICE OF THE STATE AUDITOR

Hector H. Balderas
State Auditor

December 4, 2014

RECEIVED

DEC 08 2014

LESC

Carla C. Martinez
Deputy State Auditor

Via Email and U.S. Mail

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

**Re: Forensic Audit Contract Status Related to Southwest Learning Centers -
Notification of Public Education Department's Noncompliance**

Dear Secretary-Designate Skandera:

It has come to my attention that the spokesperson for the Public Education Department (PED) stated publicly that a contract for forensic audit of the Southwest Learning Centers was "finalized" and "was in place as of last week." As a follow-up to my previous letters, most recently my letter dated December 2, 2014, this notification is to once again to remind you of the requirements under law which your Department must follow with regard to the Office of the State Auditor's review and approval of the forensic audit contract. Close of business has expired today, and my office has not received a contract for approval, reviewed a final scope of work or received any updates from PED officials regarding the current status.

The Audit Rule (2.2.2 NMAC), which is promulgated pursuant to the State Auditor's authority under the Audit Act (Section 12-6-1 NMSA 1978 et seq.), imposes the following requirements:

An agency or an [independent public accountant (IPA)] shall not enter into a professional services contract for a special audit, performance audit or attestation engagement regarding the financial affairs and transactions of an agency and relating to financial fraud, waste or abuse in government without the prior written approval of the state auditor. The proposed professional services contract must be submitted to the state auditor for review and approval after it has been signed by the agency and the IPA. The contract must include the contract fee, start and completion date, and the specific scope of services to be performed by the IPA. (2.2.2.15(E)(2) NMAC).

Therefore, the professional services contract between PED and the IPA must be approved by the State Auditor before work may commence. Absent this approval, PED is in violation of

state regulation and appears to be intentionally evading this explicit requirement. PED's IPA for fiscal year 2014 will be notified of this violation.

Finally, your staff has contacted my office about issuing an RFP for PED's fiscal year 2014 financial audit. However, I have not yet received a response to my December 2, 2014 request for clarification regarding termination of PED's fiscal year 2014 financial audit contract with Moss Adams. Based on Deputy Secretary Hipolito Aguilar's letter of November 14, 2014, it appears PED has not terminated the fiscal year 2014 financial audit contract, but has instructed Moss Adams to terminate the contract. Section 5(C) of the audit contract requires the party that terminates the contract to "immediately send the State Auditor and the Department of Finance and Administration written notice of the termination." Again, update my office immediately regarding whether Moss Adams has terminated the contract, PED has terminated the contract or whether the contract remains in effect.

I am troubled that PED continues to be contemptuous and dismissive of the legal requirements applicable to its fiscal agent and oversight role imposed by state law and regulations. It is my expectation that my office will receive the forensic audit contract and financial audit contract termination information from PED by close of business tomorrow, Friday, December 5, 2014.

Respectfully,

A handwritten signature in black ink, appearing to read "Hector H. Balderas", with a stylized flourish at the end.

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
Dan Hill, General Counsel, PED
Hipolito Aguilar, Deputy Secretary of Finance and Operations, PED



RECEIVED

DEC 05 2014

LESC

State of New Mexico
OFFICE OF THE STATE AUDITOR

Hector H. Balderas
State Auditor

December 2, 2014

Carla C. Martinez
Deputy State Auditor

Via Email and U.S. Mail

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

Re: Notification of the Public Education Department's At-Risk Status Due to Noncompliance – Forensic Audit Contract Status Related to Southwest Learning Centers – Risk Observations and Directive to Audit Systemic Oversight Failures

Dear Secretary-Designate Skandera:

As State Auditor, it is my duty under the Audit Act (Section 12-6-1 NMSA 1978 et seq.) to provide New Mexico's citizens with an independent opinion of all government agencies' financial affairs in a greater effort to increase transparency, promote accountability, and eliminate financial fraud, waste and abuse. Accordingly, this letter notifies you that the Office of the State Auditor (OSA) has designated the Public Education Department (PED) "at-risk" due to your Department's delay and failure in submitting a forensic audit contract for the Southwest Learning Centers by the November 5, 2014 deadline set forth by my office. Additionally, this letter notifies you of certain risk observations made by my staff related to PED's own oversight weaknesses that may have contributed to Dr. Scott Glasrud's exploitation of apparent conflicts of interest for personal gain. In light of these risk observations and pursuant to the State Auditor's authority, I have determined that PED will be required to ensure risks of criminal conduct are mitigated by including test work within the forensic audit scope that audits systemic oversight failures.

I. Designation of the PED's At-Risk Status Due to Noncompliance

On October 31, 2014, I received a letter from Hipolito Aguilar, PED's Deputy Secretary of Finance and Operations, in response to my updated Risk Review of October 29, 2014 related to the Southwest Learning Centers. The updated Review conveyed my concerns regarding your Department's substantial delays in submitting a contract for a forensic audit that would verify the extent of systemic oversight failures and test significant risks of fraud, waste and abuse at the schools. I also notified you of PED's noncompliance with state law's requirement that your Department "immediately have an audit made of all funds under the control" of the charter schools following its August 28, 2014 suspension of the schools' boards of finance pursuant to Section 22-8-39 NMSA 1978.

For these reasons, I stated it was imperative that PED submit a signed contract for a forensic audit to the OSA by November 5, 2014 so that the audit can immediately test systemic oversight failures, the likely existence of fictitious vendors, potential unlawful profiteering by certain school employees and officials, and other violations of law related to the misappropriation of public education funds. I also informed you that PED must take this action to fulfill its responsibilities as an oversight agency and the current board of finance of the charter schools. However, nearly one more month has now passed, and despite my continuing regulatory efforts to compel swift action you have yet to submit a forensic audit contract to my office.

Although Deputy Secretary Aguilar confirmed that PED is working with a forensic accountant, his letter does little to dispel my worries over PED's sluggish response to this crisis, failure to meet oversight expectations related to compliance with state law, and refusals to respond to our inquiries regarding the status of the forensic audit scope and contract which state law and regulation require you to submit to my office. My intention has always been to try to work with your Department to achieve the best outcome for the schools and its students. However, I continue to be troubled that my office has been forced, at every turn, to request your Department take immediate action regarding the entire financial audit and forensic audit processes after your suspension of the schools' boards of finance.

These actions included notifying Deputy Secretary Aguilar, Moss Adams, and the schools' legal counsel on October 6, 2014 that a meeting must be held on October 8, 2014 to address the apparent failures in communication between the parties regarding the stalled financial audit test work and forensic audit process. My office's intervention led to a consensus on the paths forward for the financial and forensic audits, and it was our understanding following the meeting that PED would pursue an emergency procurement approval and quickly move to negotiate a contract with an expert forensic auditor. PED staff subsequently made representations to my staff that the OSA would receive a proposed fraud scope of work and contract for review and approval, as required by law, by Friday, October 24, 2014. Except for that date, PED has never offered a "timeline" to which my office "specifically agreed" as Deputy Secretary Aguilar asserted in his letter. But unfortunately that date also came and went, and our inquiries to PED staff about the status of the contract went unanswered.

In his letter, Deputy Secretary Aguilar also neglected to specify a date by which my office can expect submission of a final forensic audit scope and signed contract, which is precisely the problem. Now, over one month since I received the Deputy Secretary's letter, my office is still awaiting receipt of a contract. In the meantime, the schools, oversight agencies and the public have no assurance regarding the resolution of considerable fraud risks. This inexplicable delay is unacceptable.

Therefore, as further incentive for you to submit the forensic scope and audit contract to ensure all risks and systemic oversight failures are audited immediately, this letter is to notify you that the OSA hereby designates PED "at-risk" for failure to submit the forensic audit contract in accordance with the deadline set forth by this office. Your at-risk status will be included in our monthly report to oversight agencies, and the list of at-risk agencies can be found

on the OSA's website main page (www.osanm.org) under the section labeled, "Government Agencies At-Risk."

II. Risk Observations Related to PED's Oversight of SSLC and SAMS – Directive to Audit Systemic Oversight Failures

Regrettably, PED's delays have engendered skepticism about your capacity to successfully navigate this crisis pursuant to your oversight obligations under state law. My concerns are further heightened by PED's repeated failures to address Dr. Scott Glasrud's conflicts of interest and violations of law prior to the issuance of the OSA's August 5, 2014 Risk Review of the financial affairs of Southwest Secondary Learning Center (SSLC), and Southwest Aeronautics, Mathematics and Science Academy (SAMS). The risk observations noted below highlight PED's own oversight weaknesses that may have contributed to Dr. Scott Glasrud's exploitation of apparent conflicts of interest. I previously notified you on October 29, 2014 that the forensic audit scope must include a review of PED's oversight practices and procedures. In light of these observations, PED will be required to ensure risks of criminal conduct are mitigated by including test work within the forensic audit scope that audits systemic oversight failures:

- 1) *PED failed to take adequate oversight action to address multiple financial audit and program evaluation findings related to Dr. Glasrud's conflicts of interest and violations of law.*

Prior to issuance of the OSA's August 5, 2014 comprehensive Risk Review, multiple financial audit report and program evaluation findings had identified problems and violations of law related to Dr. Glasrud's conflicts of interest. Despite these findings, PED was reluctant or unwilling to take adequate oversight actions to address the clear risks to public education funds.

First, during its annual financial audit for fiscal year 2012, SSLC received a finding for Dr. Glasrud's violation of the Governmental Conduct Act and conflict of interest related to the school's payments to Dr. Glasrud's private company, Southwest Educational Consultants (SEC). Because SSLC is a state-chartered charter school, the finding was contained in PED's own financial audit report for that fiscal year. In the finding (CS 12-03-Y for SSLC), the auditor identified a significant deficiency for SSLC's noncompliance with the Governmental Conduct Act's conflict of interest restrictions. Specifically, the finding cited Dr. Glasrud's official action as a public employee to enter SSLC into a contract with a business in which he has a substantial financial interest. In the finding's condition, the auditor stated, "[t]he director of the school [Dr. Glasrud] signed two lease agreements with a company [SEC] in which he has a direct financial interest. Total amount paid was \$216,000." An exit conference for the fiscal year 2012 report was held on December 11, 2012, for which Deputy Secretary Aguilar was in attendance.

Shortly following this exit conference, on January 14, 2013 the Legislative Finance Committee (LFC) released a program evaluation report on charter school facilities lease assistance that raised additional concerns about Dr. Glasrud's personal business relationships with SSLC. The report was addressed to the Public School Facilities Authority, which serves as staff to the Public School Capital Outlay Council (PSCOC). The Secretary of Education is a

member of the PSCOC and Deputy Secretary Aguilar serves as the Secretary's designee on the PSCOC. The LFC report cited "potentially inappropriate relationships not addressed by statute or rule are costly." Among these relationships, the report identified the lease arrangement between SSLC and Dr. Glasrud's private company, SEC, for a building located at 9904 Montgomery Blvd NE in Albuquerque. The report stated Dr. Glasrud, as a school founder and Head Administrator of SSLC, personally profited from this arrangement. In the report's recommendations, the LFC recommended that the Legislature consider amending statute to "address conflicts of interest to include foundation board members, school founders, and contracted employees and make funding contingent on avoiding these conflicts."

Even though your Department was undoubtedly notified and aware of these red flags related to Dr. Glasrud's business relationships, PED either neglected or was unwilling to take meaningful oversight actions to address the problems. For example, my office discovered during its Risk Review that PED's Charter School Division (CSD) scuttled meaningful oversight action related to Dr. Glasrud's conflicts of interest in the fall of 2013. In a letter to Dr. Glasrud dated July 10, 2013, the then Director of the CSD, Tony Gerlicz, requested Dr. Glasrud respond to certain concerns CSD noted during a site visit to SSLC. Mr. Gerlicz informed Dr. Glasrud that the lease arrangement between SEC and SSLC for the building space on Montgomery Blvd in Albuquerque was a possible conflict of interest under state law, was "not only a possible serious violation but causes damage to the charter movement and draws negative attention to SSLC," and that it was "unacceptable to continue this practice." Mr. Gerlicz also raised Dr. Glasrud's conflict of interest related to SAMS lease of aircraft from SEC, and explained that Dr. Glasrud only disclosed the conflict of interest after Moss Adams called the possible violation of law to his attention. In closing his letter, Mr. Gerlicz requested Dr. Glasrud respond to the issues highlighted in the letter so the CSD "can move forward in evaluating what you can do to remove these dark clouds from the Southwest Learning Centers."

On September 23, 2013, the schools' legal counsel, Patricia Matthews, responded in a nine-page letter on behalf of the schools' governing bodies. In sum, Ms. Matthews vigorously disputed each of Mr. Gerlicz's points, asserted various legal positions in defense of Dr. Glasrud's contractual arrangements, and argued that it is "very critical to correct any inference that the principals of SEC had any intent to violate a law." Ms. Matthews also stated that "the concept that the boards are blind to Dr. Glasrud's and Dr. [Dolly] Juarez's actions is very far from true," and that SEC made no financial profit from its building lease with SSLC. She further noted that the schools had presented corrective action plans to PED and the Department had recommended no follow-up action regarding the leases.

Based on our inquiries to PED in early 2014, following Ms. Matthews' letter the CSD did not send any additional correspondence or requests for information related to Dr. Glasrud's business relationships, either to Ms. Matthews or Dr. Glasrud. It appears no attempts were made by PED to evaluate the legitimacy of Ms. Matthews' claims, including her statement that SEC made no financial profit from its building lease with SSLC – a representation that the OSA recently confirmed through review of documentation is not true. In responses to OSA inquiries, the CSD also represented it opted to wait on the results of the charter schools' fiscal year 2013 financial audit rather than immediately follow-up on its initial concerns regarding Dr. Glasrud's conflicts of interest. Moreover, in January 2014 the OSA was also told by a PED Ethics

Investigator that she “was asked to look at SSLC some time ago . . . and then told there was nothing to look at – move along . . . I think there was an issue about whether the guy is profiting from the charter school. Still don’t know because I was pulled off.”

In PED’s fiscal year 2013 financial audit report, released on March 24, 2014, SSLC received another finding related to Dr. Glasrud’s conflict of interest. In the finding, repeated and modified from the prior year, the independent auditor noted that SSLC’s Head Administrator (Dr. Glasrud) signed and approved purchase orders and checks for amounts paid to his own private business. The finding cited a violation of the Charter Schools Act, specifically Section 22-8B-5.2(B), which provides, “[n]o member of a governing body or employee, officer or agent of a charter school shall participate in selecting, awarding or administering a contract with the charter school if a conflict of interest exists.” The finding stated that the violation renders the contract voidable under state law.

Even though this conflict of interest finding surfaced in PED’s financial audit report for a second consecutive year, PED openly expressed reluctance to address or remedy the violations of law raised by the audit and program evaluation findings. In an interview with KRQE aired on March 31, 2014, Deputy Secretary Aguilar publicly articulated his unwillingness to evaluate Dr. Glasrud’s conflicts of interest, stating it was not for him to say whether the schools’ sizeable payments to Dr. Glasrud’s private company were “a good or bad expenditure.” At the end of fiscal years 2012 and 2013 collectively, Dr. Glasrud’s private company, SEC, was paid a total of \$666,573 under his contracts with the charter schools to lease aircraft and the building on Montgomery Blvd in Albuquerque.

It is unclear why PED deliberately refused to take adequate oversight action after multiple financial audit and program evaluation findings indicated improper conflicts of interest and violations of law related to Dr. Glasrud’s lucrative contracts with the charter schools. It was only following the public release of the OSA’s August 5, 2014 Risk Review, and PED’s receipt of my office’s recommendations that PED demand supporting documentation from the schools, when PED finally took meaningful oversight action to address the inherent risks to public education funds.

- 2) *Dr. Glasrud, now the subject of a federal criminal investigation, directly lobbied the Secretary-Designate of Education to oppose stronger restrictions on conflict of interest requirements that would be detrimental to his personal financial interests.*

On the heels of the recommendations contained in the LFC’s program evaluation report on charter school facilities lease assistance, the New Mexico Legislature passed Senate Bill 333 in the 2013 Legislative Session. The bill strengthened the conflict of interest restrictions in the Charter Schools Act (Chapter 22, Article 8B NMSA 1978) by prohibiting a person from serving as an employee of a charter school “if the person or an immediate family member of the person is an owner, agent of, contractor with or otherwise has a financial interest in a for-profit or nonprofit entity with which the charter school contracts directly, for professional services, goods or facilities.” The bill also required that a contractual relationship between an employee and a charter school which violated this restriction rendered the contract void.

A few weeks after the bill's passage and during the Governor's consideration of Senate Bill 333 for final enactment, on April 2, 2013 Dr. Glasrud wrote an email to you, as Secretary-Designate of PED, copied Deputy Secretary Aguilar, and expressed his concerns over the conflict of interest restrictions of Senate Bill 333. Dr. Glasrud argued that the bill's conflict of interest provisions violated existing state statutes, the New Mexico Constitution, and were based on a "flawed LFC report." He stated that it was his understanding that "the Governor's Office is planning to review this legislation this evening," and wrote that "your assistance in bringing these concerns to her attention is greatly appreciated!" You responded and assured him that his comments would be considered.

Given that Dr. Glasrud is currently the subject of a federal criminal investigation related to his conduct at the schools, his direct lobbying of PED officials to persuade the Governor to weaken accountability standards is troubling. I am concerned that the Governor's Office may have been misled in not supporting more restrictive conflict of interest standards that were pocket vetoed on April 5, 2013, particularly in light of the financial audit and program evaluation findings discussed above.

III. Submission of Forensic Audit and Financial Audit Contracts

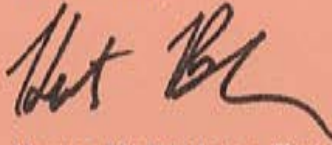
To review, my office has designated PED "at-risk" for failure to submit the forensic audit contract in accordance with the deadline set forth by this office. Through the forensic scope and audit and pursuant to the State Auditor's authority, PED will be required to ensure risks of criminal conduct are mitigated by including test work within the forensic audit scope that takes into account the risk observations above and audits systemic oversight failures. Moving forward, it is critical that PED's oversight practices and procedures related to these types of transactions receive an independent review to ensure the full protection of public education funds. Your Department should quickly engage in proactive and timely measures to reassure stakeholders and address risks to the schools.

I also received a copy of your Deputy Secretary Aguilar's letter dated November 14, 2014 informing Moss Adams that "PED believes that Moss Adams must terminate its engagement due to its impaired independence." Upon further review of the letter, it appears PED has not terminated the fiscal year 2014 financial audit contract, but has instructed Moss Adams to terminate the contract. Section 5(C) of the audit contract requires the party that terminates the contract to "immediately send the State Auditor and the Department of Finance and Administration written notice of the termination." Please update my office immediately regarding whether Moss Adams has terminated the contract or whether the contract remains in effect.

Finally, I am puzzled that you, as the Secretary-Designate of Education, have chosen to remain conspicuously silent on the very serious investigations of the Southwest Learning Center Schools. In fact, I have yet to receive a response from you to any of my previous letters, or see any public statement from you regarding the revelations of potential criminal activity at the schools. The importance and urgency of this case nevertheless demand a speedy response, and I am willing to meet with you to discuss how I may assist your Department in this regard.

Thank you for your prompt attention to this matter.

Respectfully,

A handwritten signature in black ink, appearing to read 'Hector H. Balderas', with a stylized flourish at the end.

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
Dan Hill, General Counsel, Public Education Department
Paul Aguilar, Deputy Secretary of Finance and Operations, Public Education Department