

# STATE OF MINNESOTA

## Office of the State Auditor



**Rebecca Otto**  
**State Auditor**

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PETITION ENGAGEMENT

**INDEPENDENT SCHOOL DISTRICT 282**

2008 THROUGH SEPTEMBER 30, 2010

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The mission of the Office of the State Auditor is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

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# **INDEPENDENT SCHOOL DISTRICT 282**

**2008 Through September 30, 2010**



## **Petition Engagement**

**Audit Practice Division  
Office of the State Auditor  
State of Minnesota**

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Petitioners  
Superintendent and School Board  
Independent School District 282

## INTRODUCTION AND BACKGROUND

Eligible voters of St. Anthony-New Brighton Independent School District 282 (District) petitioned the Office of the State Auditor (OSA) to examine the books, records, accounts, and affairs of the District in accordance with Minn. Stat. § 6.54, including issues described in the petition.<sup>1</sup> The statute allows the OSA, in the public interest, to confine the scope of the examination to less than that requested by the petition. Through discussion and agreement with petitioner representatives, the scope of our review was limited to addressing the issues discussed below.

### Use of Bond and Levy Money and Source of Excess Funds

In the original petition, the petitioners raised concerns regarding the use of excess levy moneys of \$1.3 million for projects rejected by the voters in a bond ballot referendum. (The petitioners use the term “levy moneys” in reference to the Alternative Facilities Bonds.) During our meeting with the petitioners, they broadened their concern to include the potential commingling of funds between the \$10,410,000 GO School Alternative Facilities Bonds, Series 2008A (the Alternative Facilities Bonds) and the \$11,515,000 GO School Building Bonds, Series 2008B (the School Building Bonds).

In July 2008, the District issued the Alternative Facilities Bonds in the amount of \$10,410,000. At the same time, the District issued the School Building Bonds in the amount of \$11,515,000. The Alternative Facilities Bonds were issued under the authority of Minn. Stat. § 123B.59. As long as a district meets the requirements of Minn. Stat. § 123B.59, it can issue alternative facilities bonds, and no referendum is required.<sup>2</sup> The School Board and the Commissioner of

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<sup>1</sup>See Supporting Citizen Report of Petitioners for the Minnesota State Auditor to Audit Independent School District 282.

<sup>2</sup>See Minn. Stat. § 123B.59, subd. 3.

Education approved the indoor air quality plan, and on July 8, 2008, the School Board approved a resolution authorizing the issuance of the Alternative Facilities Bonds. The Alternative Facilities Bonds were to be used to bring indoor air quality up to current minimum standards at Wilshire Park Elementary and at the Middle School-High School.

The issuance of the School Building Bonds was approved by voters in the May 20, 2008, referendum election for the acquisition and betterment of school sites. This referendum consisted of four questions, of which the passing of questions two through four were dependent on the passing of question one. Question one passed, but questions two, three, and four did not pass. Ballot question one stated:

Shall the school board of Independent School District No. 282 (St. Anthony-New Brighton) be authorized to issue its general obligation school building bonds in an amount not to exceed \$11,515,000 to provide funds *for the acquisition and betterment of school sites and facilities, including* the repair, remodeling, renovation, upgrading, equipping and construction of improvements to the existing secondary and elementary school facilities; the construction, renovation and equipping of science labs, computer labs and other program-related facility improvements to the elementary and secondary school facilities; the construction and renovation of a new kitchen at the secondary school facility; and the construction of drainage, parking, and bus arrival and student drop-off improvements at the secondary school site?

(Emphasis added.) Ballot question one went on to state:

If Question 1 is approved by a majority of voters, any or all of the remaining three questions may also be approved. If question 1 is not approved by a majority, none of the remaining three questions can pass on their own.

In October 2009, the District identified that total updated budgeted costs relating to the projects being funded by the combined Alternative Facilities Bonds and the School Building Bonds were \$1.3 million dollars less than the proceeds from both bond issues, based on a cost analysis prepared by Wold Architects and Engineers dated October 1, 2009.

The excess proceeds from the two bonds are attributable to two construction contracts that were awarded below the architect/engineer estimates (a \$698,200 savings in the bid/award of the Wilshire Park Elementary 2009 Improvement Projects and a \$2,282,000 savings in the bid/award of the St. Anthony Secondary School 2009 Improvement Projects), less two additional School Board approved building construction projects (a \$276,558 classroom audio project and a \$306,951 football field renovation project) and less numerous change orders totaling \$1,102,382 approved by the Project Oversight Committee (POC). The POC was established by the School Board. A summary of the excess bond proceeds is presented on the following page.

Combined Funding Sources

|   |                          |
|---|--------------------------|
| Alternative Facilities Bonds  | \$ 10,410,000            |
| School Building Bonds   | <u>11,515,000</u>        |
| <br>Total Combined Funding Sources  | <br><u>\$ 21,925,000</u> |
| <br>Wilshire Park Improvement Projects Budget   | <br>\$ 3,426,000         |
| Wilshire Park Improvement Projects Bid Award  | <u>(2,727,800)</u>       |
| <br>Wilshire Park Improvement Projects Budget over (under) Bid Award  | <br><u>\$ 698,200</u>    |
| <br>Secondary School Improvement Projects Budget  | <br>\$ 12,160,000        |
| Secondary School Improvement Projects Bid Award   | <u>(9,878,000)</u>       |
| <br>Secondary School Improvement Projects Budget over (under) Bid Award   | <br><u>\$ 2,282,000</u>  |
| <br>Total Wilshire Park Improvements and Secondary School Improvements<br>Budgets over (under) Bid Awards   | <br><u>\$ 2,980,200</u>  |
| Less:   |                          |
| Classroom audio project   | (276,558)                |
| Football field renovation   | (306,951)                |
| Change orders approved by Project Oversight Committee   | <u>(1,102,382)</u>       |
| <br>Remaining Bond Proceeds as of October 2009 (On December 2, 2009,<br>the Board approved a 5-year plan for deferred maintenance/enhancement<br>projects for the 2009-10 through 2013-2014 school years) | <br><u>\$ 1,294,309</u>  |

Pursuant to Minn. Stat. § 123B.59, subd. 8, in relation to the Alternative Facilities Bonds and the indoor air quality plan, the District must “establish a separate account under the uniform financial accounting and reporting standards (UFARS) for this program.” The projects funded by both bond issues used the same architect/engineer as the construction manager and estimator as well as the same bond underwriter. Proceeds from the Alternative Facilities Bonds can be used only to pay for projects included in the air quality improvement plan. The proceeds from the School Building Bonds, however, can be used to pay for the acquisition and betterment of school sites generally, pursuant to the language of the referendum quoted on page two.

We reviewed an analysis of the expenditures of the two separate bond issues as of September 30, 2010, at which time the projects were nearly complete, to determine if the funding sources and related spending had been commingled. Of the 281 total disbursements, there were 219 disbursements that related to one of the two bond issues, but not both; and there were 62 disbursements that related to both bond issues. We tested a sample of 20 random disbursements from both populations, for a total of 40. For the sampled disbursements that related to the alternative facilities, we tested for adequate supporting documentation to classify

each disbursement as an Alternative Facilities Bond disbursement and that the disbursement was properly recorded in a separate account under UFARS. For the sampled disbursements that related to the school buildings, we tested for adequate supporting documentation to classify the disbursement as a School Building Bond disbursement and that the disbursement was properly recorded into an account under UFARS. Disbursements not related to the alternative facilities project cannot be recorded in the alternative facilities construction account; however, alternative facilities construction projects disbursements can be recorded in the building bond construction account. All 40 disbursements tested were both supported by proper documentation and were recorded in the appropriate account.

We also found as of October 13, 2010, the District had spent all of the revenues relating to the Alternative Facilities Bonds and had a balance of \$41,341 in funding related to the School Building Bonds.

### **Appearance of Conflict of Interest**

Petitioners questioned the appearance of impropriety or conflict of interest with the District's use of a bond underwriting firm (Firm), when the Firm's representative to the District is a Firm shareholder and the husband of the District's Director of Business Services.

The District has done business with the representative since approximately 2001, when he assisted with the District's "Blueprint for a Bright Future."<sup>3</sup> The District's Director of Business Services was hired in 2003.

#### **A. Conflict of Interest Statutes**

The primary Minnesota law regarding contract-related conflicts of interest for political subdivisions, including school districts, provides:

Except as authorized in section 471.88, a public officer who is authorized to take part in any manner in making any sale, lease, or contract in official capacity shall not voluntarily have a personal financial interest in that sale, lease, or contract or personally benefit financially therefrom. Every public officer who violates this provision is guilty of a gross misdemeanor.<sup>4</sup>

Because the general rule is so strict, the legislature has created a number of exceptions, which are set forth in Minn. Stat. § 471.88. Under this statute, a school board, "by unanimous vote, may contract for goods or services with an interested officer" if the contract is one "for which competitive bids are not required by law." Minn. Stat. § 471.88, subds. 1 and 5.

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<sup>3</sup>The representative at that time worked for a different financial services company. The District maintained its relationship with the representative after he moved to the Firm in approximately 2005.

<sup>4</sup>Minn. Stat. § 471.87.



To use this broad exception, however, a school district and the interested officer must follow the procedures set forth in Minn. Stat. § 471.89. This section requires the school board to “authorize the contract in advance of its performance by adopting a resolution setting out the essential facts and determining that the contract price is as low as or lower than the price at which the commodity or services could be obtained elsewhere.” In addition, before claims are paid on the contract, the interested officer must file an affidavit stating, among other things, that he or she believes “the contract price is as low as, or lower than, the price at which the commodity or services could be obtained from other sources.”

A preliminary step in analyzing any situation under this standard is to determine whether the government officer or employee is a “public officer who is authorized to take part in any manner in making any sale, lease, or contract in official capacity.”

In general, authority to make school district contracts is vested in the school board.<sup>5</sup> Minnesota law also provides:

The board may authorize its superintendent or business manager to lease, purchase, and contract for goods and services within the budget as approved by the board. Any transaction in an amount exceeding the minimum amount for which bids are required must first be specifically authorized by the board and must fulfill all other applicable requirements in [Minn. Stat. § 123B.52,] subdivision 1.<sup>6</sup>

The Director of Business Services and Superintendent both indicated the School Board has not delegated authority to the Director of Business Services to contract for the financial services provided by the representative. Although contracting authority has not been delegated by Board action, the Director of Business Services can purchase or contract for day-to-day items within the School Board approved budget. Such items may include minor repairs, maintenance, purchases of equipment not subject to competitive bidding, and procurement of property and liability insurance. The Superintendent indicated expenditures related to any such purchases would be approved by the School Board.

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<sup>5</sup>See e.g., Minn. Stat. § 123B.02, subs. 1 (“The board must have the general charge of the business of the district.”), 14 (“The board may employ and discharge necessary employees and may contract for other services.”)

<sup>6</sup>Minn. Stat. § 123B.52, subd. 2.

Based on the information provided, the Director of Business Services does not have authority to participate in making contracts with the bond underwriting firm or its representative, and we therefore conclude that there is not a statutory conflict of interest.<sup>7</sup>

B. District Conflict of Interest Policies

The District is in the process of reviewing its policies. Currently, two conflict of interest policies are in place. Most recently, the District adopted on October 6, 2009, a policy entitled “CONFLICT OF INTEREST - SCHOOL BOARD MEMBERS.” This policy applies to School Board members, and it incorporates standards from Minn. Stat. §§ 471.87, 471.88, and other statutes cited as legal references.

An older policy, that applies to both employees and School Board members, designated “CONFLICT OF INTEREST” and coded “401.3” was implemented in 1987 and last reviewed in 1999. It provides, in part:

It is understood that District personnel may have an interest in or be employed by a business other than the St. Anthony School District. It is, however, the policy of the District to direct employees to conduct no school business with any firm which is selling to the District if the employee has a personal interest in that business without competitive pricing and/or service considerations.

Another provision states:

This policy requires that employees and Board Members have no relationships or engage in any activities that might impair their independence of judgment. Therefore, any District employee who buys/sells goods/services or who has responsibility for such on behalf of the District is prohibited from having any substantial economic interest in private/publicly-held business concerns which transact business with the District. An interest is substantial if it represents a substantial proportion of the individual’s net worth or a substantial proportion of such business enterprise.

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<sup>7</sup>The Superintendent believes the School District consulted with legal counsel regarding this issue in 2003 when the Director of Business Services was hired. A letter was obtained from counsel in 2005 or 2006 after the Superintendent was hired, but the Superintendent indicated it could not be found. A reissued letter, dated October 21, 2010, was provided. It concluded:

There is no conflict of interest arising under Minnesota law that prohibits the School District from contracting with [the bond underwriting firm]. Therefore, the School Board may enter into contracts for services with [the bond underwriting firm] as the School Board deems to be warranted.

*See* October 21, 2010 Knutson and White letter to Thompson.

Information provided by the Superintendent and Director of Business Services indicates that the Director of Business Services does not contract with the Firm or representative. The Superintendent indicated that the representative provides various financial services to the District, as determined by the School Board at a regular meeting or a working session.

We have not been presented with any documented conclusion on whether the relationship between the Director of Business Services and the representative violates the District's current policies.

As part of the process of reviewing its policies, we recommend that the School Board consider including policy provisions regarding organizational conflicts of interest. Minnesota law requires the Commissioner of Administration to make reasonable efforts to avoid, or neutralize organizational conflicts that may arise during the state public procurement process.<sup>8</sup> We recommend that any public entity should make such efforts.

An "organizational conflict of interest" exists when, because of existing or planned activities or because of relationships with other persons, (1) a vendor is unable or potentially unable to render impartial assistance or advice to the State, or (2) the vendor's objectivity in performing the contract work is or might be otherwise impaired, or (3) the vendor has an unfair competitive advantage.<sup>9</sup>

Policies regarding organizational conflicts of interest seek to ensure adherence to two underlying principles: (1) preventing the existence of conflicting roles that might bias a contractor's judgment, and (2) preventing unfair competitive advantage in the awarding of contracts.<sup>10</sup>

To help avoid organizational conflicts of interest, all solicitation documents should include a provision that requires potential consultants to provide information concerning any past, present, or planned interest relating to the work, and whether the consultant has a possible organizational conflict of interest. The interest could be financial, contractual, organizational, or otherwise. If the consultant does not disclose any information about a possible conflict, the solicitation document should provide that, by submitting the offer or signing the contract, the consultant warrants, to the best of their knowledge and belief, that no facts exist relevant to a possible organizational conflict.<sup>11</sup>

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<sup>8</sup>See Minn. Stat. §§ 16C.04, subd. 3; Minnesota Department of Administration Policy & Procedure Admin 01-13 (updated), Organizational Conflicts of Interest Policy (October 6, 2008), available at: <http://www.mmd.admin.state.mn.us/pdf/alpn9.pdf>.

<sup>9</sup>See Minnesota Department of Administration Policy & Procedure Admin 01-13 (updated), Organizational Conflicts of Interest Policy (October 6, 2008), available at: <http://www.mmd.admin.state.mn.us/pdf/alpn9.pdf>.

<sup>10</sup>*Id.* The State Organizational Conflicts of Interest Policy recognizes "It is not possible to prescribe in advance a specific method or set of criteria which would serve to identify and resolve all of the organizational conflict of interest situations which might arise," but it provides a list of sample questions to ask in determining whether an organizational conflict of interest might exist.

<sup>11</sup>The State Organizational Conflicts of Interest Policy contains a sample provision for state agencies.

It recognizes that an organizational conflict of interest can be waived if, for example (1) the work cannot reasonably or satisfactorily be performed except by the consultant whose interests give rise to a question of conflict of interest; and (2) contract administration and monitoring methods can be employed to neutralize the conflict. As noted above, the District has represented that the Director of Business Services does not assign work to the representative.

The adoption of an organizational conflict of interest policy would provide the District an opportunity to formalize procedures for disclosure and mitigation of potential organizational conflicts of interest, including setting out procedures for assignment of work to the representative by persons or bodies other than the Director of Business Services.

### **Process for Underwriting of Bonds**

The petitioners raised concern about the lack of transparent process for requesting proposals or other “bidding” processes regarding the underwriting of bonds. In addition, the petitioners felt that the debt service schedule resulted in excess interest being paid by the taxpayers.

Both the Alternative Facilities Bonds and the School Building Bonds were underwritten and issued by Northland Securities in a negotiated sale. The repayment schedule for both bond issues is included in the final bond documents. The principal payments for the Alternative Facilities Bonds are scheduled to begin February 1, 2012, with interest payments beginning February 1, 2009. Principal payments range from \$10,000 to \$985,000, with interest rates ranging from three to five percent; the final principal payment is scheduled for February 1, 2029. The principal payments for the School Building Bonds began February 1, 2010, with interest payments beginning February 1, 2009. Principal payments range from \$40,000 to \$1,725,000, with interest rates ranging from three to five percent; the final principal payment is scheduled for February 1, 2031.

The underwriting of bonds is a professional services contract and does not fall into the definition of “contract” in the Municipal Contracting Law, Minn. Stat. § 471.345. Subdivision 2 of the statute defines a “contract” as, “an agreement entered into by a municipality for the sale or purchase of supplies, materials, equipment or the rental thereof, or the construction, alteration, repair or maintenance of real or personal property.” A municipality, for the purpose of this law, is “a county, town, city, school district, or other municipal corporation or political subdivision of the state authorized by law to enter into contracts.” The Minnesota Attorney General has opined that neither the Municipal Contracting Law nor the “work or labor” provision require bidding for professional and technical contracts. *See* Op. Minn. Atty. Gen. No. 707a-7 (July 22, 1985). The District is not required to solicit bids for the underwriting of bonds.

Bond repayment schedules are developed as part of the bond offering and must take into consideration many factors, from previously issued bonds still in repayment to completion of the construction of the current bond projects. It is typical with construction projects for principal repayment not to occur until the projects have been completed, thus starting later than the interest payments.

The formal process of bidding serves several public objectives. Certainly one objective is to obtain the lowest price, but another important goal of bidding is the opportunity it allows qualified entities to obtain public business in an open process.

A formal bidding process is not statutorily required for professional services. Given the nature of professional services, seeking the lowest responsible bidder may not always be the best decision for a public entity. However, the goals of allowing qualified interested professionals the opportunity to obtain public contracts in an open process can be obtained through a Request for Proposals (RFP) process.

While mindful of the value of relationships that develop over a period of time, we recommend that public entities periodically review all of their professional service contracts, including legal, auditing, and public finance contracts, and consider whether to conduct an RFP for professional services so that qualified, interested professionals can inform the District of their services and charges. This process will periodically inform the District's Board of the availability and costs of professional services available to the District.

### CONCLUSION

We were not engaged to, and did not perform an audit, the objective of which would be the expression of an opinion on specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters may have come to our attention that we would have reported to you.

This report has been prepared solely for the information and use of the Petitioners, Superintendent, and School Board of Independent School District 282, but is a matter of public record, and its distribution is not limited.

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

January 7, 2011