

# STATE OF MINNESOTA

## Office of the State Auditor



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

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**INDEPENDENT SCHOOL DISTRICT 709**

**PETITION ENGAGEMENT**

**COMPREHENSIVE LONG-RANGE FACILITIES PLAN**

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**INDEPENDENT SCHOOL DISTRICT 709**

**Comprehensive Long-range Facilities Plan**



**Petition Engagement**

**Audit Practice Division**  
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### **INDEPENDENT PETITION ENGAGEMENT**

Petitioners  
Superintendent and School Board  
Independent School District 709

#### INTRODUCTION

Eligible voters of Independent School District 709 (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 and as related to the District's Comprehensive Long-range Facilities Plan. 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 with petitioner representatives and evaluation of concerns, the scope of our review was limited to addressing the issues discussed below.

#### BACKGROUND

The District entered into agreements with Johnson Controls, Inc., (JCI) to act as program manager for the District's Comprehensive Long-range Facilities Plan (Plan). In this capacity, JCI was to provide all the professional program management services including planning, architecture, engineering, construction management, and commissioning required to deliver the Plan. JCI indirect construction costs associated with these services are generally recognized as soft costs. The Master Agreement stated the District would pay JCI a lump sum fee of \$250,000 for Phase I - Assessment and Phase II - Plan Evaluation. The Master Agreement also bound the District to using JCI for Phase III of the Plan.

Phase III consisted of implementation of the Plan. Specific terms and conditions for JCI's professional services related to Phase III were defined in the Program Management Agreement. Pursuant to the District's agreements, JCI was to provide professional services either directly or using qualified sub-consultants. During this phase, professional services were not to include construction contracts, which were to be entered into by the District and contractor, and not with JCI.

PETITIONERS' CONCERNS

**1. Soft Costs**

The petitioners expressed concerns regarding increases to soft costs paid to JCI and whether job/change orders for those increased soft costs were properly approved by the Board. The OSA reviewed the Master Agreement and the Program Management Agreement between the District and JCI along with the job/change orders for soft cost increases.

The Program Management Agreement was based on the total Plan budget of \$295,983,647, which consisted of \$257,776,306 in construction costs approved by the Minnesota Department of Education (MDE); an inflation contingency adjustment approved by the MDE in the amount of \$36,088,683; and additional work requested by the MDE in the sum of \$2,118,658. Of the total Plan budget, JCI's program management fee (2%) and program management fee for land acquisition (1%) combined was budgeted at \$5,700,276. Contract language states that appropriate adjustments shall be made to the program management fee when total program cost changes are made. The program management fee is separate and apart from any fees charged by JCI in its capacity as a construction manager on any specific project. The Program Management Agreement states that certain contingent and optional services outside of the work and services identified in the agreements shall be paid for by the District as a reimbursable expense or as a separate job order in addition to the price agreed to in the agreements. In addition to the program management fee, the agreements state that JCI would be compensated, under various specifics, at the following rates based on a percentage of the related cost:

<u>Services Related to:</u>	<u>For Renovations, Repairs, or Remodels</u>	<u>For New Construction</u>
Architectural Construction Costs	8.0%	7.0%
Engineering Construction Costs	9.5%	8.5%
Commissioning Construction Costs	2.5%	2.5%
Construction Management	5.0 - 6.0%	4.0%

The District provided the OSA with the following information regarding fees associated with JCI through December 31, 2013. These include both amounts due to JCI for services performed and amounts for services provided by other contractors where JCI was responsible for payment to the third party for services rendered.

Architectural	\$	7,579,451
Engineering		13,493,194
Construction management		12,946,404
Project commission		1,646,916
Architectural/engineering fee		2,775,506
Program management		6,080,859
Furniture, fixtures, equipment		836,639
Reimbursables		<u>11,166,719</u>
Total	\$	<u>56,525,688</u>

The following actual total Plan costs through December 31, 2013, were also provided to the OSA by the District.

<b>Construction Costs</b>	<b>\$ 224,665,842</b>
<b>Soft Costs:</b>	
General Conditions Reimbursables	\$ 3,730,459
CM Site Services/Supervision	9,406,090
A/E & CM Fees/Professional Services	37,986,561
Program Management Fee	5,164,145
Miscellaneous Reimbursables	105,045
Communications Consultant	242,045
LEED Coordination	156,489
FF & E Coordination Services	698,472
Asbestos Abatement Consultants	685,376
Roof Construction Observation (inspection)	93,470
SWWPP Consultants (AET)	53,714
Technology Equipment	4,969,007
Security/Intrusion Sensors	81,242
Miscellaneous Owner Cost	3,970,693
MN Power	265,956
City of Duluth - Water & Gas	433,597
Construction Testing	717,462
Test and Balancing	437,398
School Moving Expenses	375,050
CAF Fees (WLSSD Charge)	626,038
Building Permit/Plan Review Fee	1,120,191
Builders Risk Insurance	2,779,884
Property Acquisition	7,463,934
Real Estate Consulting Services	592,503
Professional Services - Reimbursables	1,044,967
Reallocation District-wide Expenses	816,942
Bond Interest	168,252
<b>Total Soft Costs</b>	<b>\$ 84,184,982</b>
<b>Total Plan Costs</b>	<b>\$ 308,850,824</b>

Comparing the two preceding tables, the \$56.5 million in soft costs associated with JCI are 67 percent of the total \$84.2 million in soft costs and 18 percent of the total Plan costs through December 31, 2013.

Board resolution #B-8-08-2565 dated August 19, 2008, authorized the Director of Business Services or Superintendent to approve changes to agreements or contracts related to the Plan that did not exceed 15 percent of the original contract amount and cause expenditures to exceed the project budget. The School Board Chair or Vice-Chair was required to be consulted to confirm that these conditions were met. Board resolution B-6-11-2904 dated June 27, 2011, approved Plan Amendment 2, which provided for \$15,450,000 in additional funding to complete work; directed staff to prepare and submit to the MDE a Review and Comment; and authorized the Chair to sign project agreements with JCI.

As provided by the District, the job/change orders for soft costs associated with JCI consisted of the following:

November 30, 2009	Furniture, Fixtures, & Equipment Reuse Plan	\$	836,639
November 30, 2009	Amended Project Scopes		1,589,549
January 13, 2012	Additional Scope Items	\$	2,813,439
	Additional Pre-Construction Services		1,041,969
(Note: The District was not obligated to pay for services under this change order that were part of the most recent Amendment to the Review and Comment until such was approved by the MDE.)	Additional Change in Services	<u>900,336</u>	4,755,744
	Program Management Fee Increase Due to Extended Duration of Congdon Park Elementary Project		426,812
	Asbestos Additional Services		432,742
	Construction Management Reimbursables (Change in Project Duration)		<u>3,131,641</u>
	Total		<u>\$</u>

The School Board Chair's signature was on each of the soft cost job/change orders we reviewed. We were informed that this signature signified confirmation that the specific conditions noted above were met, including the Director of Business Services or Superintendent's approval of the job/change orders.



## 2. Source of General Fund Transfers

The petitioners were concerned about the sources of funds that were transferred from the General Fund to pay for project costs of the Plan.

The funding overview for the Plan included estimated cost savings projected to be realized due to operating fewer schools. Funding sources of the District did not decrease to coincide with the estimated reduction in operating expenditures. Instead, funds available as a result of cost reductions were put into a designated account in the General Fund along with the proceeds from property sales and rebates and miscellaneous funding sources. The funding overview then called for enough funds to be transferred out of the designated account to the Debt Service Fund to offset a portion of the debt levy in order to maintain the property tax impact goal per home.

The total annual savings originally estimated from the Plan was \$5.3 million. The Plan estimated \$23.4 million in property sales as a funding source. Actual sales of property did not occur as anticipated. The effect of surplus schools not being sold or demolished, and still incurring utility and related property holding costs, was that some of the operating expenditure reduction was not realized.

The District provided the OSA with an accounting of sources and uses of the General Fund's designated account activity. Following is a summary of that information as of June 30 for each year. Other General Fund resources have offset the deficit in this account.

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>Total</u>
<u>Sources:</u>					
Rebates	\$ 92,625	\$ 46,664	\$ 193,675	\$ 122,358	\$ 455,322
Property sales	-	448,085	2,250,855	1,502,906	4,201,846
Operational savings	547,481	1,127,811	2,323,291	3,589,484	7,588,067
Escrow lease purchase proceeds	582,014	-	-	-	582,014
Insurance recoveries and miscellaneous	-	-	126,472	18,050	144,522
<b>Total Sources</b>	<b>\$ 1,222,120</b>	<b>\$ 1,622,560</b>	<b>\$ 4,894,293</b>	<b>\$ 5,232,798</b>	<b>\$ 12,971,771</b>
<u>Uses:</u>					
Transferred to Debt Service Fund	\$ 2,283,687	\$ 3,344,250	\$ 4,587,733	\$ 3,012,034	\$ 13,227,704
Property sales, insurance, and other expenses	36,718	35,529	202,071	69,349	343,667
Principal lease repayment	-	90,000	1,365,000	1,390,000	2,845,000
Interest payments	-	2,156,826	1,562,716	1,701,389	5,420,931
<b>Total Uses</b>	<b>\$ 2,320,405</b>	<b>\$ 5,626,605</b>	<b>\$ 7,717,520</b>	<b>\$ 6,172,772</b>	<b>\$ 21,837,302</b>
<b>Balance</b>	<b>\$ (1,098,285)</b>	<b>\$ (5,102,330)</b>	<b>\$ (7,925,557)</b>	<b>\$ (8,865,531)</b>	<b>\$ (8,865,531)</b>

### **3. Minnesota Department of Education Review and Comment**

The petitioners were concerned that additional funding authority for some schools changed in Review and Comment requests submitted to the MDE between the versions of those requests that were not approved and the Review and Comment that was approved.

The District prepared several Review and Comment submissions related to the Plan for the MDE approval pursuant to the process described in Minn. Stat. §§ 123B.70 and 123B.71. Subsequent to the MDE's approval of the original Plan, the District submitted a Review and Comment for Amendment 1, which was approved by the MDE in 2010. This revision increased and decreased estimated costs between schools and resulted in no total change to the overall Plan budget.

In September 2011, the District submitted a Review and Comment to the MDE for a second amendment to the Plan. The effect was to increase the budget/funding by \$15,450,000 between six schools. In October 2011, the MDE requested the District provide additional clarification and rationale for the proposed project changes. In January 2012, the District re-submitted the Review and Comment for Amendment 2 along with a response providing the additional information requested by the MDE. The MDE informed us that this Review and Comment was not acted on positively or negatively by the MDE. The District then submitted a new Review and Comment in March 2012 as authorized by Board resolution B-3-12-2983. The effect was to increase the budget for two schools, Congdon Park and Myers-Wilkins (Grant), for which construction had not yet begun. The MDE granted a positive Review and Comment on this request in April 2012.

The combined budget for Congdon Park and Myers-Wilkins (Grant) schools in the originally approved Plan and JCI contracts was \$23.5 million. At the time of the approval of the second Plan amendment, this budget had increased \$12.1 million to \$35.6 million. The MDE's positive Review and Comment in April 2012 included approving a funding increase of \$19.3 million, the difference between the new budget plus bond issuance costs and the \$16.9 million identified as funds available. At that point in time, the funds available were also less than the original budget for these schools.

The following table is a summary of cost information by school as of December 31, 2013, based on information provided by the District.

School Name - Current (Original)	Actual Costs			Original JCI Contract and Budget	Approved Amendment 1 (2010)	Approved Amendment 2 (2012)	Actual Total Over(Under) Original and Amendments  (c)-(d)-(e)- (f)=(g)
	Construction Costs	Soft Costs	Total Costs				
	(a)	(b)	(a)+(b)=(c)				
Congdon Park	\$ 9,769,616	\$ 4,831,336	\$ 14,600,952	\$ 10,177,222	\$ -	\$ 5,441,208	\$ (1,017,478)
Ordean East MS (Eastern MS)	21,513,962	8,020,047	29,534,009	28,986,257	-	-	547,752
Myers-Wilkins (Grant)	13,736,232	5,046,021	18,782,253	13,327,749	2,226,304	4,472,033	(1,243,833)
HOCHS	448,400	40,102	488,502	6,659,511	(4,225,092)	-	(1,945,917)
Homecroft	6,000,615	1,983,369	7,983,984	8,600,682	-	-	(616,698)
Lakewood	2,140,897	829,610	2,970,507	2,958,084	-	-	12,423
Lowell	5,305,764	1,745,508	7,051,272	7,680,944	-	-	(629,672)
East HS (Ordean HS)	47,345,348	15,718,166	63,063,514	57,260,533	1,473,623	-	4,329,358
Laura MacArthur	16,061,833	7,250,811	23,312,644	21,105,467	1,863,926	-	343,251
Lester Park	15,026,970	6,132,780	21,159,750	19,954,011	346,174	-	859,565
Piedmont (Piedmont/Lincoln)	14,883,022	4,830,990	19,714,012	18,587,380	1,500,000	-	(373,368)
Lincoln Park MS (Western MS)	36,963,951	13,240,506	50,204,457	48,270,888	-	-	1,933,569
Secondary Technical Center	-	-	-	5,235,221	(5,062,309)	-	(172,912)
Stowe	3,171,085	1,278,328	4,449,413	4,304,790	-	-	144,623
Transportation Center	-	219,429	219,429	2,537,449	(2,325,225)	-	7,205
Denfeld HS (Western HS)	32,298,147	13,017,979	45,316,126	40,337,459	4,202,599	-	776,068
<b>Total</b>	<b>\$ 224,665,842</b>	<b>\$ 84,184,982</b>	<b>\$ 308,850,824</b>	<b>\$ 295,983,647</b>	<b>\$ -</b>	<b>\$ 9,913,241</b>	<b>\$ 2,953,936</b>

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 relating to the petitioners' concerns as identified in this report. 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 709, 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

July 22, 2014