

Minutes of the Special School Board Meeting

Of the School Board of Independent School District No. 709 held at the Historic Old Central High School, 215 North First Avenue East, Duluth, Minnesota 55802, on

Tuesday, July 22, 2014

Members Present:

Annie Harala
Art Johnston
Rosie Loeffler-Kemp
Mike Miernicki
Harry Welty
Bill Westholm

Others Present:

Bill Gronseth, Superintendent
Bill Hanson, Deputy Clerk
Sue Talerico, Secretary

Members Excused:

Judy Seliga Punyko

- Chair Miernicki called the special school board meeting of July 22, 2014 to order at 4:30p.m.

The Office of the State Auditor representatives present were: Dianne Syverson, Audit Manager; Mark Kerr, Assistant Legal Counsel; and Lisa Young, Audit Staff Specialist.

Dianne Syverson provided a summary of the report as related to Independent School District 709's Comprehensive Long-range Facilities Plan.

Office of the State Auditor representatives took questions from School Board Members and provided answers and clarification.

- Chair Miernicki adjourned the Special School Board meeting of July 22, 2014 at 5:52 p.m.

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

INDEPENDENT SCHOOL DISTRICT 709

PETITION ENGAGEMENT

COMPREHENSIVE LONG-RANGE FACILITIES PLAN

Description of the Office of the State Auditor

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.

The State Auditor performs approximately 160 financial and compliance audits per year and has oversight responsibilities for over 3,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits of local governments;

Government Information - collects and analyzes financial information for cities, towns, counties, and special districts;

Legal/Special Investigations - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

Pension - monitors investment, financial, and actuarial reporting for approximately 730 public pension funds; and

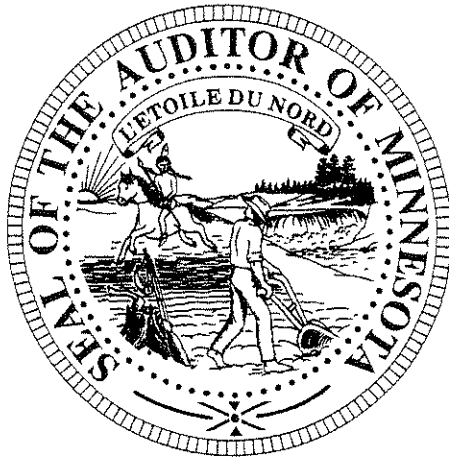
Tax Increment Financing - promotes compliance and accountability in local governments' use of tax increment financing through financial and compliance audits.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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INDEPENDENT SCHOOL DISTRICT 709
Comprehensive Long-range Facilities Plan



Petition Engagement

Audit Practice Division
Office of the State Auditor
State of Minnesota

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STATE AUDITOR

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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.

| | | |
|--|-----------|---------------------------|
| Construction Costs | \$ | <u>224,665,842</u> |
| Soft Costs: | | |
| 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 |
| Total Soft Costs | \$ | <u>84,184,982</u> |
| Total Plan Costs | \$ | <u>308,850,824</u> |

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 | | \$ |

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 |
| Total Sources | \$ 1,222,120 | \$ 1,622,560 | \$ 4,894,293 | \$ 5,232,798 | \$ 12,971,771 |
| <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 |
| Total Uses | \$ 2,320,405 | \$ 5,626,605 | \$ 7,717,520 | \$ 6,172,772 | \$ 21,837,302 |
| Balance | \$ (1,098,285) | \$ (5,102,330) | \$ (7,925,557) | \$ (8,865,531) | \$ (8,865,531) |

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 | | | Total 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 | (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 | |
| Denfield HS (Western HS) | 32,298,147 | 13,017,979 | 45,316,126 | 40,337,459 | 4,202,599 | - | 776,068 | |
| Total | \$ 224,665,842 | \$ 84,184,982 | \$ 308,850,824 | \$ 295,983,647 | \$ - | \$ 9,913,241 | \$ 2,953,936 | |

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