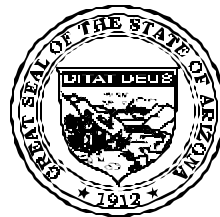


**Investigative
Report:
Scottsdale Unified
School
District No. 48
Officials Failed to
Comply with
Consent Judgment**



**November
2001**

**Debra K. Davenport
Auditor General**

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**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

November 29, 2001

Members of the Arizona Legislature

The Governing Board of the
Scottsdale Unified School District No. 48

The Honorable Janet Napolitano
Attorney General

The Honorable Jaime Molera
State Superintendent of Public Instruction

In conjunction with the Office of the Attorney General, we have conducted a special investigation of the Scottsdale Unified School District No. 48 for the period August 1999 through June 2001. Our investigation was performed to determine whether there were procurement violations during that period and whether the District's business practices were consistent with legal requirements.

Our investigation consisted primarily of inquiries and the examination of selected financial records and other documentation. Therefore, our investigation was substantially less in scope than an audit conducted in accordance with generally accepted auditing standards. Accordingly, we do not express an opinion on the District's financial records or internal control structure, nor do we ensure that all matters involving the internal control structure established by the American Institute of Certified Public Accountants or other conditions that require correction or improvement were disclosed.

The accompanying Investigative Report describes our findings and conclusion as a result of this special investigation.

After this report is distributed to the members of the Arizona State Legislature, the Attorney General, and the State Superintendent of Public Instruction, it becomes public record.

Debbie Davenport
Auditor General

Attachment

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Summary

In October 2000, the Office of the Attorney General requested that the Office of the Auditor General investigate certain allegations of financial improprieties on the part of administrators and employees of Scottsdale Unified School District No. 48. As a result of that request and in conjunction with the Attorney General's Office, we conducted an investigation of those allegations and submitted the following findings to the Attorney General. The Attorney General has taken corrective legal action against the District (see Conclusion, page 9).

 **Investigation Highlights:**



The District failed to charge a charter school \$101,378 in rental fees



A governing board member failed to disclose that he was employed by a contractor



District officials breached their fiduciary duty

Our investigation revealed that from August 1999 to June 2001, District officials failed to comply with the terms of its October 1998 consent judgment with the Attorney General's Office. Specifically, District officials improperly managed school property by failing to charge a charter school approximately \$101,378 in rental fees and by exposing the District to unnecessary financial risk. In addition, a District governing board member failed to disclose that he was employed by the charter school, even though it was contracting with the District. District officials also breached their fiduciary duty to ensure that proper alternative school services were provided for high school students. They circumvented the procurement process and failed to make sure that the alternative school services complied with state statute or District policy.

Accordingly, by violating the covenants and obligations of its October 1998 consent judgment, former officials may have also violated Arizona Revised Statutes, school district procurement rules, and District policies. This 3-year judgment, a result of the District's previous breach of fiduciary duty, required it to place \$150,000 in trust with the Arizona State Treasurer as a pledge to fully perform the agreed-upon conditions. This amount could be forfeited if the District is found in violation of the consent judgment, of which certain components required the District to conduct business according to established rules and regulations.¹

¹ Arizona Antitrust Act; Arizona State Procurement Code; Arizona Education Act; Arizona Administrative Code, Title 7, Chapter 2; Public Buildings Improvement Act; Arizona Public Records Act; the *Uniform System of Financial Records*; and District policies and procedures.

Background

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Prior Investigation Highlights:



Projects totaling \$11,725,425 were awarded in violation of procurement rules



Former district employees received discounts and other favors from certain vendors

The State of Arizona provides educational opportunities for children through a public school system organized by local districts. Each district has a governing board that is elected by the district's voters and is held accountable to the local community for the quality of education provided. In addition, districts are fiscally accountable to Arizona taxpayers for the appropriate spending of state and local monies. Scottsdale Unified School District No. 48 received state revenues of approximately \$39,294,462 for fiscal year 2000 based on a student count of 25,999 and local property taxes of \$111,486,651.

School district procurement rules, applicable Arizona Revised Statutes, and the *Uniform System of Financial Records* exist to help ensure that districts receive the best possible value for the public money they spend and school property they manage by prohibiting the restraint of free trade and unreasonable reduction of competition among vendors.

Our October 6, 1998, Investigative Report revealed that from July 1994 through June 1998, certain prior administrators and employees violated the laws and regulations associated with lawful District activities. They breached their fiduciary duty to use public money prudently, personally profited from their official business dealings, and misused District resources. Mainly, they violated or circumvented procurement rules for projects totaling \$11,725,425. Further, some of them improperly accepted favors from vendors and misused District equipment.

◆


The District agreed to abide by state procurement laws in the future

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Consequently, on October 20, 1998, the governing board entered into a 3-year consent judgment with the Attorney General's Office. Certain elements of the judgment required the District to follow proper bidding and procurement practices in accordance with state laws and District policy. However, if a court determines that the District has failed to perform the covenants of the judgment, the \$150,000 trust amount could be forfeited and the Attorney General would receive \$100,000 as partial reimbursement of its costs and fees, and the State General Fund would receive \$50,000 as a civil penalty.

Finding I

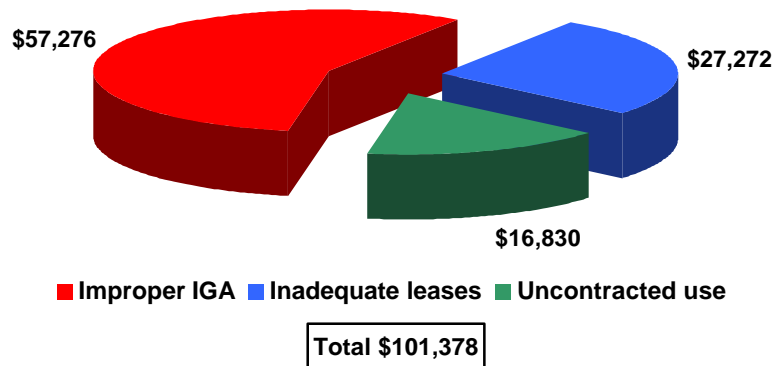
District Officials Mismanaged School Property


District officials sacrificed over \$100,000 of potential rental revenue


Arizona law requires school district governing boards to manage and control their school property. However, during fiscal years 2000 and 2001, Scottsdale Unified School District officials failed to charge approximately \$101,378 in rental revenue and needlessly exposed the District to financial liability. Specifically, the governing board improperly entered into an intergovernmental agreement (IGA) with a charter school for free use of District facilities at Tonto Elementary School. No authority exists for such an agreement and the terms did not comply with District rental policies. Also, one board member, who withdrew his vote for the agreement, failed to disclose his employment interest in the charter school. Prior to the IGA, former District officials used inadequate lease agreements with the same charter school for several classrooms at Tonto Elementary School. The leases were incomplete and did not comply with District rental policies. Finally, District officials also previously allowed the charter school to use some of those facilities without any lease or formal contract.

Exhibit 1

**District Rental Fees Not Charged to Charter School
August 1999 through June 2001**



Source: Auditor General staff analysis of records from Scottsdale Unified School District, Arizona Department of Education, and the charter school.

Improper IGA

During fiscal year 2001, the District governing board improperly entered into an intergovernmental agreement with a charter school for District space and utilities at no cost in return for the charter school providing alternative education. However, the District did not benefit from this agreement as the charter school provided the alternative education to its own students and not those students enrolled in the Scottsdale Unified School District (see Finding II, page 7). Also, the intergovernmental agreement is not legally authoritative and the terms do not comply with District rental policies. Consequently, the District failed to realize about \$57,276 in rental fees during fiscal year 2001.

The District had no authority to enter into an intergovernmental agreement with the charter school

No legal authority—Although the District’s legal counsel approved the intergovernmental agreement as to form, no specific authority exists for the District and the charter school to enter into this agreement. The Attorney General’s Office declared that charter schools with private operators do not appear to fall within the public agency definition outlined in statutes allowing intergovernmental agreements. Accordingly, although they have not officially addressed the issue, the Attorney General’s Office indicated that a formal opinion would likely find that charter schools do not have the authority to enter into intergovernmental agreements.

Rental policies violated—The governing board did not charge the charter school for rent, even though under District rental policies the charter school was subject to rental fees that amounted to approximately \$57,276. District rental policies allow for rental fees to be offset or waived only when the District directly benefits from a measurable value provided by the renter. These measurable values normally include cash contributions to the District, in-kind gifts, or program fee reductions for students. However, the District did not receive any cash or in-kind gifts and the students did not receive any program fee reductions from the charter school.

Finally, while the District rental policies require that specific facilities and rooms be identified, the intergovernmental agreement indicates only that “space and utilities at the Tonto School” will be provided.

Undisclosed employment interest

One board member failed to properly disclose his employment status with the charter school

Although one board member is employed by this same charter school, he failed to disclose this noteworthy interest to the District. In fact, the board member signed his employment contract with the charter school the same day the governing board approved the intergovernmental agreement. The board member initially voted to approve the intergovernmental agreement, but then directly requested his vote be withdrawn because of his conflict of interest. However, he did not detail his individual employment interest.

Arizona law requires that public officials make known their substantial interest in any decision as well as refrain from voting on or participating in that decision. The board member had previous experience with disclosing conflicts, having revealed his ownership interest in another corporation that leased facilities from the District. Nevertheless, in this instance, he failed to disclose his employment relationship with the charter school and his particular conflict of interest was not made known. Accordingly, his lack of full disclosure may have impacted the governing board's decision that allowed his employer, the charter school, to use District facilities without paying rent or utilities.

Inadequate lease agreements

In the previous year, fiscal year 2000, former District officials leased several Tonto Elementary School classrooms to the same charter school at lower rates than specified in the District's rental policies. As a result, the District lost approximately \$27,272 in additional rental income. The District did not receive any measurable value from the charter school that would allow reduced rental fees during this fiscal year either.

For 14 months, the District failed to invoice the charter school for the lease payments

In addition, the District was potentially liable for all general, bodily injury, and property damage claims at the site because officials failed to ensure that the charter school's certificate of insurance specifically identified the leased property. This failure violated provisions in the District's lease with the charter school. Further, former District officials failed to sign one lease and did not date any of them.

Finally, former District officials failed to bill the charter school for lease payments until November 2000, the same month this Office requested supporting documentation for lease payments. Although payments were up to 14 months overdue, the District failed to include interest charges in its bill.

Uncontracted use of facilities

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*The District failed to
protect itself with
appropriate contracts*
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Also during fiscal year 2000, former District officials improperly allowed this same charter school to use two classrooms, a storage room, and athletic fields at Tonto Elementary School without a contract and without charging the use fees specified in the District’s rental policies. As a result, the District lost about \$16,830 in rental income. Further, the District may have been liable for any general, bodily injury, and property damage claims at the site because officials failed to ensure that the charter school provided proper insurance for the facilities it used.

Finding II

District Officials Breached Their Fiduciary Duty

District officials must safeguard and manage public money and property for and on behalf of the community and the schools. More importantly, they are responsible for educating the children in their care. Therefore, District officials should use business practices that help ensure the District is receiving the best possible services for students at the most efficient cost.

However, the District did not properly secure an acceptable alternative-to-suspension program for its students. District officials violated state law and District policy, circumvented procurement rules, and did not ensure that high school students received the alternative school services they required.

Statute and policy noncompliance—Arizona state law required each school district to establish an alternative-to-suspension program by January 1, 2001. Further, the program had to meet the following criteria:

- It must be established in consultation with local law enforcement or school resource officers;
- It must be discipline-intensive, require academic work; and
- The governing board must adopt program participation policies.

The governing board did not approve alternative-to-suspension program policies until February 20, 2001, nearly 2 months after the statutorily established deadline. In addition, District officials were unable to provide documentation demonstrating that its alternative-to-suspension program was established in consultation with local law enforcement or school resource officers, was discipline-intensive, or required academic work.

In order to obtain alternative school services for high school students, District officials entered into the lease and intergovernmental agreements with the charter school described in Finding I. The District would withdraw the student and the student could enroll in the charter school that would then assume responsibility for the high school student's education. Accordingly, the arrangement with the charter school did not function as an alternative to suspension. Because the withdrawn students were no longer the District's responsibility, District officials did not determine how these alternative services would be provided or monitor these students' attendance, behavior, or academic progress. As a result, District officials failed to ensure that the services provided complied with state statutes or District policy.

*The District improperly
arranged for services
through a charter school
instead of properly
procuring the services
according to state
procurement law*

Procurement rule evasion—Former District officials did not follow the proper procurement process when establishing the alternative-to-suspension program. Although the District originally solicited competitive proposals for high school alternative school services, they failed to complete the process. Specifically, they did not document evaluations of the responses, keep any record of discussions held with the offerors, or make a determination of which proposal was the most advantageous to the District. Instead, they entered into agreements with the charter school to provide District facilities, at low or no cost, in return for the charter school assuming responsibility for the high school students' education. Hence, former District officials evaded the procurement rules and may not have acquired the appropriate services at the most efficient cost.

District officials should have known the importance of properly evaluating competitive proposals for alternative student services. In August 1999, after the sealed competitive process, the governing board awarded a contract to another vendor for alternative school services needed for their students in grades 4-8. In fact, a former interim superintendent submitted an explanation to the governing board that the competitive sealed proposal process was necessary to compare the different price, quality, and contractual factors of the proposals submitted. Nevertheless, the governing board did not require District officials to follow the same process for their high school students.

Conclusion

The Scottsdale Unified School District No. 48, as a governmental entity, is responsible to Arizona citizens for compliance with the laws and regulations associated with lawful District activities. In particular, the District agreed to fully perform the covenants and obligations of its October 20, 1998, consent judgment with the Attorney General's Office. In this accord, the District agreed to certain provisions, one of which was to abide by the Arizona Antitrust Act, Arizona Education Act, Arizona Procurement Code, and District policies and procedures.

On November 29, 2001, the Attorney General's Office and the Scottsdale School District governing board mutually agreed to a stipulation to extend the consent judgment. All of its terms and conditions are to remain in full effect through August 9, 2002. The District's \$150,000 trust amount will remain on deposit with the State Treasurer during that period. In addition, the District must nullify and void the intergovernmental agreement with the charter school. The District is also required to appropriately provide an alternative-to-suspension program in compliance with state law.