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AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

May 14, 2018

Members of the Arizona Legislature

The Honorable Doug Ducey, Arizona Governor

Governing Board
Scottsdale Unified School District

The Honorable Mark Brnovich, Arizona Attorney General

The Honorable Diane Douglas, Arizona State Superintendent of Public Instruction

The Office of the Auditor General (Office) has conducted a financial investigation of Scottsdale Unified School District's finance department for the period February 2017 through January 2018. The Office performed the investigation to determine the amount of public monies misused, if any, during that period.

The investigation consisted primarily of inquiries, observations, examination of selected financial records and other documentation, and selected tests of internal control over the District's finance department. The investigation was not conducted in accordance with U.S. generally accepted auditing standards and was more limited than would be necessary to ensure we discovered all misused public monies or to give an opinion on internal controls. Accordingly, we do not express an opinion on the effectiveness of internal controls or ensure that all deficiencies are disclosed.

The Financial Investigation Report describes our findings and recommendations as a result of this investigation.

Sincerely,

Lindsey Perry
Auditor General

Attachment

Scottsdale Unified School District Criminal Indictment—Conflict of Interest

SYNOPSIS: The Arizona Attorney General’s Office requested the Office of the Auditor General to assist in its investigation of possible conflict-of-interest violations by Laura Smith, former chief financial officer of Scottsdale Unified School District (District). Our joint investigation revealed that from February 2017 through January 2018, Ms. Smith failed to disclose her substantial interest with a district vendor, The Professional Group Public Consulting, Inc. (PGPC), and she participated in district decisions affecting PGPC. On May 8, 2018, the Arizona Attorney General’s Office presented evidence to the Arizona State Grand Jury. The action resulted in the indictment of Ms. Smith on 11 felony counts of conflicts of interest and fraudulent schemes.

Overview

Laura Smith began working for the District in February 2017 as the chief financial officer and was responsible for budget planning, financial management, business services, and internal auditing. In addition to her district employment, Ms. Smith was employed by PGPC, a for-profit corporation engaged in the business of providing consulting services to Arizona schools and public entities, including the District. The District had an ongoing contract with PGPC through a purchasing cooperative at the time of Ms. Smith’s hiring. Ms. Smith and her sister were shareholders of PGPC with respective interests of 17.72 percent and 50.63 percent. They each also held director and officer positions in PGPC, and until December 2017, Ms. Smith was PGPC’s statutory agent, which is the individual designated to receive service of process when the business is a party to a legal action.

In November 2017, the District’s general counsel retained outside legal counsel to review certain issues, including the procurement of PGPC’s services and Ms. Smith’s alleged conflict of interest with PGPC. On January 19, 2018, after outside legal counsel interviewed Ms. Smith, the District placed Ms. Smith on administrative leave, and on January 26, 2018, Ms. Smith submitted her resignation effective that day.

Ms. Smith may have engaged in conflicts of interest with a district vendor, The Professional Group Public Consulting, Inc., which paid her \$28,430

Ms. Smith failed to disclose that she and her sister were employees, directors, officers, and shareholders of PGPC—Although Ms. Smith signed a district staff conflict-of-interest form in February 2017 shortly after being hired, she made no mention of PGPC or any other substantial interest. She completed another form in May 2017 after a constituent inquired about Ms. Smith’s conflict-of-interest disclosures, yet she identified only that she was a part owner of PGPC. She failed to disclose the proportion of her ownership and that she was also an employee, director, and president. Additionally, Ms. Smith made no mention of her sister, who is also a shareholder and director, and was at the time secretary and treasurer. All these situations, including those of Ms. Smith’s sister, meet the criteria of substantial interest and should have been disclosed.

Although Ms. Smith should have known she was required to disclose her substantial interest in PGPC and refrain from participating in any district decisions affecting PGPC, she failed to do either.

Ms. Smith should have known the importance of adhering to conflict-of-interest statutes and policies. In particular, prior to becoming a district employee and during her work with PGPC, Ms. Smith conducted at least one consulting review of the District’s special education department in which she and another consultant specifically addressed whether district employees were also vendors and had conflicts of interest. Additionally, Ms. Smith was a member of the Arizona Association of School Business Officials whose Code of Ethics states, in part, that members should “Avoid conflict of interest situations by not conducting business with a company or firm in which the official or any member of the official’s family has a vested interest.”

Ms. Smith inappropriately participated in district decisions affecting PGPC—District conflict-of-interest policies specifically cite Arizona Revised Statutes (A.R.S.) §§38-501 through 511 and require that employees affirm that for any substantial interest circumstances, they will refrain from participating in any manner; however, Ms. Smith still participated in district decisions affecting PGPC. Specifically, in March 2017, Ms. Smith coordinated with her sister and several district employees concerning hiring PGPC for services involved in reviewing one of the District's construction procurements.

Further, she participated in the approval process from March through May 2017 for three change orders increasing payment thresholds for PGPC by \$8,863. All three PGPC change orders lacked the required procurement officer approval signatures, and for one change order, Ms. Smith more than doubled the purchase order amount from \$5,400 to \$11,400.

Finally, from April through October 2017, Ms. Smith participated in the approval process for six purchase orders to PGPC totaling \$43,766, two of which were improperly issued after PGPC services had already been provided. During Ms. Smith's employment with the District, the District paid PGPC \$86,733.

After accepting district employment, Ms. Smith received \$28,430 from PGPC—Ms. Smith reportedly divested herself of PGPC when she sold her PGPC shareholder interest back to the company in May 2017. However, she continued to receive payments from PGPC through January 2018 while employed by the District and participating in district decisions affecting PGPC. Specifically, in addition to the \$10,000 payment for her PGPC shareholder interest, from April 2017 through January 2018, Ms. Smith received commissions, hourly wages, and travel, mileage, and other reimbursements of \$18,004 and an Individual Retirement Account match of \$426 from PGPC.

Former district administrators established a business climate that encouraged a disregard for responsibilities associated with conflict-of-interest statutes and policies

Certain administrators, including the former superintendent and an assistant superintendent, were either already aware through general knowledge or were informed by others that when Ms. Smith was hired, she and/or her sister worked for and/or owned PGPC. Nonetheless, these administrators failed to take timely action, which allowed Ms. Smith to continue participating in district decisions affecting PGPC.

Recommendations

Although no internal control system can completely prevent inappropriate behavior such as Ms. Smith's, the following recommendations are actions district officials can take to help ensure all employees adhere to conflict-of-interest statutes and policies. Specifically, district officials should:

- Conduct annual training to ensure district conflict-of-interest policies are communicated to employees and acknowledged as received and understood.
- Ensure all employees complete and sign conflict-of-interest forms at least every year. These forms should allow for full disclosure of all substantial interests as outlined in A.R.S. §§38-501 through 511 and should require a deliberate indication of "none" if no such interest exists.
- Timely and thoroughly investigate allegations of inadequate disclosure of substantial interests and/or inappropriate participation when a substantial interest may exist.
- Flag higher-risk transactions for situations of identified conflicts of interest to ensure appropriate safeguards are taken and district policies are appropriately followed.
- Ensure compliance with the *Uniform System of Financial Records for Arizona School Districts*, which requires that purchase orders are approved before goods and services are rendered for all nonexempt expenditures.