

STATE OF MINNESOTA

Office of the State Auditor



**Rebecca Otto
State Auditor**

**INDEPENDENT SCHOOL DISTRICT 2190
YELLOW MEDICINE EAST**

PETITION ENGAGEMENT

JULY 1, 1999, THROUGH DECEMBER 31, 2004

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**INDEPENDENT SCHOOL DISTRICT 2190
YELLOW MEDICINE EAST**

July 1, 1999, through December 31, 2004



Petition Engagement

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

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**INDEPENDENT SCHOOL DISTRICT 2190
YELLOW MEDICINE EAST**

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Petitioners
Members of the School Board
Independent School District 2190
Yellow Medicine East

INTRODUCTION AND BACKGROUND

Registered voters from Independent School District 2190, Yellow Medicine East (the 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 for the period July 1, 1999, through December 31, 2004.

The District is a public corporation and part of the State of Minnesota's general and uniform system of public schools. The elected School Board is responsible for the care, management, and control of the District. A Superintendent is employed by the Board and is responsible for administrative duties. The District's financial statements are audited annually by an external audit firm.

The OSA has completed its examination into the concerns identified by the petitioners of the District. The objectives of the engagement were to address the concerns of, and to answer the questions raised by, the petitioners. Where applicable and appropriate, we make recommendations to the District in this report.

Communications with the Chief Petitioner assisted us in developing an understanding of the petitioners' areas of interest or concern. We established that some of the issues raised were not within the scope of this review.

1. Petitioners' Concern: At various Board meetings during the period of review, the Superintendent announced a number of budget cuts and budget increases. What was the net effect of the budget cuts and budget increases for each fiscal year, and which areas of the budget were affected by the changes?

Finding and Response

We reviewed the District's General Fund budgets for years ended June 30, 2003, 2004 and 2005. For the year ended June 30, 2003, the District approved a budget of \$9,859,861 on June 17, 2002, and approved subsequent budget adjustments for a net increase of \$99,449. The final budget for the year ended June 30, 2003, was \$9,940,917. The detail of original budget and the budget adjustments was not readily available to determine which areas of the budget were affected by the adjustments. For the year ended June 30, 2004, no budget amendments were reported in the District's audited financial statements. The original approved and final budget for the year was in the amount of \$9,744,629. The original approved budget for the year ended June 30, 2005, was \$9,860,223; the final budget for the year was \$10,255,170. During the year, the District approved a net budget increase of \$394,947. The areas affected by the adjustments can be determined by comparing the original line item of the budget to the final.

Presented below is detail of the budgeted expenditures by program for the General Fund taken from the District's audited financial statements for the years ended June 30, 2003, 2004, and 2005.

	<u>June 30, 2003</u>	<u>June 30, 2004</u>	<u>June 30, 2005</u>	
	<u>Final Budget</u>	<u>Original and Final Budget</u>	<u>Original Budget</u>	<u>Final Budget</u>
Expenditures				
District and school administration				
Salaries and wages	\$ 447,856	\$ 464,984	\$ 423,172	\$ 427,962
Employee benefits	106,469	117,042	98,197	98,838
Purchased services	52,150	53,050	42,660	58,460
Supplies and materials	20,950	15,380	14,380	13,280
Capital expenditures	5,000	3,400	500	500
Other expenditures	<u>18,065</u>	<u>16,752</u>	<u>17,002</u>	<u>16,602</u>
Total District and school administration	<u>\$ 650,490</u>	<u>\$ 670,608</u>	<u>\$ 595,911</u>	<u>\$ 615,642</u>
District support services				
Salaries and wages	\$ 102,310	\$ 107,210	\$ 106,259	\$ 109,594
Employee benefits	23,210	24,639	24,231	24,935
Purchased services	28,900	29,300	48,750	48,750
Supplies and materials	3,500	4,300	2,900	2,900
Capital expenditures	21,000	19,037	500	500
Other expenditures	<u>650</u>	<u>600</u>	<u>570</u>	<u>570</u>
Total District support services	<u>\$ 179,570</u>	<u>\$ 185,086</u>	<u>\$ 183,210</u>	<u>\$ 187,249</u>

	<u>June 30, 2003</u>	<u>June 30, 2004</u>	<u>June 30, 2005</u>	
	Final Budget	Original and Final Budget	Original Budget	Final Budget
Regular instruction				
Salaries and wages	\$ 3,499,237	\$ 3,337,951	\$ 3,076,968	\$ 3,158,123
Employee benefits	731,297	770,585	725,769	718,894
Purchased services	238,250	239,719	232,199	252,999
Supplies and materials	204,659	168,560	196,722	166,845
Capital expenditures	86,145	71,520	27,000	303,277
Other expenditures	44,775	35,840	36,390	34,090
Total regular instruction	<u>\$ 4,804,363</u>	<u>\$ 4,624,175</u>	<u>\$ 4,295,048</u>	<u>\$ 4,634,228</u>
Vocational instruction				
Salaries and wages	\$ 105,702	\$ 58,369	\$ 72,401	\$ 60,971
Employee benefits	17,246	11,484	13,095	9,422
Purchased services	14,100	13,300	13,300	43,300
Supplies and materials	35,400	39,500	48,000	48,000
Capital expenditures	2,500	1,000	1,500	1,500
Other expenditures	5,000	2,400	3,000	3,000
Total vocational instruction	<u>\$ 179,948</u>	<u>\$ 126,053</u>	<u>\$ 151,296</u>	<u>\$ 166,193</u>
Exceptional instruction				
Salaries and wages	\$ 154,692	\$ 197,424	\$ 198,608	\$ 184,088
Employee benefits	29,870	43,347	41,356	36,025
Purchased services	1,353,800	1,445,700	1,462,700	1,468,900
Supplies and materials	1,800	1,450	1,450	1,450
Capital expenditures	5,000	500	-	-
Total exceptional instruction	<u>\$ 1,545,162</u>	<u>\$ 1,688,421</u>	<u>\$ 1,704,114</u>	<u>\$ 1,690,463</u>
Instructional support services				
Salaries and wages	\$ 151,447	\$ 147,349	\$ 121,279	\$ 144,471
Employee benefits	38,593	36,767	36,766	38,704
Purchased services	49,300	49,500	51,750	51,050
Supplies and materials	19,700	17,050	23,550	17,050
Capital expenditures	38,000	62,200	55,900	62,400
Other expenditures	2,000	1,500	1,300	1,300
Total instructional support services	<u>\$ 299,040</u>	<u>\$ 314,366</u>	<u>\$ 290,545</u>	<u>\$ 314,975</u>

	June 30, 2003	June 30, 2004	June 30, 2005	
	Final Budget	Original and Final Budget	Original Budget	Final Budget
Pupil support services				
Salaries and wages	\$ 196,895	\$ 127,490	\$ 159,640	\$ 194,524
Employee benefits	36,906	22,849	33,263	36,914
Purchased services	773,681	785,100	735,700	679,445
Supplies and materials	20,375	17,600	15,500	17,400
Capital expenditures	32,581	1,000	3,000	3,000
Other expenditures	12,100	200	200	2,232
Total pupil support services	\$ 1,072,538	\$ 954,239	\$ 947,303	\$ 933,515
Site, buildings, and equipment				
Salaries and wages	\$ 361,996	\$ 371,912	\$ 350,129	\$ 361,804
Employee benefits	92,360	98,560	91,846	91,305
Purchased services	276,500	306,009	301,974	296,974
Supplies and materials	165,900	173,700	191,200	190,200
Capital expenditures	199,800	154,500	608,500	642,700
Debt services	39,500	-	-	-
Other expenditures	3,750	400	500	500
Total site, buildings, and equipment	\$ 1,139,806	\$ 1,105,081	\$ 1,544,149	\$ 1,583,483
Fiscal and other fixed cost programs				
Interest	\$ -	\$ -	\$ 70,157	\$ 55,922
District insurance	70,000	76,600	78,500	73,500
Total fiscal and other fixed cost programs	\$ 70,000	\$ 76,600	\$ 148,657	\$ 129,422
Total Expenditures	\$ 9,940,917	\$ 9,744,629	\$ 9,860,233	\$ 10,255,170

- Petitioners' Concern: The District entered into contracts with the National School Fitness Foundation (NSFF) to purchase fitness equipment. What was the dollar amount of the contracts for equipment? Which fund(s) made payments on the debt issued for the purchase? Did the District comply with applicable Minnesota statutory requirements for contracting? What are the annual principal and interest payments from inception to the retirement of the note?

Finding and Response

A. Execution of the NSFF Agreements

According to the U.S. Department of Justice, from 1999 to May 2004, NSFF marketed and sold fitness programs and equipment to school districts across the nation. (*See* Appendix C.) Throughout the fraud scheme, NSFF promised school districts that they could obtain the fitness equipment “free” based on NSFF repayments to schools with funds raised through government grants and private donations. Based on these false representations, school districts obtained financing from banks to purchase the fitness equipment. NSFF failed to disclose to schools, however, the almost complete lack of fund raising and the company’s precarious financial condition. Instead, NSFF operated a Ponzi-type scheme in which prior school districts were almost exclusively repaid using funds obtained from subsequent school districts.

B. The School District’s Contract with NSFF

The District’s Business Manager and each of the respective school principals separately signed agreements dated January 9, 2004, with NSFF to purchase fitness equipment. The School Board voted and passed a motion to participate in the NSFF program on January 12, 2004.

On February 9, 2004, the School Board adopted a resolution for the District to enter into a lease purchase agreement for fitness equipment provided by NSFF, pending approval of the District’s attorney. The resolution approved by the District authorizing the lease purchase directed the Board Chair and Clerk to execute the lease. With the execution of the lease on February 27, 2004, funds would be released to NSFF, and the contract would be binding.

C. Warning from the Attorney General

Earlier that month, on February 5, 2004, the Minnesota Attorney General, Mike Hatch, wrote to the Commissioner of the Department of Education and the State Auditor, and a copy of the letter was sent to every school district in the State of Minnesota. (*See* Appendix A.) The letter warned about the risk of entering into contracts with NSFF. The Attorney General pointed out that NSFF tells school districts the equipment is “free” because NSFF will use government and corporate grants to reimburse school districts for the costs of the equipment and program. Based on NSFF’s own claims by Fall 2001, NSFF had sold between \$100 million and \$125 million worth of equipment programs to school districts. However, NSFF’s tax filing for the year ended June 30, 2002, showed no income at all from government grants. NSFF failed to file Form 990 for the year ended June 30, 2003. NSFF claimed it had an extension until February 15, 2004, to file this form. In his warning, the Attorney General reviewed six issues, including:

Second, school districts should require proof of NSFF's funding before entering any agreement. NSFF's most recent Form 990 shows no government grant income. School districts should carefully examine NSFF's 2003 Form 990 when it is filed with the IRS later this month [February 2004] to see if that revenue was received. School districts should also request a copy of a financial audit from NSFF as well as a list of its funding sources. (Appendix A, page 3)

The District's attorney brought to the District's attention the same financial concern regarding NSFF. In a letter dated February 5, 2004, the District's attorney wrote to the School Board:

Until recently, NSFF has been recommending Wells Fargo Brokerage Services of Salt Lake City ("Wells Fargo") as the finance company for the Program. However, Wells Fargo has informed us that it will no longer do business with NSFF. Wells Fargo has apparently been requesting copies of audited financial statements from NSFF since December 2002, which NSFF has been unwilling to provide. While Wells Fargo's decision does not prevent the District from financing the Program elsewhere, it does raise a red flag. (Appendix B, page 5)

The District did not obtain any additional financial information from NSFF as recommended by the Attorney General. The District did not wait until later in February when NSFF said it would be filing its federal income tax. The School Board minutes show no discussion regarding these two warnings received from the Minnesota Attorney General and its own attorney. Instead, the Superintendent and the Clerk proceeded and signed a commercial lease on February 27, 2004, which released funds to NSFF.

The correspondence from the Attorney General warned school districts that the equipment sold by NSFF was worth about one-third of its price. This would mean that the equipment purchased by the Yellow Medicine East School District under the \$668,671 contract was really worth \$222,890. By signing the lease purchase in February, the District made sure NSFF received its payment up front, while the payments by the District to the local bank would continue for 36 months.

D. District Fund Making Payments on Lease

Account code 01 E 005 240 000 302 535 (Program 240 - Health/Physical Education/Recreational, Finance 302 - Capital Expenditure, Object 535 - Capital Leases) of the General Fund has been used for the lease payments. Through June 2006, a total of \$436,703.75 was paid to Yellow Medicine County Bank for the fitness equipment lease. After two lease modification agreements and a bank write-off of \$155,303.06, a June 2007 payment of \$100,000 will satisfy the lease. Provisions of the arrangement with NSFF included NSFF agreeing to make a monthly "charitable

contribution” to the District equal to the District’s lease purchase payments for the term of the lease. This promise was conditional on NSFF actually receiving grant money in order to make “charitable contributions” to the District and as pointed out in the Attorney General’s February 5, 2004, letter, federal tax documents indicated that NSFF had not received any grant amounts. NSFF reimbursed the District for only one month’s lease payment (\$19,678.52 in March 2004) and did not make the agreed-upon contributions for the remaining 35 months of the original lease.

E. Annual Principal and Interest Payments from Inception to the Retirement of the Note

Following are fitness equipment lease payments made by the District to Yellow Medicine County Bank:

<u>District Check Number</u>	<u>District Check Date</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
3062	03/15/04	\$ 18,267.69	\$ 1,410.83	\$ 19,678.52 *
3296	04/12/04	17,591.49	2,087.03	19,678.52
3532	05/10/04	17,647.93	2,030.59	19,678.52
3824	06/21/04	17,704.55	1,973.97	19,678.52
3984	07/19/04	1,754.22	1,245.78	3,000.00
4224	08/09/04	1,757.87	1,242.13	3,000.00
4447	09/13/04	1,761.53	1,238.47	3,000.00
4690	10/11/04	1,765.20	1,234.80	3,000.00
4936	11/08/04	1,768.88	1,231.12	3,000.00
5180	12/13/04	1,772.57	1,227.43	3,000.00
5358	01/10/05	1,776.26	1,223.74	3,000.00
5575	02/14/05	1,779.96	1,220.04	3,000.00
5775	03/14/05	1,783.67	1,216.33	3,000.00
5959	04/11/05	9,117.27	1,212.62	10,329.89
6156	05/09/05	9,136.27	1,193.62	10,329.89
6376	06/13/05	9,155.30	1,174.59	10,329.89
6394	06/27/05	200,000.00	-	200,000.00
9828	06/12/06	100,000.00	-	100,000.00
		<u>\$ 414,540.66</u>	<u>\$ 22,163.09</u>	<u>\$ 436,703.75</u>

* - District was reimbursed by National School Fitness Foundation with a check dated 03/25/04.

F. Federal Conviction - NSFF

On December 4, 2006, the Chief Executive and Board Chair of NSFF were convicted in Federal Court in Minneapolis of 29 counts, including mail fraud, bank fraud, money laundering, and conspiracy. During the trial, the prosecutors argued that the defendants operated a Ponzi-type scheme, defrauding more than 600 schools nationwide to acquire equipment. Guilty pleas were obtained from three other individuals connected with the fraud.

Unlike Yellow Medicine East School District, the vast majority of defrauded school districts did not receive a warning from the state attorney general and their own attorney before entering into a binding agreement with NSFF. The District proceeded in spite of receiving these warnings about NSFF's suspicious financial situation. The Board did not discuss these warnings from the Attorney General and its own attorney before the signing of the final contract releasing money to NSFF. Ignoring the Attorney General's advice, the District did not wait until the end of the month to review NSFF's 2003 federal tax filing. If it had waited, it might have avoided obligating itself to pay \$668,671 in taxpayer money for equipment worth an estimated \$222,890.

3. Petitioners' Concern: The District awarded bids for the construction of a new all-weather track in May 2004. Did the District accept the lowest responsible bids? Were the contracts awarded in compliance with other Minnesota statutory requirements? What was the nature of cost overruns, if any, and were all payments for overruns approved by the Board? Which fund(s) paid the contractors? What was the total cost of the track project? Was debt issued to pay for the track?

Finding and Response

The District accepted bids from Duininck Brothers and A-1 Track and Tennis for the construction of the all-weather track. The accepted Duininck Brothers bid was the only bid for that portion of the project. The accepted A-1 Track and Tennis bid was the lowest of five bids received.

The following items were tested for legal compliance for both of the awarded contracts:

- specifications on file,
- low bid accepted or a reasonable explanation why it was not documented in the minutes,
- notice published in legal newspaper for the required two weeks,
- an abstract of proposals kept,
- an original contract in writing signed by both parties on file,
- performance and payment bonds received for the amount of the contract, and
- Form IC-134 certified by Minnesota Department of Revenue received before final payment made to the contractor.

No issues of statutory noncompliance were noted. The only issue noted with the awarding of the bids was that the Board minutes from May 10, 2004, do not state the number of bids, the bidders, the amounts of the contracts awarded, how many other bids were received (if any), or if the contracts were awarded to the lowest responsible bidder. To ensure compliance with Minnesota statutes regarding contracting, disbursements, and other areas, a complete and detailed record of District meetings should be maintained.

The contract with Duinink Brothers had four change orders to the original bid. The change orders were for the following reasons: change 12" to 15" pipe and install 60" manhole; catch basin adjustments and miscellaneous items; top soil; and rock encountered for fence and goalpost. The first three change orders were approved by the Board in the minutes on June 21, 2004, and July 19, 2004. Board approval for change order #4 (in the amount of \$4,140) could not be found in the Board minutes. Payment for change order #4 was part of the final payment to Duinink Brothers for the project.

Account codes 01 E 005 850 102 000 305 (Program 850 - Capital Facilities, Course 102 - Track, Object 305 - Professional Fees/Services/Contracts) and 01 E 005 850 102 000 511 (Object 511 - Capital - Site or Grounds improvements or acquisitions) of the General Fund were used to pay for the contractor's work on the projects. Duinink Brothers was paid a total of \$441,145.26, and A-1 Track and Tennis (also Sport Surfaces and California Products) was paid a total of \$57,985. In addition, Larson Engineering of Minnesota was paid \$56,000 to serve as project managers.

On April 12, 2004, the District adopted a resolution to execute a lease purchase agreement with Wells Fargo for the track project. The District owes Wells Fargo Brokerage Services semi-annual payments of \$27,960.67 through May 18, 2014, to repay the \$450,000 obligation of the District.

4. Petitioners' Concern: The District leases space in the Kilowatt Community Center, which is owned by the City of Granite Falls. How much does the District pay annually? Does a lease purchase agreement exist whereby the District is assuming ownership of the Kilowatt Community Center from the City? If so, does the agreement call for the school to assume the related debt of the Center? If a lease purchase agreement exists, what are the terms of the lease and the annual payments due to the City?

Finding and Response

The District leases space in the Kilowatt Community Center at an hourly rate. A lease purchase agreement does not exist. From July 2002 through June 2005, the District paid a total of \$61,772.20 to the Kilowatt Community Center.

5. Petitioners' Concern: What were the amounts of administrative salaries, including benefits and per diem, for the Superintendent, Principals, Dean of Students, and Athletic Director/Community Education Director for the 2003 and 2004 fiscal years? Why do the salaries of the aforementioned positions differ when comparing the District's report, the Minnesota Department of Education's school report card, and the OSA report?

Finding and Response

A. Administrative Salaries and Benefits

The table below displays the total gross pay, employer-paid benefits, and other expenses for the individuals holding the titles of Superintendent, Principal, Dean of Students, and Athletic Director/Community Education Director during the 2003 and 2004 fiscal years.

Total gross pay includes all salary types the individual was paid, including contracted salary, coaching, officiating, working at extracurricular events, retroactive pay adjustments, leave time pay-offs, long-term disability payments, and extra hours, less any docked pay.

Employer-paid benefits include the District's share of health, life, and dental insurances; pension contributions; and payroll taxes. The District did not offer any unique fringe benefits, such as car allowances, cash allowances, golf memberships, or health club memberships to any employees during the 2003 and 2004 fiscal years.

Other expenses include all payments to the individual that did not go through the District's payroll system, including, but not limited to, meals, mileage, conference registration, and supplies or equipment reimbursements.

<u>Fiscal Year 2003</u>	<u>Position</u>	<u>Gross Pay (a)</u>	<u>Employer-Paid Benefits (a)</u>	<u>Other Expenses (b)</u>	<u>Total</u>
Scott Staska	Superintendent	\$ 30,787.70	\$ 5,258.61	\$ 455.35	\$ 36,501.66
Steve Kjorness	Superintendent	9,450.00	722.93	1,215.00	11,387.93
Dwayne Strand	Super/Principal	80,581.52	20,038.48	4,838.81	105,458.81
Karen Norell	Principal	81,517.12	20,497.13	-	102,014.25
Dan Halvorson	Principal	3,495.60	442.20	88.33	4,026.13
David Brokke (d)	Athletic Director	84,093.29	22,620.25	2,877.92	109,591.46
David Guertin	Dean of Students	66,728.86	12,988.03	448.20	80,165.09
Dehli Consulting	Principal	-	-	28,170.00	28,170.00

		<u>Gross Pay (a)</u>	<u>Employer-Paid Benefits (a)</u>	<u>Other Expenses (b)</u>	<u>Total</u>
<u>Fiscal Year 2004</u>					
Dwayne Strand	Superintendent	93,059.80	19,583.11	4,253.30	116,896.21
Karen Norell	Principal	78,932.12	21,201.37	283.22	100,416.71
Joey Page	Principal	68,777.00	18,184.67	4,080.32	91,041.99
David Brokke (d)	Athletic Director	86,649.56	17,992.30	2,145.87	106,787.73

- (a) Source of data: "Labor Distribution Report - Employee Key Order" on file in District's office
(b) Source of data: "Check Summary (Dates: 07/01/02 - 06/30/04)" search by vendor on District's accounting system
(c) Source of data: "Account Distribution Report - Detail History" on file in District's office
(d) David Brokke was both the Athletic Director and the Community Education Director

Scott Staska began the 2003 fiscal year as Superintendent but resigned and was released from his contract to accept a similar position with a different school district. Steve Kjorness was hired as Interim Superintendent.

Dwayne Strand was a Principal at the beginning of the 2003 fiscal year and became Superintendent when the School Board approved a three-year Superintendent contract with him during December 2002.

Dan Halvorson left the District at the beginning of the 2003 fiscal year.

During the 2003 fiscal year, David Guertin was part-time Dean of Students and part-time teacher. The amounts included in the totals above are the combined total for all pay types, not just earnings for the Dean of Students position. Guertin remained with the District for fiscal year 2004 but did not hold the Dean of Students title.

After Strand was named Superintendent, the District contracted with Dehli Consulting for Rosie Dehli to serve as Interim Elementary Principal.

B. Differences in the Reports

The salary expenditures in the OSA report were obtained from the Minnesota Department of Education (MDE). For the OSA report, the total salary for each position was a combination of salary expenditures for that position from all District funds.

6. Petitioners' Concern: Transportation - Were advertisement for bids done correctly?

Finding and Response

Bus services contracts do not need to be bid because they do not fit the definition of a contract under the state bidding law, Minn. Stat. § 471.345. The contracting methods of direct negotiation, obtaining quotes, or bidding would all be available to the District when contracting for bus services. Minn. Stat. § 123B.52, subd.3.

7. Petitioners' Concern: What is the student/teacher ratio, including the aides, broken down per site, H.R. Hagg Elementary, Bert Raney Elementary, YME Jr. High, and YME Sr. High?

Finding and Response

The MDE maintains on its website a data download menu. Data regarding the number of licensed teachers is broken down by buildings within a school district. Student enrollment information by school district building is also maintained at the site, and the teacher per student ratio can be determined by dividing the number of students at the building by the number of licensed teachers. Data on this site includes school years back to 1989.

8. Petitioners' Concern: Is the student tracking done correctly as it relates to the lunch programs? Which school gets credit for subsidized lunches when students are transported from one location to another (for example, Granite Falls or Clarkfield when students are bused from Granite Falls to Clarkfield)? In addition, why do the school enrollment figures for the 2004 school year differ between the District's report, MDE report, and the OSA report?

Finding and Response

A. Tracking of Lunch Programs

The OSA received a document titled "YME Food Service Procedures" from the District office. The District tracks food service expenditures by site but tracks revenues as a whole. When a check is received from a family for lunches, that family may have students in different locations/schools, and it would be nearly impossible to know which student is using the lunch ticket.

B. Reasons for Differences in Enrollment Data in the OSA's Report

The District's enrollment data in the OSA report was obtained from the MDE. The Average Daily Membership (ADM) and the Pupil Units (PUN) were computed based on the year-end data the District reported to the MDE. The ADM count the OSA used did not include two categories of students that the MDE now uses. The MDE includes residents of other states/countries and contract alternative students. Because the OSA examined trends over five years, a single ADM calculation definition was used over the period to maintain uniformity.

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 for the information of the petitioners of Independent School District 2190, Yellow Medicine East, 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

April 5, 2007

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APPENDICES

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STATE OF MINNESOTA

OFFICE OF THE ATTORNEY GENERAL

MIKE HATCH
ATTORNEY GENERAL

February 5, 2004

102 STATE CAPITOL
ST. PAUL, MN 55155-1002
TELEPHONE: (651) 296-6196

The Honorable Patricia Anderson
State Auditor
Suite 500
525 Park Street
St. Paul, MN 55103

The Honorable Cheri Pierson Yecke
Commissioner
Department of Education
1500 Highway 36 West
Roseville, MN 55113

Dear Auditor Anderson and Commissioner Yecke:

This Office recently received several inquiries concerning the solicitation of Minnesota school districts by a Utah nonprofit called the National School Fitness Foundation ("NSFF"). NSFF offers school districts "free" fitness equipment. The school districts, however, must obligate themselves to pay for the equipment through contracts with NSFF's for-profit supplier. NSFF then agrees to give the school districts grants to cover the amount they paid to the for-profit.

School districts should consider the following financial risks before entering into the contracts described below.

BACKGROUND

NSFF is a nonprofit organization organized under Utah law. *Ex. 1.* It is not registered with the Minnesota Secretary of State's Office. According to its website (www.nsff.net), NSFF was founded in March 2002 to promote fitness in schools. NSFF operates as a charitable organization under section 501(c)(3) of the Internal Revenue Code. *Ex. 2* (NSFF website). NSFF markets a fitness program for elementary and secondary schools called LIFT (Leadership in Fitness Training) America. *Id.* As part of LIFT America, NSFF states that it will provide schools with fitness equipment. *Ex. 3* (NSFF website). It also claims to provide staff training, a physical education curriculum, and an information system for assessing students progress in becoming more physically fit. *Id.* NSFF asserts that the LIFT America equipment and program is valued at more than \$300,000 for secondary schools and more than \$180,000 for elementary schools. *Ex. 2.* NSFF claims on its website that a dozen Minnesota school districts participate in the LIFT America program. *Ex. 3.*

NSFF claims tremendous growth in its two years of existence. In the fall of 2001, according to press reports, NSFF marketed its program to 17 schools. NSFF now claims to operate its programs in 500 schools in 18 states. *Ex. 2.* If each NSFF program sold for \$200,000 to \$250,000, this sales rate would result in income for NSFF of between \$100,000,000 and \$125,000,000.

NSFF tells school districts that its equipment and program is “free” because NSFF will use government and corporate grants to reimburse them for the costs of the equipment and program. NSFF’s most recent federal Form 990 tax filing for the fiscal year ending June 30, 2002, however, shows no revenue from government grants. *Ex. 4.* NSFF has failed to file its Form 990 tax filing for fiscal year ending June 30, 2003. NSFF states that it received from the IRS an extension until February 15, 2004 to file its 2003 Form 990.

CONTRACTS WITH SCHOOL DISTRICTS

To obtain the fitness equipment, NSFF requires the school district to enter into a series of contracts, which are discussed below.

One contract is a sales agreement between the school district and School Fitness Systems, LLC (“SFS”), the “authorized distributor” for NSFF. *Ex. 5.* SFS is a Utah for-profit corporation located in American Fork, Utah, the same city as NSFF. *Ex. 6.* SFS is not registered to do business in Minnesota. Under the sales agreement, a school district must pay in full to SFS the total purchase price for the equipment program. *Ex. 5, ¶ 7.* In the example provided, the school district agreed to pay \$219,000 to SFS. *Ex. 5.*

A school district also is required to execute a contract with NSFF. *Ex. 7.* Under this contract, NSFF agrees to make monthly payments, designated as “charitable contributions,” to the district. *Id.*, ¶ 5a. For school districts that finance the acquisition of the equipment program, the monthly “charitable contribution” to be provided to the school district by NSFF equals the monthly payment made by the district under a separate finance agreement. If a school district does not utilize a separate financing agreement, NSFF agrees to pay the district one-thirty-sixth of its purchase price each month. *Id.*, ¶ 5c. NSFF is relieved of its obligations if the school district is in default on the Participation Agreement (described below) or on the financing agreements. *Id.*, ¶ 5b. In the event of default by NSFF, a school district’s exclusive remedy is limited to the balance of the funds due by NSFF under the contract or the amount remaining in the district’s fiscal year or biennium, *whichever is less.* *Id.*, ¶¶ 13 e & f. In other words, if there were only one month remaining in a school district’s biennium, the district’s remedy would be limited to one month’s payments, even if the term of the agreement extended another two years, or through the next biennium. Furthermore, this limited recourse applies only against NSFF, the nonprofit, and not SFS, the for-profit to which the district has to make its payments. The contract forces the district to acknowledge that SFS, the for-profit supplier, is an independent business and not an employee, joint venturer, or partner of NSFF. *Id.*, 7, ¶ 12b.

A participating school must also enter a School Participation Agreement, which sets forth the school district’s obligations to operate the NSFF program, including staffing, record keeping,

and data sharing with NSFF. *Ex. 8*, ¶¶ 2, 6, 13; *Exh. B-1 (License Requirements)*.¹ The school district must implement certain curriculum provided by NSFF and maintain and repair the fitness equipment. *Id.*, ¶ 8; *Exh. B-1*.

Based upon the information we received, it appears that many districts finance the NSFF program through a lease-purchase agreement. Under one such agreement, a school district borrowed funds to pay for the LIFT America equipment and agreed to repay the amount, with interest, over a three-year period. *See, e.g., Ex. 9*. In the attached NSFF agreement, the school district acknowledges that it is solely responsible for making the payments on the lease-purchase agreement, even if NSFF fails to make its monthly reimbursements to the school district. *Ex. 7*, ¶ 4e. I am told that other districts have entered into similar agreements.

ISSUES FOR CONSIDERATION

As discussed below, we believe that school districts should exercise extreme caution before entering into the above-described arrangements.

First, there is a significant financial risk to school districts if NSFF does not raise sufficient funds to meet its promise to reimburse school districts that participate in the program. Based on the number of participating school districts it claimed on its website, NSFF must raise more than \$100 million from government and private sources to meet its current commitments. This is an enormous amount of money. Furthermore, as NSFF signs up additional school districts, it must raise even larger amounts of money. If NSFF fails to meet its commitment, a school district's remedies against NSFF are very limited. At most, a district could recover payments due through the end of the biennium. *Ex. 7*, ¶ 13f. At worst, NSFF would not have sufficient assets to make even those payments.

Second, school districts should require proof of NSFF's funding before entering any agreement. NSFF's most recent Form 990 shows no government grant income. School districts should carefully examine NSFF's 2003 Form 990 when it is filed with the IRS later this month to see if that revenue was received. School districts should also request a copy of a financial audit from NSFF as well as a list of its funding sources. Similarly, school districts should obtain financial records from SFS, and its agreements with NSFF, so that the districts understand all of the financial arrangements in these transactions. School districts should also demand full disclosure of any relationships between NSFF, SFS and their respective principals.

Third, I understand that some school districts finance the LIFT America program through a lease-purchase agreement. Under Minn. Stat. § 465.71, a lease-purchase is limited to the

¹ Exhibit 8 also includes a Community Participation Agreement detailing district responsibilities if the fitness equipment is used by the public, as well as other NSFF documents detailing district responsibilities.

purchase of personal property and is subject to the competitive bidding requirements of Minn. Stat. § 471.345. We have been advised that the true market value of the physical equipment being sold by NSFF (\$75,000) is only one third of the total purchase price being charged by NSFF to the school district (\$200,000-\$250,000). The remainder of the program price is purportedly used to purchase training materials. I understand that some school districts have considered the program to be exempt from these bidding requirements because the program includes more than personal property. If the purchase is exempt from bidding because it involves more than personal property, however, then questions are raised as to whether the program may be financed through a lease arrangement under Minn. Stat. § 465.71. The lease-purchase authority of Minn. Stat. § 465.71 is limited to real and personal property. If, on the other hand, the program is considered a purchase of personal property, the contract is likely subject to bidding laws under Minn. Stat. § 471.345.

Fourth, under Minn. Stat. § 465.71, a lease-purchase agreement must allow termination at the end of the fiscal year. This may provide some protection to school districts if the lease-purchase agreement meets the requirements of Minn. Stat. § 465.71. A school district is still liable, however, for payments for the remainder of the fiscal year in the event of default by NSFF.

Fifth, the NSFF agreement contemplates that school districts will share educational and medical information about students with NSFF. I am aware that at least some school districts have been working with legal counsel to ensure that such a sharing of private student information complies with the Minnesota Data Practices Act, Minn. Stat. § 13.32, and the federal Family Educational Privacy Rights Act, 20 U.S.C. § 1232g; 34 C.F.R. 99. School districts should always be concerned about sharing such sensitive information with outside parties and must comply with the privacy requirements of state and federal law.

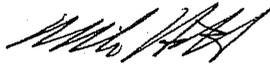
Finally, and most importantly, school districts need to adhere to the old adage that "if it sounds too good to be true, it probably is." In this case, the for-profit corporation is selling \$75,000 of equipment (with a wholesale cost much less to the corporation) in exchange for a \$200,000 commitment by the school district. The school district is told that a non-profit corporation will reimburse the school district. Rather than having the non-profit corporation directly pay the for-profit corporation, however, agreements are carefully drawn so that the school district is responsible to pay the for-profit corporation even if the non-profit corporation does not contribute funds to the school district. This arrangement raises several questions:

1. What is the incentive of the non-profit corporation to make contributions to purchase fitness equipment at a price considerably above the market price?
2. From whom does a newly formed non-profit corporation raise hundreds of millions to finance the sales?

3. Why is the for-profit corporation selling the equipment at a price considerably above market?
4. Why does the non-profit corporation state it receives government grants when no government revenue is disclosed on the Form 990's it has filed with the IRS?

I ask that each of you carefully review this matter and if you have similar concerns about the program, I ask that you take whatever steps are needed to safeguard the financial assets of Minnesota schools.

Very truly yours,



MIKE HATCH
Attorney General
State of Minnesota

MAH/rlh

Attachments

cc: Minnesota School District Superintendents

AG: #978160-v1

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February 5, 2004

**CONFIDENTIAL AND PROTECTED BY
ATTORNEY/CLIENT PRIVILEGE**

Dwayne Strand
Superintendent
Independent School District No. 2190 - Yellow Medicine East
450 9th Avenue
Granite Falls, MN 56241-1399

RE: *Review of NSFF Agreements*
Our File No. 2190-0001

Dear Superintendent Strand:

In a recent letter you asked for our opinion regarding the National School Fitness Foundation Program ("NSFF"). We have reviewed the Agreements that the District will be asked to sign if it decides to go forward with the NSFF Program. These include the NSFF Fitness Program and Contribution Agreements, School Participation Agreements, Community Use Agreements, and Sales Agreements for each of the School District's four schools. In the course of reviewing these same Agreements on behalf of several of our other clients, we have identified a number of concerns with the Agreements and have negotiated changes to the Agreements that address some of these concerns. Below we analyze the legal and practical concerns raised by the NSFF Program Agreements and discuss our negotiations with NSFF to date.

As an initial matter, we note that in late November we learned that the State Auditor's Office had been making inquiries regarding the NSFF Program. We do not know what, precisely, about the NSFF Program the Auditor intends to investigate. During our conversation with the responsible investigator in the Auditor's office, the investigator

expressed interest in NSFF's financial status, how the Program is being financed by participating school districts, and whether the Agreements are subject to Minnesota's Public Bid law. Our analysis of these issues is also included below.

A. NSFF's Use of Student Data

NSFF is a Utah-based not-for-profit organization that was founded in 2000. The NSFF Program Agreements create a framework whereby NSFF makes contribution payments to the District over a three-year period to refund the cost of the purchase of the NSFF Fitness Program. The Program consists of certain fitness equipment, proprietary curricular materials, and staff training. As part of the Program, NSFF collects health data regarding students who use the equipment. It is our understanding that NSFF funds its operations and contribution payments in part by selling this health data. NSFF also gathers federal grant money on behalf of participating schools.

In the course of our negotiations with NSFF, we have raised several concerns regarding its use of student health data. These concerns arise primarily under the Minnesota Government Data Practices Act ("MGDPA"). As explained below, NSFF has been willing to adopt the majority of our proposals to bring the Agreements into line with the MGDPA.

First, the MGDPA requires that if a government entity contracts with a private party to perform any of its functions, the government entity shall include in the contract terms that make it clear that all of the data created, collected, received, stored, used, maintained, or disseminated by the private person in performing those functions is subject to the requirements of the MGDPA and that the private person must comply with those requirements as if it were a government entity. As a result, the Agreements should be amended to account for this obligation under the MGDPA. For example, section 7 of the School Participation Agreements could be amended to include subsection d, providing the following:

NSFF agrees that insofar as User Health Data created, collected, received, stored, used maintained or disseminated by NSFF pursuant to this Agreement is subject to the requirements of the Minnesota Government Data Practices Act, Minn. Stat. Ch. 13, NSFF will comply with those requirements as if it were a government entity.

Second, the MGDPA establishes the presumption that all information maintained by school districts is public data accessible to the public for inspection and copying unless there is a federal law, state statute, or temporary classification classifying the data as not public. While there is no classification that would clearly make NSFF's proprietary materials not-public data, an argument can be made that those materials are "trade secrets" within the meaning of the Act and consequently are not public. Nevertheless, if anyone requests to review and/or copy the

NSFF proprietary materials within the District's possession, the District may be required to permit them to do so. To allow for this possibility, the Addendum negotiated with NSFF includes amendments to the Agreements which allow the District to release those proprietary materials that are public, but requires the District to advise NSFF prior to copying or disclosure and to cooperate with and assist NSFF, at NSFF's cost and expense, if NSFF seeks relief from disclosure.

Third, as we note above, NSFF funds its programs in part by selling health data to the health care and exercise equipment industry. So long as this data is "summary data" that does not identify individual students, this arrangement is not prohibited by the MGDPA. However, the District faces potentially significant liability if NSFF improperly releases individually identifiable student data. Considering that student data is gathered by NSFF's proprietary equipment, it will be difficult for the District to monitor whether the data is, in fact, de-individualized. Accordingly, the Contribution Agreements should be amended to include a provision whereby NSFF would indemnify the District for any claims arising from NSFF's collection, maintenance and use of student information. For example, a paragraph could be added to Section 17 of the Contribution Agreements providing the following:

NSFF shall indemnify, defend and hold harmless the District and its Board, employees and agents from and against any and all claims which may be made against or sustained or incurred by the District or its Board, employees or agents as a result of NSFF's breach of any duty related to the creation, collection, receipt, storage, use, maintenance or dissemination of Protected Health Information and/or User Health Data.

However, NSFF has recently indicated that it may now be unwilling to include such an indemnification provision in any future agreements.

NSFF recently made changes to the terms of the Agreements that have additional legal implications under the MGDPA and also heighten certain practical considerations. Under earlier versions of the Program Agreements, students were to be issued electronic keys to automatically track their progress on the Program equipment. Apparently NSFF was unsatisfied with the key system developed by one of its equipment vendors and dropped this aspect of the Program. Although we have not viewed the actual equipment and cannot, therefore, describe in detail how it works, our understanding is that student participants and staff will now be required to take a more hands-on role in entering student data. Ostensibly in order to make it easier for school staff to manage and track student data, NSFF amended the Agreements to require that NSFF and one of its vendors would have access to student data, identified by student name. The definition of "User Health Data" in section 1.q. of the Contribution Agreements includes each User's name.

There are arguments that, with some modifications to the Agreements, the sharing of student names would not violate the MGDPA. For example, the Agreements could be structured so that names were shared for the purpose of NSFF or its vendor to prepare summary data on behalf of the District, which would be authorized under the MGDPA. It is our understanding that this is how NSFF envisioned the proposed change. For some of our clients, however, the sharing of student names has been a deal-breaker, and NSFF has so far been willing to back down from this requirement, requiring instead that participating schools assign random ID numbers to Program participants.

We note that NSFF's collection and use of student information may create negative political fallout for the District. Even if data about students is de-individualized, we can envision parents and other community members being uncomfortable with a program that gathers health information about students and then sends that information off to another state to be researched and sold. We imagine that this level of discomfort could rise if the District were sharing individually identifiable data with NSFF, even if it were doing so in a manner consistent with the MGDPA. While these are not legal bars to the Agreements, they are practical considerations that we believe the District may want to consider.

B. NSFF's Contribution Payments and Remedies for Default

The District may purchase the Program and equipment using existing funds or may acquire financing for the Program with NSFF's assistance. Once financing is obtained, NSFF makes monthly contributions to the District over a three-year period to reimburse the purchase price or the financing payments.

If the District does not meet the conditions specified in the agreement, NSFF is not obligated to continue making monthly contributions and the District will be responsible for the remainder of the financing payments. We note that the Agreements are written with so many provisos and conditions that it would be easy for the District to go inadvertently into default. In our negotiations, NSFF has been largely unwilling to change the manner in which the Agreements are written, explaining that it is their policy to minimize costs by using standardized forms to which they only allow minor modification by addendum.

Further, NSFF does not guarantee its contributions. The sole remedy to the District should NSFF default on its contribution obligation is a liquidated damages provision, which restricts the District's recovery to discounted contribution payments for the remainder of the fiscal year in which NSFF's breach occurs. We proposed to NSFF that this provision be amended to allow the District the full range of remedies available under contract law, but they rejected this proposal.

If NSFF terminates its contributions and the District financed the Program through a lease-purchase agreement, the loss to the District would be limited by the requirement, under Minn. Stat. § 465.71, that lease purchase agreements allow an option of terminating the agreement at the end of any fiscal year. However, the finance company would then have the right to repossess the equipment.

Several provisions in the Agreements require the District to purchase additional equipment and Program materials that NSFF designates as "critical components" of the program. In effect, these provisions allow NSFF to change the terms of the Agreements and require the District to purchase equipment that it did not bargain for. In the course of our negotiations, NSFF has refused to change these provisions. This concern is, however, alleviated by the fact that the Agreements allow for a corresponding increase in NSFF's contribution payments.

The Agreements also provide that they will be governed by, construed, and enforced in accordance with Utah law and that all disputes arising under the Agreements will be heard exclusively in state and federal courts in Utah. In the course of negotiations, NSFF has repeatedly rejected our proposals that the Agreements be governed by Minnesota law and that disputes be heard in any court of competent jurisdiction. They also informed us that these provisions are deal breakers. The District should be aware that it would be exposing itself to the risk, and attendant additional expense, of having to defend itself against claims in another state or, in the case of a default by NSFF, pursue remedies against NSFF in another state. We note also that we have not reviewed the Agreements under Utah law and cannot render an opinion as to how Utah law might affect the contract terms in the event of a dispute.

Until recently, NSFF has been recommending Wells Fargo Brokerage Services of Salt Lake City ("Wells Fargo") as the finance company for the Program. However, Wells Fargo has informed us that it will no longer do business with NSFF. Wells Fargo has apparently been requesting copies of audited financial statements from NSFF since December 2002, which NSFF has been unwilling to provide. While Wells Fargo's decision does not prevent the District from financing the Program elsewhere, it does raise a red flag. We cannot, however, opine whether this reflects that NSFF is financially unsound or merely that it is the result of being a relatively new organization. As mentioned above, NSFF's financial condition is at least one of the topics which the State Auditor has expressed interest.

C. Insurance Requirements

The Agreements will also require the District to secure insurance for the Program equipment and to add NSFF and the equipment distributor as named insureds under its liability insurance. The Agreements also previously provided that NSFF can approve or disapprove the

insurance secured by the District. In the course of prior negotiations, NSFF has agreed to drop this last requirement.

Based on some of our clients' initial inquiries with their insurers, it appears that their insurance policies may not provide the type or levels of coverage required by the Agreements.¹ Accordingly, before entering the Agreements, we strongly recommend that the District inquire with its insurer to verify that the District has the required coverage and that the District can add NSFF and the equipment distributor as additional named insureds.

In the event that the District does not have insurance deemed satisfactory by NSFF, NSFF reserves the right to secure additional insurance and to charge the District for the premiums. Based on our discussions with NSFF, the cost of such premiums would be approximately \$15.00 per month during the first year of the Program. The District could also arrange to make a single payment of \$180.00 to cover the cost of NSFF's additional insurance during the first year of the Program. While NSFF cannot guarantee that the monthly amount will remain the same throughout the three-year license term, we have no indication that any increase would be disproportionate with the \$15.00 amount.

D. Compliance with the Bid Law

Under Minn. Stat. § 123B.52, the District has an obligation to solicit bids before entering into a contract for the purchase of equipment when the estimated cost or value of the contract exceeds the amount specified in Minn. Stat. § 471.345. Depending on the size of the municipality involved, section 471.345 requires bidding when the amount of the contract exceeds either \$35,000 or \$50,000. After analyzing the NSFF Agreements and in light of relevant Attorney General opinions and judicial decisions, we believe that there are three arguments for not soliciting bids for the Agreements.

First, although the cost of the Program equipment and materials clearly exceeds \$50,000, all of that cost will be reimbursed by NSFF's contributions. Accordingly, the net "amount of the contract" for purposes of Minn. Stat. § 471.345 is zero. We note that a counter argument could be made that, if the District or NSFF defaults and NSFF stops making contribution payments, the "amount of the contract" would be at least the total of remaining payments in the then-current fiscal year. However, it is our belief that at the time the District and NSFF enter the Agreements, they do so based on the good-faith belief that both parties will meet their contractual obligations. Therefore, at the time that the contract is signed, the "amount of the contract" would be zero.

¹ The Agreements require the District to procure and maintain "policies of general commercial liability insurance (with broad form general liability endorsement covering injury to persons or property arising from or related to the use, possession or operation of the NSFF Fitness Program including, without limitation, Community Use) with policy limits of at least \$1,000,000 per claim and an aggregate limit of at least \$3,000,000 at each Participating School."

Second, older court decisions and Attorney General's opinions recognize a common law exception to the bid law. Under this exception, bidding is not required when it would not serve the purposes of the bid law; namely, to ensure the "best bargain for the least dollar and exclude favoritism and corruption in the furnishing of labor, services and property." The NSFF Agreements do not simply provide for the purchase of equipment; rather, they provide for an integrated program of equipment, assessment tools, curriculum and staff training that also includes contributions to reimburse the purchase price. As such, a strong argument could be made that the Program is unique and that it would be futile to solicit bids for it.

Third, an argument could be made that the complex nature of the Agreements takes them outside the coverage of the Bid Law. In Hubbard Communications v. Metropolitan Sports Facilities Commission, 381 N.W.2d 842 (Minn. 1986), the Metropolitan Sports Facilities Commission contracted with a vendor to supply a scoreboard system for the Metrodome. In exchange, the Commission agreed that the vendor would retain the right to sell advertising exhibited on the scoreboard and split the revenue with the Commission. Even though the contract included "equipment" (the scoreboard), the court found the public bidding statute inapplicable because the nature of the contract made it more than simply a contract for "materials, supplies and equipment." The court explained that "public bidding provisions are to be construed narrowly," and went on to hold that the Commission's contract was outside the scope of the public bidding statute because, under the contract, the Commission granted more rights and took on more responsibilities than those required in typical contracts for materials or equipment. Here, the exchange of health data and the NSFF contribution payments create ambiguity regarding whether the Agreements fall within the statutory definition under Minn. Stat. § 123B.52 of a "contract for work or labor, or for the purchase of furniture, fixtures, or other property." Further, the District takes on many more responsibilities under the Agreements than those required in a typical equipment contract. Accordingly, the bidding requirement would appear not to apply.

Based on the foregoing, it is our opinion that the District would not be required to solicit bids before entering the NSFF Agreements. As we note above, the State Auditor is currently making inquiries regarding the NSFF Agreements. One of the topics the Auditor has expressed interest in is whether the public bid law applies to the NSFF Program Agreements. While it is our belief that this question falls outside of the Auditor's jurisdiction, the Auditor could refer it to the office of the Attorney General for consideration.

If the District should decide to go forward with the Agreements without soliciting bids, we recommend that the School Board adopt a resolution approving the Agreements. The resolution should contain findings going to the three arguments addressed above so that there will be a record of the School Board's reasoning for not soliciting bids. We could assist in preparing such a resolution for you if you would like.

If the District decides to solicit bids, we note that the "Competitive Bid Information" that is being circulated by NSFF's equipment distributor is inadequate for that purpose. First, the Competitive Bid Information is based on the assumption that the equipment distributor can solicit bids on behalf of the District. Minnesota law does not, however, authorize a school district to allow a private party to solicit bids on the school district's behalf. Second, the descriptions of the equipment in the Competitive Bid Information are so general that they do not meet the specificity requirements of the Bid Law. Accordingly, if the District should decide to solicit bids, we recommend that it request a more detailed description of the equipment from NSFF or the equipment distributor before attempting to do so.

E. Community Use

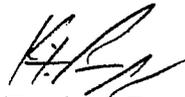
The NSFF Agreements also include a Community Use Agreement ("CUA"), whereby the District can agree to allow members of the community to use the program equipment. The District is not required to enter into the CUA to participate in the NSFF Program. If, however, it is interested in doing so, there are a few additional factors that the District may want to consider:

1. The CUA requires the District to provide "qualified staff to manage and supervise" the community use. "Qualified staff" must have completed NSFF's training;
2. Community use must be supervised at all times by a "sufficient number of qualified staff," with NSFF determining what is sufficient in terms of the number of staff;
3. The District must make monthly reports to NSFF regarding the community use;
4. The District must require community users to submit periodic assessments of their physical condition and progress (similar to the health data that is gathered with regard to students);
5. The District must secure additional insurance to cover the community use;
6. The CUA requires the District to charge a user fee, the amount of which is determined at the District's discretion (this fee could be used to defray the cost of providing staff supervision).

CONCLUSION

The NSFF Program promises the District the opportunity of acquiring a significant amount of new exercise equipment, seemingly at no cost. As is set forth above, with that opportunity comes a significant amount of risk. We have been able to reduce that risk somewhat through negotiations with NSFF. If the District decides to go forward with the Program, we would be happy to assist in negotiating a similar Addendum on behalf of the District. Please let us know if you have any further questions or need any assistance regarding the NSFF Program.

Very truly yours,



Kevin J. Rupp
Eric J. Quiring

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U.S. DEPARTMENT OF JUSTICE
OFFICE OF THE U.S. ATTORNEY
DISTRICT OF MINNESOTA

NEWS RELEASE. Monday, December 4, 2006

Contact: Rachel K. Paulose, United States Attorney
Jeanne F. Cooney, Director of External Relations

Media Line: 1-888

Minneapolis - Two executives of a Utah-based charity that promised “free” fitness equipment to hundreds of school districts across the nation were convicted today by a federal jury. Cameron J. Lewis, age 36, of Highland, Utah, and his father, J. Tyron Lewis, age 65, of Monticello, Utah, both were convicted on five counts of mail fraud, nine counts of wire fraud, one count of bank fraud, one count of conspiracy to launder funds, and thirteen counts of money laundering. Cameron Lewis was also convicted on one additional count of money laundering. Following seventeen days of trial before United States District Judge Joan E. Ericksen, the jury deliberated one and one-half days before finding the defendants guilty of those crimes.

According to court documents and trial evidence, from 1999 to May of 2004, Cameron Lewis and Tyron Lewis operated National School Fitness Foundation (NSFF), a company that marketed and sold fitness programs and equipment to school districts across the nation. Throughout the fraud scheme, Cameron Lewis was the chief executive officer and Tyron Lewis was the chairman of the board of trustees for that company. Through NSFF, the defendants promised school districts that they could obtain the fitness equipment “free” based on NSFF repayments to schools with funds raised through government grants and private donations. Cameron Lewis and Tyron Lewis also misrepresented to schools that NSFF was operating as a non-profit charity. Based on these false representations, school districts obtained financing from banks to purchase the fitness equipment. What Cameron Lewis and Tyron Lewis failed to disclose to schools, however, was that they personally profited from NSFF through excessive and hidden compensation, including lucrative contracts and kickbacks from vendors. They also failed to disclose to schools the almost complete lack of fund raising and the company’s precarious financial condition. Instead, Cameron Lewis and Tyron Lewis operated a Ponzi-type scheme in which prior school districts were almost exclusively repaid using funds obtained from subsequent school districts. Evidence at trial showed that Cameron Lewis and Tyron Lewis defrauded over 600 schools and dozens of banks across the nation of more than \$60 million.

Trial evidence also showed that Cameron and Tyron Lewis improperly enriched themselves by accepting funds directly from NSFF and indirectly through other sources, including profiting from hidden ownership interests in several NSFF vendors and contractors. Furthermore, the defendants furthered their fraud scheme by paying themselves before the victims of their scheme or NSFF’s other creditors. For example, in March of 2004, when NSFF’s financial circumstances were especially precarious because of outstanding obligations owed to school districts, Cameron Lewis and Tyron Lewis paid themselves approximately \$1.4 million under the guise of a repayment of a loan.

Evidence at trial also showed that Cameron Lewis and Tyron Lewis conspired to launder hundreds of thousands of dollars in proceeds from their fraud by making lulling payments to school districts and using funds to remodel their homes.

Both Cameron Lewis and J. Tyron Lewis face a maximum potential penalty of thirty years in prison and

a \$1 million fine on each count of mail fraud, wire fraud, bank fraud, and conspiracy, and up to twenty years in prison and a \$250,000 fine on each count of money laundering. The actual sentences will be determined by Judge Ericksen. Sentencing dates have not been set.

Two co-defendants pled guilty earlier this year in connection with the fraud. Cameron Lewis' sister, Shanna L. Black, age 28, of Lehi, Utah, pled guilty in February of 2006, to a misdemeanor charge in connection to the operation of National School Fitness Foundation. NSFF's former chief financial officer, Marion H. Markle, age 45, of Highland, Utah, pled guilty in April of 2006, to misprision of a felony related to the Lewises' scheme to defraud.

Guilty pleas were also obtained in a related case. Joseph Mont Beardall, the owner and president of School Fitness Systems, LLC, and the company, School Fitness Systems (SFS), pled guilty in July of 2004 to defrauding financial institutions and Minnesota school districts of more than \$1 million. SFS managed the delivery and installation of fitness equipment, as well as received payments from schools which were divided between NSFF and SFS. As part of his plea agreement, Beardall agreed to pay restitution to victims by selling his \$1 million Highland, Utah, residence and various collectibles and bronzes; and by liquidating his interests in the Beardall Family Foundation Trust and his IRA account. School Fitness Systems agreed to surrender its assets, including inventory and bank accounts valued at approximately \$2.6 million to be paid towards restitution.

This case is the result of a multi-agency investigation by the Federal Bureau of Investigation; the Internal Revenue Service, Criminal Investigation Division; the United States Postal Inspection Service; the Minnesota Department of Commerce, Division of Enforcement; the Minnesota Office of State Auditor; and the Minnesota Attorney General's Office. The Illinois, California, and Pennsylvania Attorneys General also assisted in the investigation of this case. Assistant United States Attorneys Robert M. Lewis and W. Anders Folk prosecuted the case.

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