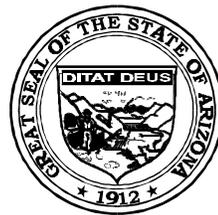


**Investigative Report:
Misfeasance by Officials of
Scottsdale Unified School
District No. 48**



**October
1998**

**Douglas R. Norton
Auditor General**

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Summary

In June 1997, 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 the Conclusion on page 10.

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Investigation Highlights:



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



District employees received discounts and other favors from certain vendors



A District administrator and his spouse personally benefited by misusing District equipment

Our investigation revealed that from July 1994 through June 1998, certain administrators and employees practiced misfeasance; that is, they violated the laws and regulations associated with lawful District activities. Furthermore, they breached their fiduciary duty to use public money prudently. In addition, certain administrators personally profited from their official business dealings and misused District resources. Accordingly, officials may have violated Arizona Revised Statutes, school district procurement rules, and District policies. Principally:

- Certain District administrators and employees were responsible for violating and circumventing procurement rules affecting projects totaling \$11,725,425.
- Certain District administrators and employees accepted favors from vendors. Examples of these favors include deep-sea fishing in San Diego, vendor discounts on personal services, and various sporting event tickets.
- A District administrator misused District equipment for the benefit of his and his spouse's personal businesses.

These financial improprieties occurred primarily because District top management established a business climate that encouraged a disregard for responsibilities associated with administering public monies.

District administrators and employees often acted autonomously without consideration for the community they served. For instance, the Governing Board was not apprised of projects on a timely basis and was presented with limited information. Employees were reportedly instructed to include less than adequate detail concerning procurement items in agendas provided to the Board members. In addition, many local vendors were prohibited from participating in full and open competition for District projects because procurement rules were not enforced. These vendors complained to District employees but the complaints went unheeded.

Finding I

District Officials Breached Their Fiduciary Duty

As public officials, all District employees have a responsibility to safeguard and manage District assets for and on behalf of the community and the schools. Further, they must protect and use public monies according to state law. However, certain employees repeatedly acted with misfeasance. They breached their fiduciary duty, were not responsive to their obligation for the prudent use of public money, and were not held accountable for their imprudence. Some employees also had improper close relationships with vendors. Finally, an attitude that promoted circumventing procurement rules and limiting fair competition among qualified vendors was so pervasive that it led to a complete breakdown of credible business practices.

◆

District administrators caused or condoned repeated procurement violations

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 by prohibiting the restraint of free trade and the unreasonable reduction of competition among vendors. However, during the period July 1994 through June 1998, administrators and employees in the Superintendent's Office, Building Services Department, and Purchasing Department failed to abide by those rules and statutes. Consequently, school district business was often directed toward favored vendors without the benefit of full and open competition. Therefore, the District may have paid more than the fair market value for certain projects. In addition, many critical procurement records were not available for review.

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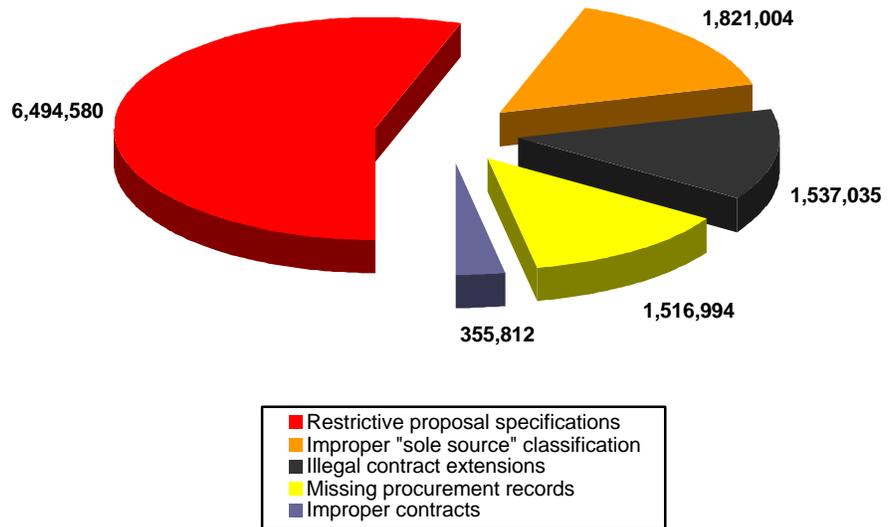
Over \$11 million of District purchases were improperly awarded

During our investigation, we noted the following procurement violations for projects totaling \$11,725,425.

- Specifications for a competitive sealed proposal were restrictive to benefit a certain vendor
- Purchases were improperly classified as "sole source"
- Contracts were illegally extended
- Critical procurement records were missing
- Contracts were approved without obtaining the required sealed proposals or price quotations
- Unauthorized individuals entered into contracts and allowed contract increases

Exhibit 1

**Summary of Procurement Violations
July 1994 through June 1998**



Source: Records of Scottsdale Unified School District, vendor confirmations, and investigation reports.

*The Auditor General was
refused access to certain
records*

Further, during the investigation process numerous items were requested for review, including certain personnel files, project bid files, payment records, Governing Board minutes, and internal investigation reports. The then-acting Superintendent refused to provide certain records to this Office in clear opposition to state statutes that authorize such access to the Auditor General. Consequently, our investigation was delayed for approximately three months until a court process ultimately provided our lawful access.

District officials' failure to properly abide by school district procurement rules was a breach of their fiduciary duty, a restraint of free trade, and inadequate managerial oversight. More importantly, it created a climate conducive to the improper use of public money.

A few examples of the improper conduct we found follow.

Restrictive Proposal Specifications

In October 1993, the District purported to follow competitive sealed proposal procedures to purchase instructional technology services. However, the District's specifications in the request for proposals (RFP) were so restrictive that only one vendor submitted a proposal. In fact, an employee of this vendor helped prepare the specifications for the District and was later hired by the District. That vendor was awarded the contract and, as a result, was paid nearly \$6.5 million from July 1994 through June 1998. Some of the details relating to this particular RFP follow.



The winning vendor of a \$6.5 million proposal employed an individual who assisted the District in compiling the specifications for the proposal



- There was inadequate time to respond to the 37-page RFP. The invitation for proposals was publicized only 7 days prior to the proposal-opening deadline instead of the lawfully required 14-day minimum.
- Some proposal specifications were taken directly from the winning vendor's literature. According to a competing vendor, a District employee refused to allow any specification substitutes and stated that all vendors had to provide what was specified in the RFP.
- Finally, the following statements recorded in a District e-mail message from the Director of Information Services to the Director of Building Services indicate that the contract may have been improperly steered to a certain vendor. The Information Services Director's e-mail message was his reaction to the RFP four days after the Building Services Director submitted it to the Purchasing Department and eight days prior to the issuance of the RFP.



An administrator's e-mail message detailed the purposeful selection of a favored vendor



- *“The RFP seems terribly restrictive. It's as if you know exactly what you want and you've developed a generic description for that system but it still is obviously based on one system that we know about and they don't.”*
- *“The continual mention of the UNIX-based operating system is mentioned so many times that again as a vendor I have to sit there and say why? Certainly this can be done with some other operating system.”*
- *“Now I know that that is precisely what you've done and I just hope that nobody raises a fuss about that.”*

Although his e-mail message was dated several days before the RFP was issued, the Director of Information Services identified the winning vendor by name.

- *“Once [the named vendor] wins the RFP I assume that we will sit down with them and redesign the system to fit exactly what we (not they) want to do.”*

In accordance with their usual procedures, Purchasing Department employees contacted the non-responding vendors to determine why they did not submit a proposal. The vendors stated that the RFP was too specific to one vendor, the specifications were very limiting, and there was not enough time to respond. Despite the warning of possible impropriety implicit in these comments, the District did not pursue the matter or reissue the proposal.

Improper “Sole Source” Classification

In February 1997, based on improper information from the Office of the former Superintendent, the Governing Board approved a \$1.4 million purchase of educational software without going through the competitive procurement process. In fact, the software was purchased directly from a Minnesota company that had previously employed the former Superintendent.



The former Superintendent engineered the payment of \$1.4 million to a former employer



The procurement rules allow school districts to purchase a required item without obtaining price quotations or going through the competitive sealed proposal process if the district can document that there is only one source for the item. However, this particular educational software could have been purchased in Arizona from at least one other vendor. Furthermore, District employees did not compare this software to other brands that perform a similar education function to determine which brand would offer the best possible value to the District.

Illegal Contract Extensions

In December 1990, the District entered into a five-year contract with an energy management contractor and paid that contractor \$7,678,103 over the contract term. In 1996, based on the recommendation of the Business Services Department Assistant Superintendent, the Governing Board unlawfully renewed that contract beyond the five-year limit established by state statute. In 1997, the Board again renewed the contract without following the procurement process. The Board granted these renewals despite the lack of sealed proposals or a determination that the District was receiving the best possible value. This contractor was paid an additional \$1,537,035 under these illegal contract extensions.



The District spent \$1.5 million on illegal contract extensions



Missing Procurement Records

Employees in the Purchasing and Building Services Departments could not locate or did not retain significant documents supporting several sealed proposals. In particular, an October 1993 RFP for high-performance air conditioners was missing all vendor proposal submittals, as well as recap sheets detailing their responses. Consequently, it was impossible to determine the propriety of the \$1,065,773 paid to the winning vendor. Additionally, District employees failed to request contract approval from the Governing Board until January 1995. By then, over \$400,000 had been paid to the vendor.

◆
*Procurement records for a
\$1 million purchase were
missing*

Improper Contracts

Building Services Department employees steered District projects to favored vendors by circumventing procurement requirements. Although many projects were completed before Purchasing Department employees became aware of the evasion, they made little or no effort to stop the circumvention. Below are some examples of employees' failure to abide by procurement laws designed to ensure free trade and competition among vendors.

- A security vendor was allowed to increase prices on a fixed price contract and was paid nearly \$100,000 for services not included in the contract. The contract stated that all prices were to remain unchanged and the contract was not to be transferred, conveyed, or sublet. However, not only was the security vendor allowed to subcontract with another vendor, but the District also paid an extra 20 percent to the security vendor for the subcontracting.
- Although lacking the authority to do so, a Building Services Department Manager entered into a contract with a glass repair vendor and allowed a carpet vendor to perform work on a project outside the scope of the contract. The employee did not solicit the required price quotes or inform the Purchasing Department that sealed proposals were necessary. Consequently, these favored vendors were paid more than \$110,000 without a proper contract and without the District ensuring that it received the best possible value.
- A construction vendor who sponsored part of a San Diego fishing excursion attended by District officials was overpaid \$9,000. This overpayment went undetected by the District for two years, until uncovered by the Auditor General's Office.

◆
*A favored security vendor
was paid \$100,000 more than
the contract allowed*

- Building Services Department employees split construction projects into phases thereby circumventing the procurement rule requiring price quotes from at least three vendors. By allowing this evasion to proceed, Purchasing Department employees also failed to ensure compliance with procurement rules. As a result, the District may have paid more than market value when it avoided the competitive process and paid over \$129,000 to favored construction vendors. Using a similar scheme, the Building Services Director told contractors not to expect action on change orders over \$10,000, indicating that he could avoid Governing Board approval only if the change order was for less than \$10,000.

Finding II

Employees Improperly Received Economic Benefits

A public official is in a fiduciary position to do business on behalf of the citizens. That business should be conducted at “arm’s length,” in an open, above-board manner. For public officials to profit personally from their official business dealings violates the public trust and jeopardizes the integrity of the District as a whole.

District officials profited personally from their relationships with certain favored District vendors. District policies prohibit any employee from accepting or receiving gifts, gratuities, or anything of value from anyone doing, or desiring to do, business with the District. Notwithstanding District policies, we noted the following instances of District employees receiving gifts.

Administrators responsible for the management of District purchases received personal benefits from District vendors

- The Director of Building Services, and his spouse, received a total discount of at least \$2,708 on the installation of, and monitoring services for, their personal security systems. A District security vendor did the work and provided the discount.
- The Assistant Superintendent of Business Services, Director of Building Services, and a former Superintendent accepted a San Diego fishing trip sponsored in part by a District construction vendor.
- Various employees have accepted offers of tickets from existing and potential District vendors for Phoenix Open golf and box seats for Phoenix Suns basketball.
- Numerous meals were provided to District officials and staff as they met with existing and potential vendors.

Many vendors frequently offered District employees out-of-state trips, golf outings, tickets for various sporting events, and meals. In fact, at least one employee attended an out-of-state entertainment event with the vendor. By accepting these gifts, District employees presented at least the appearance of impropriety.

Finding III

District Administrator Misused District Resources

Employees in the Building Services Department are responsible for the construction and maintenance of all District facilities. Accordingly, some employees were issued specially purchased personal computers to take home so they could remotely control the District's energy management system. However, in addition to the District's software, the personal computer issued to the Director of Building Services (Director) improperly contained software programs and numerous client files from his spouse's tax and accounting business.

District employees also use other computers for network applications such as e-mail and word processing; however, the other computer issued to the Director contained not only the District software, but also many personal documents, including corporate records of an electrical business he and his spouse owned. This indicates that the computer improperly held data used for the Director's private corporation.

On April 4, 1997, the day the Director was placed on administrative leave, he deleted personal and possibly District documents from the computer in his office. He also called his spouse, who then reformatted the hard drive on the District's personal computer purchased for its energy management system. As a result, not all information on these computers could be retrieved; however, an examination of both hard drives revealed the following items improperly stored on the computers:

 *An administrator misused District computers to benefit his and his spouse's private businesses*

- Private business software that was installed by the Director's spouse
- At least 62 separate account files that were clients of the Director's spouse
- Financial records of 2 local businesses that were clients of the Director's spouse
- Business reports from 1987–1994 for the Director's private corporation
- Other personal documents

The Building Services Department Regulation and Procedure Manual, issued March 1995, states that "absolutely no District-owned equipment, tools or materials are to be used on or off District property for personal reasons." This manual was prepared with the Director's supervision and guidance.

Conclusion

The Scottsdale Unified School District No. 48, as a government entity, is responsible to Arizona citizens for the prudent use of public money.

Arizona taxpayers in general and District students, parents, teachers, and taxpayers in particular were denied the benefits of full and open competition and may have paid more than market value for certain projects for the following reasons.

- District administrators fostered a climate of disregard for the proper use of public monies.
- District administrators and employees ignored or circumvented required school district procurement rules.
- District administrators and employees accepted favors from preferred vendors.

In addition, a District administrator misappropriated District resources to his own use and that of his spouse.

On October 6, 1998, the Attorney General's Office filed a 25-count civil complaint in Maricopa County Superior Court against the Scottsdale Unified School District. This complaint alleges conspiracies in restraint of trade and violations of Arizona procurement laws for District projects totaling \$11,725,425. In addition, the District is charged with tampering with public records, and unlawfully withholding and failing to maintain official records.

Within the complaint, the Attorney General's Office seeks damages as follows:

- Civil penalties of \$150,000 for each of the six antitrust violations.
- Penalties in the amount of the entire dollar value of each contract, plus 20 percent, totaling \$14,070,510.

Further, the Court was requested to issue a ten-year injunction restraining the District from:

- Engaging in unlawful procurement conduct and conspiracies in restraint of trade.
- Failing to maintain, refusing to produce, or tampering with documents.