

# STATE OF MINNESOTA

## Office of the State Auditor



**Rebecca Otto**  
**State Auditor**

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PETITION ENGAGEMENT

**CITY OF McGRATH, MINNESOTA**

JANUARY 1, 2006, THROUGH DECEMBER 31, 2010

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The mission of the Office of the State Auditor is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

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# **CITY OF McGRATH, MINNESOTA**

**January 1, 2006, through December 31, 2010**



## **Petition Engagement**

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

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REBECCA OTTO  
STATE AUDITOR

# STATE OF MINNESOTA

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Petitioners  
City Council Members  
City of McGrath

### INTRODUCTION AND BACKGROUND

Eligible voters from the City of McGrath, Minnesota, petitioned the Office of the State Auditor (OSA) to examine the books, records, accounts, and affairs of the City in accordance with Minn. Stat. § 6.54 for the period January 1, 2006, through December 31, 2010.

The City of McGrath is a municipal corporation. The elected City Council is responsible for the care, management, and control of the City. A Clerk is employed by the City Council and is responsible for administrative duties and has custody of the records, books, and papers of the City. A Treasurer is employed by the City Council and is responsible for taking charge of, and accounting for, all money belonging to the City. The City is not required to be audited annually by an independent audit firm.

The OSA has completed its examination into the concerns identified by the petitioners of the City of McGrath. 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 City Council in this report.

The OSA is allowed by Minn. Stat. § 6.54, in the public interest, to confine the scope of the examination to less than that requested by the petition. Communications with representatives of the petitioners 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. Our examination was limited to addressing the issues discussed below.

A. Conflict of Interest - City Employee and Council Member

For the period under review, Calvin (Cal) Stemig is the City's Zoning/Planning and Public Works Commissioner. Cal's wife, Nancy Stemig, is a City Council member. The petitioners question whether there is a conflict of interest when Ms. Stemig votes on motions which involve her husband's position with the City.

Mr. Stemig attends the City Council meetings and reports to the Board.<sup>1</sup> The City has no written employment agreement with him. He is paid the same amount that City Council members are paid - \$20 a month beginning the second half of 2010, an increase from the previously paid \$10 a month. At the beginning of each year, the City Council identifies its appointments for the year. These include Mr. Stemig's position as City Zoning/Planning and Public Works Commissioner. The City Council minutes for 2006 through 2008 indicate that Ms. Stemig voted to approve Mr. Stemig's appointment for each of these years. For 2009 and 2010, she abstained from such voting. Ms. Stemig voted against a motion to approve a termination letter for Mr. Stemig in May 2008. The motion failed on a 2-3 vote.

Under Minnesota law, "no member of a [city] council shall be directly or indirectly interested in any contract made by the council," except as provided by Minn. Stat. §§ 471.87 - 471.89. Minn. Stat. § 412.311. In addition, a public officer authorized to take part in making a contract in official capacity may not voluntarily have a personal financial interest in the contract or personally benefit from it financially. Minn. Stat. § 471.87.

A city contract with the spouse of a council member generally constitutes a financial interest to the council member if the council member and spouse share their finances. *See e.g.* Op. Atty. Gen. July 30, 1948.

Exceptions to the statutory prohibition are available under Minn. Stat. § 471.88. One exception provides that a city council, "by unanimous vote, may contract for goods or services with an interested officer" if the contract is one "for which competitive bids are not required by law." Minn. Stat. § 471.88, subs. 1 and 5. An employment contract does not require bids.

To use this broad exception, however, a city and the interested officer must follow the procedures set forth in Minn. Stat. § 471.89. This section requires the city council to "authorize the contract in advance of its performance by adopting a resolution setting out the essential facts and determining that the contract price is as low as or lower than the

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<sup>1</sup> In 2005, Mr. Stemig was asked whether he would consider taking a non-paying position as "Financial Advisor" or "General Consultant." Mr. Stemig was instead given the title "Zoning Commissioner" in July 2005. *See* Minutes, Regular Meetings of the McGrath City Council, June 2, 2005 and July 7, 2005. Pay for the position was initially approved on July 13, 2005. The Minutes state "Cal's position will allow him to bring problems or ideas to the Council. He will be paid the same as other council members." Minutes, Special Meeting of the McGrath City Council, Budget for 2005, July 13, 2005.

price at which the commodity or services could be obtained elsewhere.” In addition, before claims are paid on the contract, the interested officer must file an affidavit stating, among other things, that he or she believes “the contract price is as low as, or lower than, the price at which the commodity or services could be obtained from other sources.”

Whether a Council Member votes or abstains from voting on a spouse’s employment with the City, a conflict of interest exists unless the conditions are met for the statutory exception. The City Council would, by unanimous vote (including the interested Council Member), need to pass the resolution and obtain the affidavit required by Minn. Stat. § 471.89 to eliminate the conflict of interest. We recommend the City Council document the terms of its employment agreements in writing.

## B. City Vendor

### Background

The City of McGrath has a long-standing history of doing business with Dave’s Dirt Works for such things as sewer-related work, gravel, and other special projects. In the March 2, 2006, minutes, the City Council approved Dave’s Dirt Works as the service agent for the City’s sewer.<sup>2</sup> In the January 3, 2008, minutes, the City Council approved Dave’s Dirt Works as the City’s “Sanitary Engineer.” The City Council re-approved this for 2009 and 2010. Ms. Stemig voted for each of these appointments.<sup>3</sup>

Sanitary engineer is not a legally prescribed city officer position defined in state law. The minutes do not document, nor is there a formal agreement between the City and Dave’s Dirt Works defining, the services to be provided or the compensation to be paid. However, the City has been paying Dave’s Dirt Works \$195 a month for sewer servicing.

For the period 2006 through 2010, payments to Dave’s Dirt Works for things other than the regular monthly sewer servicing include:

- \$15,173 in 2006 for part of a large sewer project funded by the Minnesota Public Facilities Authority;
- \$1,035 in 2006 for sewer-related pump, grinder, repair, and cap;
- \$380 in 2008 for sewer-related prep, repair, and effluent test;

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<sup>2</sup> “Dave’s Dirt Work” was an assumed name filed by Dave and Denise Engdahl in April 1999. Information from the Secretary of State’s Office indicates this filing expired in April 2009.

<sup>3</sup> According to the City’s minutes, Mr. Stemig and Council Member/Mayor Larry Bullen held the appointment as the City’s Sanitary Engineer(s) in 2006 and 2007.

- five payments totaling \$3,429 in 2009 for culvert, ditch, fill, and gravel; and
- two payments totaling \$2,226 in 2010 for sewer pump and switch replacement parts and labor.

1. Contracting Law

The Uniform Municipal Contracting Law (Minn. Stat. § 471.345) provides that contracts of \$25,000 or less may be awarded on quotes or the open market.

If the City wishes to contract for construction, alteration, repair, or maintenance of real property on an annual basis, we recommend the City enter into a written agreement with the vendor. The contract should define the services to be provided and the compensation for those services. Although formal bidding may not be required, we recommend that the City periodically review its contracts and consider whether a Request for Proposals (RFP) process or solicitation of quotations is warranted so that qualified, interested contractors can inform the City of their capabilities and charges. This process will periodically inform the City Council of the availability and costs of qualified contractors.

2. Conflict of Interest

The petitioners were concerned that there may be a conflict of interest surrounding the relationship between Dave's Dirt Works, Cal Stemig, and Nancy Stemig. The petitioners questioned whether Mr. Stemig was both directing some of the work done by Dave's Dirt Works on behalf of the City and being paid as an employee of Dave's Dirt Works while Ms. Stemig voted on work awarded and payments made to Dave's Dirt Works.

We noted the following exchange in the minutes of the December 4, 2008, Council meeting:

Item 3. - "APPROVAL OF AGENDA: Mayor Bullen states, Dave Engdahl is here, add to agenda. Since April we have been trying to get answers to what is going on here. Mayor wants to add after Treasurers (sic) report. Stemig states, add after approval of agenda. Council agrees to add, 3A."

Item 3A. - “question to Dave Engdahl on sewer. This was brought to Mayor’s attention at inspection with Roger Clapp USDA, at which the Mayor and Darlene M were present. C. Stemig is being paid to do work with the sewer. We want to know what kind of work Cal is doing and what he is being paid. Krebs wants to know what this is all about. N. Stemig objects to this line of questioning. The City is not paying Cal, the City is contracting with Dave. Bullen states, if Cal is supervising and Dave is paying his supervisor, that is illegal. Bullen states, I want this brought out in the open, or I will bring this to the county attorney. Motion Stemig to table this discussion. Second Krebs. All in favor, Clark, Krebs, Stemig. Bullen opposed. Motion carried.”

The Attorney General has taken the position that whether a city council member has an interest in a contract is a matter that involves questions of fact. Furthermore, questions of fact are appropriately determined by the city council.<sup>4</sup>

If, in the future, the City employs a contractor that employs a Council Member’s spouse, the Council Member may have a conflict of interest, prohibited by law. Further, city employees cannot supervise or oversee City contractors that they in fact work for. If such a situation arises, we recommend that the City determine whether the Council Member has a statutorily prohibited conflict of interest by inquiring of that member, the spouse and the contractor:

- whether the Council Member’s spouse receives, or has received, payments from the contractor;
- whether the spouse works or has worked on City projects for the contractor and whether he or she supervised work performed for the City; and
- whether the Council Member and spouse share common finances.

If the Council member has a personal financial benefit, an exception to the statutory prohibition may apply if the projects do not have to be formally bid. However, to take advantage of the exception in Minn. Stat. § 471.88, subd. 5, the City Council and the interested member must pass the resolution and obtain the affidavit required by Minn. Stat. § 471.89.

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<sup>4</sup> Op. Atty. Gen. 90a-1 (October 7, 1976); *See also* Op. Atty. Gen. 90-E-5 (November 13, 1969).

The City Council should have determined whether a personal financial interest existed between Council Member Stemig and Dave's Dirt Works. Had such a prohibited conflict existed, the City should have refrained from contracting with Dave's Dirt Works until there was compliance with Minn. Stat. § 471.89.

Furthermore, in Stone v. Vevans, 92 N.W. 520 (Minn 1902), the Minnesota Supreme Court, referring to a statute similar to Minn. Stat. § 471.87, declared:

“It is a fundamental principle that the same person cannot act for himself, and at the same time, with respect to the same matter, as the agent of another, whose interest might be in conflict with his. The two relations impose different obligations, and their union would at once involve a conflict between their interest and duty. Wardell v. Union Pac. R. Co., 103 U.S. 651. This rule is applicable to the officers of public as well as private corporations. Dillon, Mun. Corp. Secs. 444, 915.”

*See also* Op. Atty. Gen. 90-A-1 (Sept 21, 1955). Whether or not there is a statutory conflict of interest, no person overseeing City projects performed by contractors should perform work for contractors on those City projects.

#### C. City Planning Committee Meetings

The petitioners were concerned that City Planning Committee meetings were not being held as scheduled.

We reviewed the 2010 minutes provided to us for the City Council meetings and the Planning Committee meetings and noted the following.

1. It is the City's practice to distribute a meeting calendar for the upcoming year to the City Council members at the first Council meeting of each year. Item 8.D. of the January 7, 2010, City Council minutes indicates that such a meeting calendar for 2010 was distributed to the Council members. We obtained a copy of the meeting calendar and noted that, except for the month of November, Planning Committee meetings were to be held on the last Thursday of each month. The November Planning Committee meeting was to be held on the third Thursday (November 18).
2. There are minutes for the City Planning Committee meetings held on January 28, 2010, and April 29, 2010. Subsequent to every other month in which a Planning Committee meeting was not held, the minutes for the City Council's regularly scheduled meetings state, "PLANNING COMMITTEE: No meeting".

For comparison purposes, we noted there were minutes for five Planning Committee meetings in 2006, one in 2007, four in 2008, and ten in 2009.

As the meeting calendar is established each year, we recommend it reflect a realistic schedule of planned meetings. Consideration should be given to schedule the City Planning Committee meetings less frequently, for instance quarterly or every other month. Once the schedule of meetings has been approved by the City Council, the meetings should be held as scheduled.

D. Fire Hall Rentals

The petitioners were concerned that funds paid by citizens and other groups for rental of the City's Fire Hall are not being properly accounted for by the City.

The Fire Hall is owned and used by the City of McGrath. Based on an unwritten agreement, the McGrath Fire Department Relief Association, a separate nonprofit entity, is also allowed to use the City's Fire Hall. This includes allowing the Relief Association to keep rental fees paid by citizens or groups for use of the Fire Hall. The Relief Association records the Fire Hall rental receipts in its general fund. In exchange, the charitable gambling fund of the Relief Association directly pays the heat and power expenses of the Fire Hall.

This informal lease arrangement between the City and the Relief Association creates a number of legal issues:

- Any lease of City property must be in writing. Leases for more than one year that are not in writing are void. Minn. Stat. § 513.05.
- The City cannot lease City property to a nonprofit corporation for no or nominal consideration. The rent paid by the nonprofit must be reasonable. Op. Atty. Gen. 469-a-9 (May 5, 1967) and Opinions cited therein.
- The Fire Hall is tax-exempt as City property. However, if it is leased to an association and the association uses the property in connection with a business conducted for profit, it may become taxable under state law. *See* Minn. Stat. § 272.01, subd. 2(a).
- It appears that payment of the utility bills for a building from which the Relief Association receives monetary benefit may not be a lawful use of gambling funds by the Relief Association. *See* Minn. Stat. § 349.12, subd. 25; Minn. R. 7861.0320, subp. 17, C. This payment is not a donation to the City but a payment for the use of property by the Relief Association.

The effect of paying utility bills with gambling proceeds and then receipting “rent” into the general fund is that, through this unwritten arrangement, the Relief Association is using money from its gambling fund to generate money for its general fund. This is not a permitted use of gambling proceeds under Minn. Stat. ch. 349.

We recommend that the City discontinue the informal lease arrangement of the Fire Hall with the Relief Association. The City should pay costs of maintaining the building, and all receipts from the rental of the building need to be deposited in the City’s account. If the Relief Association wishes to lease space in the Fire Hall, a written lease should be executed, and the Relief Association should consult with the Gambling Control Board on the use of gambling proceeds.

E. Gifts to the City from the Relief Association

While scanning 2010 activity recorded by the City, we noted two significant receipts reported in the City’s Fire Department fund. We were informed that the Relief Association paid the City \$3,000 in January for City Fire Department expenses and \$10,000 in July to replace the transmission in a fire truck.

Gifts to the City must be approved by the City Council. Further, the terms of the gift must be set forth in a resolution and be adopted by two thirds of the City Council. Minn. Stat. § 465.03. We recommend that the City Council accept gifts in compliance with Minn. Stat. § 465.03.

F. Reporting Requirements

The City of McGrath is required by State statute to submit the following annual reports to the Office of the State Auditor (OSA):

- City Summary Budget Data Financial Reporting Form (due January 31; Minn. Stat. § 471.6965);
- Local Government Lobbying Costs Reporting Form (due January 31; Minn. Stat. § 6.76);
- City Financial Reporting Form - Cash Basis of Accounting (due March 31; Minn. Stat. § 471.6965); and
- City Financial Statements Audited or Unaudited - Cash Basis of Accounting (due March 31; Minn. Stat. § 471.698).

We reviewed the City's compliance with the reporting requirements and noted the following:

- For 2006, the City submitted all four reports to the OSA by the required deadlines.
- For 2007, the City submitted the Financial Reporting Form and unaudited financial statements, but both were received by the OSA on May 23, 2008, significantly past the March 31, 2008, deadline. The City failed to submit the Summary Budget Data Financial Reporting Form and the Local Government Lobbying Costs Reporting Form for 2007.
- For 2008, the City submitted the Local Government Lobbying Costs Reporting Form and the unaudited financial statements by their respective deadlines. The City submitted the Summary Budget Data Financial Reporting Form, but it was not received by the OSA until June 3, 2009, significantly past the January 31, 2009, deadline. Also, the Financial Reporting Form was not received by the OSA until June 28, 2009, significantly past the March 31, 2009, deadline.
- For 2009, the City submitted all four reports to the OSA by the required deadlines.
- For 2010, the City submitted all four reports to the OSA by the required deadlines.

We recommend the City of McGrath continue to submit its annual reports to the OSA by their respective deadlines as required by State statute.

#### 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. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters may have come to our attention that we would have reported to you.

This report has been prepared solely for the information of the petitioners of the City of McGrath and City Council members, 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

June 6, 2011