



REBECCA OTTO  
STATE AUDITOR

# STATE OF MINNESOTA

## OFFICE OF THE STATE AUDITOR

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April 8, 2008

The Honorable LeRoy Clausen  
Chairperson, New Market Township Board  
27157 Dakota Avenue  
Elko, MN 55020

The Honorable George Silverness  
Supervisor, New Market Township Board  
11375 - 237th Street E  
Lakeville, MN 55044

The Honorable Kenneth Chlan  
Supervisor, New Market Township Board  
27656 Texas Avenue  
Webster, MN 55088

Dear New Market Town Board:

The Office of the State Auditor received concerns about a possible conflict of interest in the Township of New Market ("Town"). Specifically, our Office understands that the Town purchased a road grader and leased the grader to Town Supervisor Kenneth Chlan. It appears the Town did not follow the proper procedures for purchasing the grader, or for entering into a contract with a Town Supervisor. This letter contains our recommendations to bring the Town into compliance with Minnesota law.

### **Grader Purchase**

The Town Board Chair and the Town Clerk informed us that the Town purchased a road grader in the summer of 2007. According to the Town Board Chair, the grader was purchased from Ziegler in Bloomington for \$236,000. The contract was not put out for bid. Rather, according to the Town Board Chair, the purchase was made from a State approved vendor. The Town Board Chair and the Town Clerk informed us that the Town went to the bank and obtained a regular loan to pay for the grader.<sup>1</sup>

Under the Municipal Contracting Law, competitive (sealed) bids are required for Town equipment purchases if the amount of the contract is estimated to be over \$50,000.<sup>2</sup> There are exceptions to this requirement, however. For example, governmental entities

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<sup>1</sup> According to the Town Board Chair, the loan was to be paid back over five years, at \$50,000 per year.

<sup>2</sup> See Minn. Stat. § 471.345, subs. 1 - 3. For contracts estimated to cost between \$10,000 and \$50,000, the contract may be made either upon sealed bids or by obtaining two or more quotations. See Minn. Stat. § 471.345, subd. 4. Contracts under \$10,000 can be made either upon quotations or in the open market. See Minn. Stat. § 471.345, subd. 5.

may buy and sell equipment among themselves without regard to the Municipal Purchasing Law.<sup>3</sup>

In addition, towns participating in the State's Cooperative Purchasing Venture may buy equipment under the State contract without having to engage in their own contracting process.<sup>4</sup> However, the Cooperative Purchasing Venture is a members-only joint powers program operated by the Minnesota Department of Administration. To purchase through the program, a town must join and pay an annual membership fee. The Town Board Chair informed us that he does not believe the Town is a member of the Cooperative Purchasing Venture program. Towns may not avoid the normal bidding requirements by simply purchasing at the state contract price, or from a state contract vendor, without joining the program and following its requirements.<sup>5</sup>

The authority of a town to incur indebtedness is also governed by statute. Generally, Minnesota law does not allow towns to borrow money from a local bank simply by filling out standard loan forms. However, a town does have the authority to enter into lease-purchase agreements.<sup>6</sup> Under the lease-purchase agreement, the lessor could be a bank or an equipment company. However, we know of no authority for a Town to simply go to a bank and take out a conventional loan.

We recommend that the Town comply with the Municipal Contracting Law. If the Town wants to purchase under the Cooperative Purchasing Venture, the Town should consider joining the program. We also recommend that the Town comply with Minnesota law relating to public indebtedness.

### **Conflict of Interest**

The legislature has created a broad prohibition against public officers having an interest in a contract with their own community. Under Minn. Stat. § 471.87, "a public officer who is authorized to take part in any manner in making any sale, lease, or contract in official capacity shall not voluntarily have a personal financial interest in that sale, lease, or contract or personally benefit financially therefrom."<sup>7</sup> For town supervisors, a similar prohibition is also contained in Minn. Stat. § 365.37.<sup>8</sup>

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<sup>3</sup> See Minn. Stat. § 471.64.

<sup>4</sup> See Minn. Stat. §§ 16C.03, subd. 10, and 16C.11.

<sup>5</sup> Additional information about the Cooperative Purchasing Venture is available at: <http://www.mmd.admin.state.mn.us/coop.htm>. Information about the Cooperative Purchasing Venture may also be obtained by contacting Ms. Sherry Brown with the Minnesota Department of Administration at 651-201-2404.

<sup>6</sup> See Minn. Stat. § 465.71. Such purchases are subject to the Municipal Contracting Law's bidding requirements. *Id.*

<sup>7</sup> The statute also provides that every public officer who violates this provision is guilty of a gross misdemeanor. See Minn. Stat. § 471.87.

<sup>8</sup> See Minn. Stat. § 365.37, subd. 1 (copy enclosed). The statute provides, in relevant part: "Except as provided in sections 471.87 to 471.89, a supervisor or town board must not be a party to, or be

Because the general rule is so strict, the legislature has created a number of exceptions, which are found in Minn. Stat. § 471.88. Under this statute, a town board, "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."<sup>9</sup>

To use the exception found in Minn. Stat. § 471.88, a town and the interested supervisor must follow the procedures set forth in Minn. Stat. § 471.89. This statute requires the town board 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 price at which the commodity or services could be obtained elsewhere."<sup>10</sup>

In addition, before claims are paid on the contract, the interested officer must file with the town clerk an affidavit stating:

- (a) The name of the officer and the office held by the officer;
- (b) An itemization of the commodity or services furnished;
- (c) The contract price;
- (d) The reasonable value;
- (e) The interest of the officer in the contract; and
- (f) That to the best of the officer's knowledge and belief the contract price is as low as, or lower than, the price at which the commodity or services could be obtained from other sources.<sup>11</sup>

The Town Clerk provided the Office of the State Auditor with a Road Grader Lease Agreement dated October 9, 2007, between the Town and Supervisor Chlan. The Lease Agreement leases the Town grader to Supervisor Chlan for a period of 12 months. Under the Lease Agreement, Supervisor Chlan pays the Town \$40 per hour for use of the grader, based upon an "hour meter" located on the grader. Supervisor Chlan is responsible for storing the grader, and providing fuel for the grader. The Town is responsible for maintenance and repair of the grader, and for maintaining insurance on the grader.

We understand from the Town Clerk that Supervisor Chlan is using the Town's grader to perform grading services for the Town, although the Lease Agreement is silent regarding these services. Documents provided to us by the Town Clerk show that the Town paid Supervisor Chlan \$3,886.75 in 2007 for his grading services. We were informed that

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directly or indirectly interested in, a contract made or payment voted by the town board." *Id.* The statute also provides that a town officer who violates this section is guilty of a misdemeanor and must leave office. *See* Minn. Stat. § 365.37, subd. 5.

<sup>9</sup> *See* Minn. Stat. § 471.88, subs. 1 and 5.

<sup>10</sup> *See* Minn. Stat. § 471.89, subd. 2 (copy enclosed).

<sup>11</sup> *See* Minn. Stat. § 471.89, subd. 3.

there is no separate contract between the Town and Supervisor Chlan regarding his grading services.

The Town Board meeting minutes for October 9, 2007, make no reference to the resolution required by Minn. Stat. § 471.89 prior to a town entering into a contract with a town supervisor. The Town Clerk and Town Board Chair informed us that they do not believe the Town passed a resolution regarding the Lease Agreement.

We recommend that the Town follow the requirements of Minn. Stat. §§ 365.37, 471.88, and 471.89, when contracting with a Town Supervisor. Enclosed is a copy of the Minnesota Association of Township's materials on "Statutory Conflicts of Interest" for your review. The enclosed document explains in further detail the statutory requirements for contracting with a town officer.<sup>12</sup> It also contains a sample resolution and sample affidavits.

### **Personal Use of Town Equipment**

The Road Grader Lease Agreement provides that the grader may not be operated outside the Town's boundaries, but it lacks a restriction on personal use of the Town grader. According to the Town Clerk, Supervisor Chlan's claim forms submitted in connection with his grading work contain the readings of an "hour meter" that is on the grader.

All town expenditures and use of town equipment must have a "public purpose" to be valid.<sup>13</sup> The Minnesota Supreme Court has generally defined a "public purpose" as something that is directly related to the function of government and benefits the community as a body. As a result, the use of town equipment for a private party's benefit or for personal use does not qualify as a public purpose.

We recommend that the Town consider amending the Road Grader Lease Agreement to expressly prohibit any personal use of the Town's grader. In addition, we recommend that the Town obtain sufficient documentation from Supervisor Chlan to establish that the grader was used exclusively for public purposes.<sup>14</sup>

We also recommend that the Town enter into a written agreement with Supervisor Chlan regarding the services he is providing to the Town. A written contract identifies the significant terms of the agreement for both parties, including the services to be performed and conditions for payment. A written contract may also limit the Town's exposure to the risk of damages.

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<sup>12</sup> Page 3 of the document specifically discusses the use of town machinery by a town supervisor.

<sup>13</sup> Minn. Const. Art. 10, § 1.

<sup>14</sup> For example, Supervisor Chlan could maintain a log showing where the work was performed for each hour reflected on the grader's "hour meter."

Finally, we recommend that the Town consider adopting a policy that restricts the personal use of any Town property.

### **Payroll Documentation**

The Town Clerk informed us that Supervisor Chlan is considered an “independent contractor” for the grading services he provides to the Town.<sup>15</sup> In response to our inquiries, the Town issued Supervisor Chlan a Form 1099 for 2007.<sup>16</sup> The Form 1099 was filed on March 18, 2008, although it was due by February 28, 2008.

A town has the authority to hire independent contractors. Typically an independent contractor has greater control over the time and manner of the work to be performed than a regular employee. However, a Town has a duty to keep track of payments made to independent contractors, and to issue a 1099 tax form to individual independent contractors paid \$600 or more. While a town must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee, a town generally does not have to withhold or pay taxes on payments made to independent contractors.

We recommend that the Town consult with its attorney or tax advisor to determine whether Supervisor Chlan is properly classified as an employee or an independent contractor for federal tax purposes.<sup>17</sup> We recommend that the Town examine its payments at year-end to determine whether 1099 forms and/or W-2 forms should be issued, so the forms are filed in a timely manner in the future.

### **Meeting Minutes**

We reviewed the meeting minutes for the Town’s October 9, 2007 Town Board meeting. The minutes state that road grader lease was approved. However, the minutes do not identify that the lease was with a Town Supervisor. The minutes also do not state whether Supervisor Chlan abstained from the vote.

We recommend that the Town review and implement the suggestions contained in our Statement of Position No. 2007-1024 on “Meeting Minutes.” A copy of our Statement of Position is enclosed for your convenience. By following these recommendations, we believe that the Town will have better documentation for purchases and contracts, and will be better prepared to address questions and concerns that may arise regarding the Town’s activities.

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<sup>15</sup> Generally, elected officials are considered employees for Federal income tax withholding purposes per Section 3401(c) of the Internal Revenue Code, and for social security and Medicare purposes per Section 3121(d)(2) and 3121(d)(4) of the Code. For further information on this topic, see IRS Publication 963.

<sup>16</sup> Employee wages are reported on IRS Form W-2.

<sup>17</sup> We note that the Town paid for Supervisor Chlan’s training on the grader, which appears to be more consistent with the status of an employee than an independent contractor.

## Conclusion

We expect the recommendations contained in this letter will help the Town comply with Minnesota law. Please let us know how the Town resolves these issues. Specifically, please provide the Office of the State Auditor with a copy of:

- Any resolution passed by the Town Board to contract with a Town Supervisor for grading services, as required by Minn. Stat. § 471.89;
- One of the affidavits filed by Supervisor Chlan seeking payments for his grading services, as required by Minn. Stat. § 471.89;
- Any written contract entered into by the Town and Supervisor Chlan regarding grading services;
- Any revised Lease Agreement between the Town and Supervisor Chlan regarding the Town's grader; and
- Any policy adopted by the Town Board regarding the private use of Town equipment.

Please also provide us with copies of the Town Board meeting minutes related to these items.

The Office of the State Auditor appreciates the Town's cooperation in this matter. As required by Minn. Stat. § 6.51, a copy of this letter is being provided to the Scott County Auditor and the Scott County Attorney. If you have any questions or concerns regarding our recommendations, please feel free to contact me directly at 651-297-5853.

Sincerely,

*/s/ Nancy J. Bode*

Nancy J. Bode  
Assistant Legal Council  
Office of the State Auditor

Enclosures

cc. The Honorable Albert Zweber, Town Clerk  
The Honorable David Frame, Town Treasurer  
Mr. Eric Braaten, Town Attorney  
Ms. Cynthia M. Geis, Scott County Auditor (without enclosures)  
The Honorable Patrick Ciliberto, Scott County Attorney (without enclosures)