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STATE AUDITOR

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September 29, 2004

Mr. Tom Theroult, CEO  
Minnewaska Regional Health Systems  
610 West Sixth Street  
PO Box 160  
Starbuck, Minnesota 56381

Dear Mr. Theroult:

The State Auditor's Office has been asked to review various aspects of the Western Pope County Hospital District (Hospital District). The State Auditor's Office serves the Minnesota taxpayers by helping to ensure financial integrity, accountability, and cost effectiveness of Minnesota's local government entities. In response to various concerns brought to the attention of this office, we have looked at the following matters:

- The state of the Hospital District's financial statements;
- The purchasing policy of CEO;
- The Hospital District's donation to a charity;
- The Hospital District's hiring of an interim CEO;
- Payments made to a former CEO;
- The CFO's role at board meetings;
- The Hospital District hiring an outside attorney;
- The Hospital District's hiring of consultants;
- The role of the Hospital District's comptroller;
- The CEO creating positions;
- The formation of a nonprofit corporation to run the hospital;
- Contracts made with board members;
- Contract made with spouse of a board member.

The State Auditor's Office has reviewed these concerns and its conclusions are contained in this letter.

## **Background**

It is the understanding of the State Auditor's Office that the Western Pope Hospital District is comprised of the cities of Starbuck, Cyrus, and Lowry, and the townships of Barsness, Ben Wade, Blue Mounds, Hoff, Langhei, Minnewaska, New Prairie, Nora, Rolling Forks, Walden, and White Bear Lake.<sup>1</sup> The "hospital district [is] governed by a hospital board composed of one member elected from each city and town in the district and one member elected at large."<sup>2</sup>

The Hospital District is funded through patient revenue, investment income, contributions, and tax revenue.<sup>3</sup> In the fiscal year ending June 30, 2003, the Hospital District collected \$308,496 in tax revenue.<sup>4</sup>

The Hospital District operates Minnewaska District Hospital located in Starbuck Minnesota. The Minnewaska District Hospital provides a full range of in-patient services and a wide array of outpatient procedures to thousands of patients each year, including 24-hour emergency care.<sup>5</sup> The Hospital is attached to the Minnewaska Medical Clinic, which was acquired by the Hospital District in January 2003.<sup>6</sup>

The Hospital District owns and operates a 50% interest in Holly Ridge Manor, a retirement community attached to the Hospital. The Hospital District board appoints members to a committee that oversees Holly Ridge Manor. Minnewaska Lutheran Home, a nursing home run by a private entity, owns the other 50% interest in Holly Ridge Manor.

The Hospital District is also organized into a Building and Grounds committee and an Executive committee. These committees oversee various aspects of running the Hospital District. The committees report to the board as a whole. Recently, the Executive committee was appointed to the Pope County Health Care Planning Commission.<sup>7</sup> The Commission was formed from both the Minnewaska Regional Health System<sup>8</sup> of the Western Pope County Hospital District and the Glacial Ridge Health System of the Eastern Pope County Hospital District.<sup>9</sup> The budget for the newly formed commission

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<sup>1</sup> See Certificate as to Corporate Organization, Pope County Hospital District, November 19, 1973. It appears that Minnewaska Township was not listed on the Certificate as to Corporate Organization, which formed the Hospital District. However, the town has passed a resolution to join the Hospital District. See Town of Minnewaska Resolution, June 28, 1973.

<sup>2</sup> Minn. Stat. § 471.32 subd. 1 (2002).

<sup>3</sup> See Western Pope County Hospital District Combined Financial Statements June 30, 2003 and 2002.

<sup>4</sup> See Western Pope County Hospital District Combined Financial Statements June 30, 2003 and 2002.

<sup>5</sup> <http://www.starbuckmn.org/minnewaskahospital.htm>.

<sup>6</sup> <http://www.starbuckmn.org/starbuckclinic.htm>.

<sup>7</sup> Minutes of special board meeting of the Minnewaska Regional Health System, May 17, 2004.

<sup>8</sup> Minnewaska Regional Health System is the name the Western Pope County Hospital District has given to its health care system.

<sup>9</sup> Minutes of special board meeting of the Minnewaska Regional Health System, May 17, 2004.

was set at \$50,000 to be split between the two Hospital Districts.<sup>10</sup> The purpose of the Commission was to:

- Develop a health care delivery model which utilizes the assets in both district to better serve all residents in Pope County, and which is unified, efficient, improved, and sustainable.
- Recommend a governance system for the unified system.
- Evaluate the financial reimbursement implications of a combined system.<sup>11</sup>

The commission is comprised of the executive committees of each hospital district, one board appointed physician from each medical staff, and the mayors of Starbuck and of Glenwood. This committee is currently examining the possibility of combining the Starbuck hospital, maintained by the Western Pope County Hospital District, with the Glenwood hospital, which is run by the Eastern Pope County Hospital District. Our review was limited to the Western Pope County Hospital District.

Minnesota Statute grants hospital districts the powers reasonably necessary and convenient to operate its health care related functions.<sup>12</sup> Hospital districts are granted specific powers to:

- Employ nursing, administrative, and other personnel, legal counsel, engineers, architects, accountants, and other qualified person, who may be paid for their services;<sup>13</sup>
- Have reports, plans, studies, and recommendations prepared;<sup>14</sup>
- Lease, purchase, and contract for the purchase of real and personal property;<sup>15</sup>
- Adopt, by resolution, rules for the operation and administration of the hospital and nursing home facilities under its control, and for the admission of patients;<sup>16</sup>
- Levy taxes;<sup>17</sup>
- Borrow money and issue bonds;<sup>18</sup>
- Sell or lease its facilities or equipment as it finds expedient;<sup>19</sup>

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<sup>10</sup> Minutes of special board meeting of the Minnewaska Regional Health System, May 17, 2004.

<sup>11</sup> Minutes of special board meeting of the Minnewaska Regional Health System, May 17, 2004.

<sup>12</sup> Minn. Stat. § 447.33 subd. 1 (2002) (“Each hospital district created or reorganized under sections 447.31 to 447.37 has the powers necessary and convenient to acquire, improve, and run the hospital, nursing home facilities, and facilities described in section 447.45, subdivision 2, paragraph (b), as the hospital board finds expedient. The list of powers in this section does not restrict the power of the board. It may take any action reasonably necessary or convenient to further the purpose for which the district exists which is not otherwise prohibited by law”).

<sup>13</sup> Minn. Stat. § 447.33 subd. 2 (1) (2002).

<sup>14</sup> Minn. Stat. § 447.33 subd. 2 (2) (2002).

<sup>15</sup> Minn. Stat. § 447.33 subd. 2 (3) (2002).

<sup>16</sup> Minn. Stat. § 447.33 subd. 2 (5) (2002).

<sup>17</sup> Minn. Stat. § 447.33 subd. 2 (7) (2002).

<sup>18</sup> Minn. Stat. § 447.33 subd. 2 (8) (2002).

- Have its accounts, books, vouchers and funds audited by competent public accountants.<sup>20</sup>

In addition to these powers, a hospital district that owns or operates a hospital has, “relative to the delivery of health care services, . . . in addition to any authority vested by law, the authority and legal capacity of a nonprofit corporation . . .”<sup>21</sup> This grant of authority specifically includes the ability to:

- Enter shared service and other cooperative ventures;<sup>22</sup>
- Join or sponsor membership in organizations intended to benefit the hospital or hospitals in general;<sup>23</sup>
- Enter partnerships;<sup>24</sup>
- Incorporate other corporations;<sup>25</sup>
- Have members of its governing authority or its officers or administrators serve as directors, officers, or employees of the ventures, associations, or corporations;<sup>26</sup>
- Own shares of stock in business corporations;<sup>27</sup>
- Offer, directly or indirectly, products and services of the hospital, organization, association, partnership, or corporation to the general public;<sup>28</sup>
- Expend funds, including public funds in any form, or devote the resources of the hospital or hospital district to recruit or retain physicians whose services are necessary or desirable for meeting the health care needs of the population, and for successful performance of the hospital or hospital district's public purpose of the promotion of health.<sup>29</sup>

The powers of a nonprofit corporation also include the ability to:

- Make donations for religious, scientific, educational, or charitable purposes, and for other purposes . . . that further the corporation’s interest;<sup>30</sup>
- Establish committees of the board of directors, elect or appoint persons to the committees, and define their duties;<sup>31</sup> and

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<sup>19</sup> Minn. Stat. § 447.33 subd. 2 (10) (2002).

<sup>20</sup> Minn. Stat. § 447.33 subd. 2 (11) (2002).

<sup>21</sup> Minn. Stat. § 144.581 subd. 1 (2002).

<sup>22</sup> Minn. Stat. § 144.581 subd. 1 (a) (2002).

<sup>23</sup> Minn. Stat. § 144.581 subd. 1 (b) (2002).

<sup>24</sup> Minn. Stat. § 144.581 subd. 1 (c) (2002).

<sup>25</sup> Minn. Stat. § 144.581 subd. 1 (d) (2002).

<sup>26</sup> Minn. Stat. § 144.581 subd. 1 (e) (2002).

<sup>27</sup> Minn. Stat. § 144.581 subd. 1 (f) (2002).

<sup>28</sup> Minn. Stat. § 144.581 subd. 1 (g) (2002).

<sup>29</sup> Minn. Stat. § 144.581 subd. 1 (h) (2002).

<sup>30</sup> Minn. Stat. § 317A.161 subd. 11 (2002).

<sup>31</sup> Minn. Stat. § 317A.161 subd. 17 (2002).

- Elect or appoint officers, employees, and agents of the corporation, and define their duties.<sup>32</sup>

Despite this broad range of authority, hospital district boards are still governed by the Minnesota Data Practices Act, and the Minnesota Open Meeting Laws.<sup>33</sup>

### **Review of Financial Statements**

Based on concerns regarding the financial integrity of the Hospital District, our office has reviewed the Hospital District's two-year audit for the years ended June 30, 2002 and 2003. Eide Bailly, LLP of Fargo North Dakota performed the audit. In our review, we looked at whether the statements warranted obvious attention in the area of the Hospital District being an "ongoing concern," or whether the statements had obvious errors and/or omissions that would prove them worthless.

We noticed that the Hospital District's expenses increased from \$3,237,497 in 2002 to \$4,329,003 in 2003. Hospital District's operating revenue increased from \$3,240,733 to \$3,714,002 over the same time. In addition to its operating revenue, the Hospital District collected \$370,753 in nonoperating revenue in the fiscal year ending June 30, 2002. Included in the nonoperating revenue for that year was \$307,335 in tax revenue. In fiscal year ending June 30, 2003, the Hospital District had \$421,559 in nonoperating revenue, including \$308,496 in tax revenue.

The Hospital District had an operating loss of \$615,001 in fiscal year ending June 30, 2003. When the Hospital District's nonoperating income is factored in, it lost \$193,442 in that year. Despite the Hospital District's loss in fiscal year ending 2003, it still had a balance of \$3,480,527 at the end of the year.

For the year ending June 30, 2003, the increase in revenue was smaller than the increase in expenses. If this trend continues for the years to come, it will be alarming. Because the Hospital District had just purchased a clinic and was in the process of reorganizing, variances were to be expected when comparing the two years under this audit. The Hospital District should closely monitor its financial situation in the upcoming years.

### **Purchasing and Purchase Order Policy**

This office also received concerns that the Hospital District allows its chief executive officer (CEO) to spend up to \$25,000 without board approval. Minnesota Statute allows the Hospital District to take any action reasonably necessary or convenient to further its purpose.<sup>34</sup> The board also has the authority to appoint officer, employees, and agents,

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<sup>32</sup> Minn. Stat. § 317A.161 subd. 18 (2002).

<sup>33</sup> Minn. Stat. § 144.581 subd. 4 (2002).

<sup>34</sup> Minn. Stat. § 447.33 subd. 1 (2002).

and define their duties.<sup>35</sup> This would include allowing the CEO to spend public funds without board approval.

Although the Hospital District has the power to give its CEO the authority to spend public funds without board approval, the Hospital District board should approve such a policy by resolution. The Hospital District was unable to provide our office with any minutes approving the CEO's spending authority. The Hospital District informed this office that there was a letter of understanding with the CEO explaining the CEO's duties, but the letter has been misplaced. The Hospital District board should determine what authority it wants to give its CEO and approve the authority at a board meeting.

Both counties and cities are authorized to delegate authority to pay claims by statute. Minn. Stat §§ 375.18 subd. 1b and 412.271 subd 8. With this statutory authorization to delegate claims, there is also the legislative requirement that each public entity "shall have internal accounting and administrative control procedures to insure proper disbursement of public funds." Though not legally required of the Hospital district, we recommend that any delegation of authority to pay claims be accompanied with internal and administrative controls commensurate with the delegation. These controls and procedures should be in place when the delegation of the authority is made. We further recommend that from time to time, the Hospital District specifically request its annual auditor to perform a review of internal controls and management practices concerning the delegation of payment authority. We request that the Hospital District provide the State Auditor's Office with policies and procedures relating to the CEO's spending authority when they are formally adopted.

### **Donation to Charity**

Concerns were also brought to our office regarding a \$1,000 donation made in April 2004 by the Hospital District to the Pope County Relay for Life planning committee. It is our understanding that the Relay for Life is a fundraiser to fight cancer. The Hospital District informed this office that the decision to donate money to Relay for Life was not approved by the board. The donation was made by the Hospital's CEO.<sup>36</sup> The board did approve the payment at its next meeting. The Hospital District informed the State Auditor's Office that the donation was considered an advertising and marketing expense.

Generally, local units of government may only spend funds for a public purpose. It has been the opinion of the State Auditor's Office that funds donated to private nonprofit corporations without a return benefit are not spent for a public purpose. If the purpose of the donation truly was for the advertising and marketing of the local hospital, the donation could be viewed to have a public purpose, as the Hospital District would have received a benefit.

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<sup>35</sup> Minn. Stat. § 317A.161 subd. 18 (2002).

<sup>36</sup> As stated above, the Hospital District should clearly define the CEO's spending authority to allow him to make expenditures without board approval.

Advertising expenses should be made in a business like manner. The Hospital District should have a specific goal for its advertising and have a determination of how expenditure will meet that goal. In the future, the Hospital District board should make clear the purpose of any similar donations. The Hospital District should also have an explanation of how a donation will advance its purpose of advertising. Such actions will help ensure that public funds are being spent for a public purpose.

Additionally, a hospital district has more authority than other units of local government. The legislature has provided that a hospital district that operates a hospital “shall, relative to the delivery of health care services, have . . . the authority and legal capacity of a nonprofit corporation.”<sup>37</sup> Nonprofit corporations are entitled to make donations for religious, scientific, educational, or charitable purposes, and for other purposes consistent with law, that further the corporate interest.<sup>38</sup>

If the donation to the Relay for Life was “relative to the delivery of health care services,” it appears to have been an allowable expenditure. However, because the board did not express what the purpose of the donation was, this office cannot determine that a donation to a private nonprofit corporation was “relative to the delivery of health care services.” The State Auditor’s Office recommends that in the future the Hospital District analyze any donations to charity and clearly define what their purpose.

### **Interim CEO**

Concerns were expressed to the State Auditor’s Office that the Hospital District hired an interim CEO with unspecified duties. It is our understanding that on August 22, 2001 the Hospital District accepted the resignation of its CEO Roxann Wellman.<sup>39</sup> Ms. Wellman’s resignation was effective December 31, 2001.<sup>40</sup> At that meeting, the board passed a motion authorizing the Hospital District’s Executive Committee to take charge of seeking interim transitional consultant assistance.<sup>41</sup> Ms. Wellman presented information regarding interim assistance and informed the board of a proposal submitted by Interim Leadership, Inc.<sup>42</sup> On August 28, 2001 the Hospital District Executive Committee met and approved the hiring of Mr. Paul Anderson of Interim Leadership through December 31, 2001.<sup>43</sup> The Hospital District board approved the contract on September 26, 2001.<sup>44</sup>

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<sup>37</sup> Minn. Stat. § 144.581 subd. 1 (2004).

<sup>38</sup> Minn. Stat. § 317A.161 subd. 11 (2002).

<sup>39</sup> Board Minutes Pope County Hospital District, August 22, 2001.

<sup>40</sup> Board Minutes Pope County Hospital District, August 22, 2001.

<sup>41</sup> Board Minutes Pope County Hospital District, August 22, 2001.

<sup>42</sup> Board Minutes Pope County Hospital District, August 22, 2001.

<sup>43</sup> Minutes of the MDH Executive Committee Meeting, August 28, 2001.

<sup>44</sup> Board Minutes, Pope County Hospital District, September 26, 2001.

Mr. Paul Anderson was the interim CEO for three months starting September 26, 2001.<sup>45</sup> The owner of Interim Leadership, Mr. Tom Evans, stepped in as the interim CEO until April 7, 2003.

We have reviewed the Hospital District's contract with Interim Leadership. The contract provided for a payment of \$500 per day. It appears that the contract adequately stated Interim Leadership's role with the Hospital District. Under the contract, the interim CEO was to:

- Assist the Hospital District board with strategic plan development;
- Provide interim hospital administration, which preserves capital and maintains recent levels of fiscal performance;
- Operate in accordance with current capital and operating budgets;
- Improve communication vertically and horizontally with the hospital;
- Assist the board in developing the criteria for a permanent chief executive and provide strong support in the recruiting process;
- Develop the agenda with the chairperson's assistance, for all board meetings.

A hospital district has authority to hire consultants to perform such services.<sup>46</sup> It appears that the decision to hire Interim Leadership was agreed upon by the board to fill its perceived need to move forward after the resignation of its CEO. The contract appeared to adequately state the duties of Interim Leadership and the time frame that it was to be completed. Therefore, the decision to hire the interim CEO was within the authority of the Hospital District

Although the Hospital District properly entered into the contract with Interim Leadership, it appears that the contract was modified without further action. The contract with Interim Leadership estimated that the work would be completed by December 2001. It is our understanding that the contract was in effect until April 2003. The contract only contained a fee structure for Paul Anderson. However, after December 2001 Mr. Evans assumed the duties. The contract with Interim Leadership did not contain any language automatically extending the terms, nor did it contain language explaining how personnel would be substituted. It is our understanding that the contract with Interim Leadership was not changed to reflect the change in length or change in personnel.

The State Auditor's Office recommends that in the future, if the terms of consultant contracts need to be changed or extended, such changes be put into writing and, where appropriate, approved by the board.

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<sup>45</sup> September 26, 2001 Interim Leadership contract.

<sup>46</sup> See Minn. Stat. § 447.33 subd. 2 (2002), "every district, acting through its hospital board, may: (1) employ nursing, administrative, and other personnel, legal counsel, engineers, architects, accountants, and other qualified persons, who may be paid for their services by monthly salaries, hourly wages, and pension benefits, or by any fees agreed on . . ."



### **Payment to former CEO**

The State Auditor's Office also received concerns that a former CEO of the Hospital District was on the active payroll at full salary but was not present at board meetings. The Hospital District informed the State Auditor's Office that Ms. Roxann Wellman was a former CEO who started with the Hospital District in 1989. It is the understanding of the State Auditor's Office that she left the Hospital District in December of 2001. The Hospital District entered into a termination agreement with Ms. Wellman. The Hospital District board approved the termination agreement in September 2001.<sup>47</sup> The termination agreement called for the Hospital District to pay Ms. Wellman 12 months of regular salary and benefits.<sup>48</sup> In exchange for the 12 months full salary and benefits, Ms. Wellman released the Hospital District from all claims and causes of action.<sup>49</sup> The termination agreement appears to have protected the Hospital District from any future litigation that may have resulted from ending Ms. Wellman's employment with the Hospital District.

The termination agreement was within the authority of the Hospital District. The Hospital District has the power to hire personnel.<sup>50</sup> The Hospital District also has the powers necessary and convenient to run its facilities as the board finds expedient.<sup>51</sup> These powers include terminating an employee and entering into a contract to protect the Hospital District from future litigation. Because Ms. Wellman was no longer employed with the Hospital District and was only receiving salary and benefits under a mutually agreed upon termination agreement, we know of no reason why she be required to attend the board meetings.

### **CFO Exclusion From board Meetings**

The State Auditor's Office also received concerns that the Hospital District's Chief Financial Officer (CFO) has been excluded from board meetings. It is the understanding of this office that the CFO was told that she does not have to attend the meetings. The CFO informed the State Auditor's Office that she had no issue with the decision. While the absence of the CFO does not appear to violate Minnesota Statute, the State Auditor's Office recommends that the CFO attend meetings if the board is discussing the finances of running the Hospital District, or any agenda item that may affect the finances of the Hospital District.

### **Hiring an Outside Attorney**

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<sup>47</sup> Board Minutes Pope County Hospital District, September 26, 2001.

<sup>48</sup> Termination Agreement between Roxann Wellman and Pope County Hospital District, September 1, 2001 at 2.

<sup>49</sup> Termination Agreement between Roxann Wellman and Pope County Hospital District, September 1, 2001 at 1.

<sup>50</sup> Minn. Stat. § 447.33 subd. 2 (1) (2002).

<sup>51</sup> Minn. Stat. § 447.33 subd. 1 (2002).

Concerns were also brought to the State Auditor's Office that the Hospital District hired an attorney to reorganize its operations. The State Auditor's Office was informed that the Hospital District hired Mr. John Diehl of Larkin, Hoffman, Daly, Lindgren, Ltd. (Larkin Hoffman), as an attorney to help with the purchase and set up of a clinic. In addition, Mr. Diehl was working on the hiring and employment contracts for staff of the clinic.

The Hospital District has hired the same firm to look into the legal issues of the Minnewaska Hospital in Starbuck potentially merging with the Glacial Ridge Hospital in Glenwood. For this project a joint board comprised of members of the Western Pope County Hospital District and the Eastern Pope County Hospital District formed to review the possible merger.

The committee requested proposals from numerous law firms to provide legal analysis for the project.<sup>52</sup> A hospital district has the authority to hire outside contractors for work it deems necessary.<sup>53</sup> A hospital district also has the powers "necessary and convenient" to run a hospital.<sup>54</sup> The joint board hired Larkin Hoffman to provide legal analysis.<sup>55</sup> Larkin Hoffman gave the lowest bid of the five firms that submitted proposals.<sup>56</sup>

The joint board was not required to take the lowest bid presented to it for legal services. The joint board was not even required to take bids at all for legal services. Minnesota's competitive bidding law is limited to "agreement[s] entered into by a municipality for the sale or purchase of supplies, materials, equipment or the rental thereof, or the construction, alteration, repair or maintenance of real or personal property."<sup>57</sup> Legal services do not fall under this requirement and are not required to be bid.

It appears that the joint board could have contracted with Larkin Hoffman solely on their expertise in the area. It is our understanding that Larkin Hoffman has worked with the Hospital District in the past. The prior working relationship with the Hospital District could have given Larkin Hoffman a better understanding of the existing procedures, practices, personnel, and problems with Hospital District, which other firms would not have. The prior relationship could be a factor to consider when making contracts for legal services.

The hiring of Larkin Hoffman appears appropriate for reorganizing the Hospital District. The joint board was not required to obtain bids in hiring a law firm to advise them on the reorganization, but the joint board appears to have taken the financially prudent action in seeking proposals from several different law firms. By seeking proposals from several

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<sup>52</sup> A Hospital District is not required to take bids for a professional services contract, such as a contract for legal services. However, the State Auditor's Office encourages to the Hospital District to continue taking bids on all future professional services contract to ensure it is paying a fair rate for the services.

<sup>53</sup> Minn. Stat. § 447.33 subd. 2 (2002).

<sup>54</sup> Minn. Stat. § 447.33 subd. 1 (2002).

<sup>55</sup> See June 9, 2004 Minutes of the Health Care Planning Commission.

<sup>56</sup> Two of the proposals did not give a range of possible costs. Instead they would charge an hourly rate.

<sup>57</sup> Minn. Stat. § 471.345 subd. 2 (2002).

law firms, the joint board was able to look at both the experience and expertise of the different law firms, as well as cost. The joint board's action, although not required, appears to have been a prudent decision by the joint board for the project.

### **Hiring Consultants**

The State Auditor's Office also received concerns that the Hospital District hired an auditor/management consultant firm in an undefined role. It is the understanding of the State Auditor's Office that the Hospital District has hired Eide Bailly, LLP (Eide Bailly) for three separate projects over the past few years. First, the Hospital District hired Eide Bailly to prepare its yearly audit. Second, the Hospital District hired Eide Bailly to review the financial statements of a clinic the Hospital District was considering purchasing and to integrate the clinic with the Hospital District. Finally, the joint board hired Eide Bailly to review the financial implications of merging the hospital in Starbuck with the hospital in Glenwood.

In June 27, 2000, Eide Bailly was hired to perform the Hospital's District's financial audit, to prepare its Medicare statements of reimbursable costs, to prepare Federal Exempt organization returns, and to prepare Minnesota charitable organization annual reports.<sup>58</sup> The agreement covered the years ending June 30, 2000, 2001, and 2002.<sup>59</sup> On August 15, 2003, the Hospital District extended its agreement with Eide Bailly to cover the years ended June 30, 2003, 2004, and 2005.<sup>60</sup>

Both agreements were accepted by the acting CEO at the time.<sup>61</sup> As stated above, it appears that the Hospital District authorized its CEO to enter contracts less than \$25,000 without board approval. Both audit agreements with Eide Bailly were for more than \$25,000 when all three years worth of fees are added together.<sup>62</sup> However, the audit agreements were less than \$25,000 in any given year.<sup>63</sup>

As stated above, the Hospital District should clearly define what authority it intends to give its CEO. Such a grant of authority should specify if the \$25,000 is the limit for a particular year, or over the life of a contract. The Hospital District may want to review its contracts where it will be obligated to pay well over \$25,000 over the life of the contract, even if no individual year is over \$25,000.

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<sup>58</sup> Western Pope County Hospital District contract with Eide Bailly dated June 30, 2000.

<sup>59</sup> Western Pope County Hospital District contract with Eide Bailly dated June 30, 2000.

<sup>60</sup> Western Pope County Hospital District contract with Eide Bailly dated August 21, 2003.

<sup>61</sup> See Western Pope County Hospital District contract with Eide Bailly dated June 30, 2000 at p. 4, and Western Pope County Hospital District contract with Eide Bailly dated August 21, 2003 at p. 5.

<sup>62</sup> See Western Pope County Hospital District contract with Eide Bailly dated June 30, 2000 at p. 3 (The total fees were \$11,400 in 2000, \$12,020 in 2001, and \$12,650 in 2002, for a total of \$36,070), and See Western Pope County Hospital District contract with Eide Bailly dated August 21, 2003 at p. 3 (The total fees in the 2003 contract were \$14,800 in 2003, \$15,510 in 2004, and \$16,270 in 2005 for a total of \$46,580).

<sup>63</sup> *Id.*

The Hospital District has also informed us that Eide Bailly was hired to perform a financial analysis of the clinic the Hospital District had acquired, and to integrate the clinic's finances with the Hospital District. It is our understanding that the Hospital District paid Eide Bailly over \$74,000 for this integration. The Hospital District informed this office that it did not have a written contract or an engagement letter for the clinic analysis work.

While we understand why the Hospital District would want Eide Bailly, who performs the Hospital District's yearly audit, to perform the integration work, we suggest that the Hospital District have a written agreement or letter of understanding for such services. A written agreement allows the Hospital District to define what services a contractor is to perform. A written agreement would also protect the Hospital District from being over charged for services. The State Auditor recommends that in the future the Hospital District have a written document acknowledging new services its contractors are to perform.

Finally, Eide Bailly was hired to do a financial analysis of combining Minnewaska Hospital with Glacial Ridge Hospital. The joint committee in charge of the possible merger chose Eide Bailly out of three proposals it received.<sup>64</sup> Eide Bailly was the least expense of the three bids received by the joint committee.<sup>65</sup>

Again, similar to the hiring of Larkin Hoffman by the joint board, there is no requirement for financial analysis services to be bid. However, the joint board took the financially prudent action and requested proposals from numerous firms. This allowed the joint board to compare both the expertise of the firm along with the cost. The State Auditor's Office encourages the joint board and the Hospital District to continue the practice of requesting proposals for professional services.

### **Comptroller as Treasurer**

The State Auditor's Office also received questions regarding whether it is a good practice for the Hospital District's comptroller to be appointed as treasurer. It appears the Hospital District's bylaws and Minn. Stat. § 447.32<sup>66</sup> allow the board to appoint the comptroller as treasurer.

In the Hospital District's past financial reviews, it has been noted that due to the limited number of staff in the accounting and business office, certain functions are not segregated which normally would enhance internal controls. While the State Auditor's Office does

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<sup>64</sup> See June 9, 2004 Minutes of the Health Care Planning Commission.

<sup>65</sup> See Pope County Health Care Commission contractor submission chart.

<sup>66</sup> "[The board] shall also select a clerk and treasurer who may be members of the board or others. The chair, clerk, and treasurer shall hold office at the pleasure of the board, subject to the terms of any contract of employment that the board may enter into with the clerk or treasurer.

not view these two offices as incompatible given the limited staff of the Hospital District, we encourage Hospital District to keep in mind that the board treasurer is serving a dual role and that internal controls should be in place to prevent possible conflicts. Such internal controls would include continuing to have the monthly expenditures reviewed and approved by the board.

### **CEO Creating Positions**

The State Auditor's Office also received concerns that the board has allowed the CEO to create various positions within the Hospital District and that positions were filled without advertising them. Under the Hospital District's bylaws the administrator has the responsibility to "select, employ, control and discharge employees."<sup>67</sup> The hospital administrator also has the authority to "perform . . . duties that may be in the best interest of the hospital."<sup>68</sup> It is the understanding of the State Auditor's Office that the Hospital District's CEO is its administrator.

It appears that the Hospital District's board of directors has given the CEO the power to hire and create positions under its by-laws. Hospital districts have the authority hire employees as they see fit.<sup>69</sup> Generally, a CEO is hired for his or her experience and expertise in running a health care system, including creating positions and hiring employees. The board has the discretion to hire a trained professional to make the hospital more efficient and effective. The board also has the discretion to allow the CEO to fill positions in the manner the CEO sees fit. This could include creating and filling positions without general advertisements for candidates.

The State Auditor's Office recognizes that the Hospital District needs to recruit and have competent and qualified employees to meet its operational needs. The State Auditor's Office reminds the Hospital District that all positions should be created and filled in a manner that protects the Hospital District from claims of unfair hiring practices. This would include clearly defining the requirements of the position, advertising the position, and considering qualified candidates.

### **Formation of Nonprofit Corporation**

The State Auditor's Office has received concerns that the Hospital District is considering forming a nonprofit corporation to run the hospital as part of a reorganization effort. It is the understanding of the State Auditor's Office that as a result of the nonprofit

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<sup>67</sup> By-Laws of Western Pope county Hospital District, Dba Minnewaska District Hospital, Article IX, Sec. 2 (H).

<sup>68</sup> By-Laws of Western Pope county Hospital District, Dba Minnewaska District Hospital, Article IX, Sec. 2 (N).

<sup>69</sup> See Minn. Stat. § 447.33 subd. 1 (2002) (Specifically, every district, acting through its hospital board, may: (1) employ nursing, administrative, and other personnel, . . . , and other qualified persons, who may be paid for their services by monthly salaries, hourly wages, and pension benefits, or by any fees agreed on . . .").

corporation, the current board's responsibilities would be limited and may only meet once a year.

A hospital district has the authority to create a nonprofit corporation to run its facilities.<sup>70</sup> However, it appears that the Hospital District board may still be required to meet once a month. Minnesota statute requires, "[r]egular meetings of the hospital board must be held at least once a month. A hospital board which no longer operates a district hospital shall meet annually . . ."<sup>71</sup> If the Hospital District still operates the district hospital, it appears that it would be required to meet once a month.

There is a growing trend across the State of public hospitals being run by private enterprises. Glencoe area health center, the Luverne public hospital, Waconia-Ridgeview medical center, and the Kanabec hospital have all recently started being run by private corporations.<sup>72</sup>

This office reminds the Hospital District that although it may decide to allow a nonprofit corporation to run its hospital, the Hospital District still acquires public funds. Any reorganization of the Hospital District should ensure accountability of the taxpayers' dollars and that public funds are spent for public purposes.

### **Contract with Board Member**

It is also the understanding of the State Auditor's Office that the Hospital District has contracted with Mr. Jeff Kuhn, a board member, to provide legal services. The agreement provides that Mr. Kuhn's law firm will "provide advice on miscellaneous legal matters and general advice on all other hospital matters as requested by the hospital CEO." The Hospital District is charged \$150 per month for this service. The State Auditor's Office has received concerns that this contract may have created a conflict of interest between Mr. Kuhn and the Hospital District.

It appears that board members of a hospital district that run a hospital have two different conflict of interest standards to keep in mind. As an elected official, it appears that a board member must comply with the public official conflict of interest statutes.<sup>73</sup> In addition, because a Hospital District that operates a hospital has the same powers as a nonprofit corporation, a hospital board member may be bound by the nonprofit corporation conflict on interest statute.<sup>74</sup> In this case, neither statute has been complied with by the district or the public official.

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<sup>70</sup> See Minn. Stat. § 144.581 subd. 1 (d) (2002).

<sup>71</sup> Minn. Stat. § 447.32 subd. 5 (2002).

<sup>72</sup> See Minn. Stat. § 353F.02 subd. 4 (2003)(listing public medical facilities that were privatized and consequently are excluded from retirement coverage by the public employees retirement association).

<sup>73</sup> See Minn. Stat. § 471.88-471.89 (2002).

<sup>74</sup> See Minn. Stat. §§ 144.581 subd. 1, and 317A.255 subd. 1(b) (2002).

### Public Official Conflict of Interest

Minnesota statute provides that “a public officer who is authorized to take part in any manner in making any . . . contract in official capacity shall not voluntarily have a personal financial interest in that . . . contract or personally benefit financially there from.”<sup>75</sup> However, a board member may contract with a hospital district if the contract does not require bids and is unanimously approved by the board.<sup>76</sup> To ensure that a contract between a hospital district and a board member is not void, the board must “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>77</sup> Before any claim on such a contract is paid, the board member must file an affidavit stating:

- The name of the officer and the office held by the officer;
- An itemization of the commodity or services furnished;
- The contract price;
- The reasonable value;
- The interest of the officer in the contract; and
- 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>78</sup>

The Hospital District has informed the State Auditor's Office that the board did not unanimously pass a resolution approving the contract with Mr. Kuhn. Also, there is no record of an affidavit being filed by Mr. Kuhn with the necessary declarations. Because these steps were not taken, the contract between Mr. Kuhn and the Hospital District may be void.<sup>79</sup>

The State Auditor's Office recommends that the Hospital District board pass a resolution approving the contract with Mr. Kuhn. This office also recommends that Mr. Kuhn file the necessary affidavit before any future claims are paid to him. The State Auditor's Office requests to be notified when these actions are taken.<sup>80</sup>

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<sup>75</sup> Minn. Stat. § 471.87 (2002). The Minnesota Attorney General has given a very broad definition to “making” a contract under Minn. Stat. § 471.87. *See* Op. Atty. Gen. 90E-6 (June 15, 1988).

<sup>76</sup> *See* Minn. Stat. § 471.89 (2002) (“The governing body of any . . . hospital district, . . . by unanimous vote, may contract for goods or services with an interested officer of the governmental unit in any of the following cases. . . . A contract for which competitive bids are not required by law”).

<sup>77</sup> Minn. Stat. § 471.89 subd. 2 (2002).

<sup>78</sup> Minn. Stat. § 471.89 subd. 3 (2002).

<sup>79</sup> The State Auditor's Office recognizes that the board has unanimously approved the payments of the contract. However, approval of payments does not appear to satisfy the requirement for a resolution approving the contract under the statute.

<sup>80</sup> It has also come to the attention of this office that a board member may have been employed as a custodian with the Hospital District. Such an arrangement would create similar conflict of interest issues.

### Nonprofit Conflict of Interest

The Hospital District has the ability to act as a nonprofit corporation. As such, it may also have to comply with the conflict of interest laws for a nonprofit corporation.

Under Minnesota law, a Hospital District that owns or operates a hospital has, relative to the delivery of health care services the same powers as a nonprofit corporation.<sup>81</sup> The conflict of interest statutes are different for a nonprofit corporation than a municipality.

A contract between a board member and a board is acceptable if:

- The contract was fair and reasonable as to the corporation when it was authorized approved, or ratified.
- The material facts as to the contract and the director's interest are fully disclosed or known to the members of the board and the contract or transaction is approved in good faith by two-thirds of the member entitled to vote.
- The material facts as to the contract and the director's interest are fully disclosed or known to the board or a committee, and the board or committee authorities, approves, or ratifies the contract in good faith by a majority of the board or committee.<sup>82</sup>

It is the understanding of the State Auditor's Office that the board did not approve the contract between Mr. Kuhn and the Hospital District. The Hospital District claims that all the board members knew about the contract and the board members approved payments to Mr. Kuhn each month.

The Hospital District board should formally approve the contract with Mr. Kuhn in order to comply with the nonprofit corporation conflict of interest law. The State Auditor's Office was unable to determine exactly what work Mr. Kuhn performed under the contract. In the future, we recommend that the Hospital District request monthly accountings from Mr. Kuhn detailing what work he performed under the contract. Such an accounting will allow the board to determine if the contract is fair and reasonable. An accounting will also allow the public to understand why Mr. Kuhn is receiving these payments from the Hospital District.

### **Hiring Spouse of Board Member**

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If such an arrangement still exists, the proper resolutions should be passed and affidavits filed pursuant to Minn. Stat. §§ 471.87- 471.89.

<sup>81</sup> See Minn. Stat. § 144.581 subd. 1 (2002).

<sup>82</sup> Minn. Stat. § 317A.255 subd. 1(b) (2002).



The State Auditor's Office was also informed that the board hired the wife of one of its members as an architect for remodeling work. It is the understanding of the State Auditor's Office that the board member's wife was hired from a local architecture firm. This transaction may also raise conflict of interest concerns.

#### Public Official Conflict of Interest

A conflict of interest in this instance follows the same analysis as stated above. The Hospital District Board should have determined if the board member in question had a personal financial interest in the contract. Whether the board member had a "financial interest" in a contract with his spouse, is a question of fact that the board should have determined before proceeding with the contract. It is the understanding of the State Auditor's Office that no such determination was formally made by the board

A contract for architectural services is a professional services contract that is not required to be bid. However, to ensure that a contract between a hospital district and a board member is not void if the board member has a financial interest, the board must "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>83</sup> Before any claim on such a contract is paid, the board member must file an affidavit setting forth the declarations spelled out above.

It is the understanding of the State Auditor's Office that the board agreed that the board member in question should not vote on questions regarding this contract. This action, however, cannot replace the necessary steps required by statute. The Minnesota Attorney General's Office has opined the conflict of interest law applies to any public official "who is authorized to take part in any manner" in the making of the contract.<sup>84</sup> Simply abstaining from voting on the contract will not allow the contract to be made.<sup>85</sup>

The fact that the board member in question abstained from voting on the issue appears to show that the board had some concern with the board member's interest in the contract. The best practice for the board would have been to formally recognize the board member's interest in the contract and have the board member file the appropriate affidavit with the Hospital District.

#### Nonprofit Corporation Conflict of Interest

As discussed above, hospital district is entitled to the same authority as a nonprofit corporation in the delivery of health care services.<sup>86</sup> A conflict of interest arises if there

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<sup>83</sup> Minn. Stat. § 471.89 subd. 2 (2002).

<sup>84</sup> A.G. Op. 90-E-5 (Nov. 13, 1969).

<sup>85</sup> A.G. Op. 90e-6 (June 15, 1988).

<sup>86</sup> See Minn. Stat. § 144.581 subd. 1 (2002).

is a contract between the hospital district and a spouse of a director and the director or his spouse has a “material financial interest” in the contract.<sup>87</sup> In the case of the Hospital District, the board member’s spouse worked for a company that was hired to do work at the Hospital District. Whether being an employee of a company that contracts with the hospital district is a “material financial interest” is a determination for the board.

If the board member or his spouse had a “material financial interest” in the contract, there is still no conflict of interest if the board is made fully aware of the interest.<sup>88</sup> Based on the April 30, 2003 meeting minutes, it appears that the board was aware that the board member’s spouse was working on the Hospital District project. The board agreed that the board member in question would recuse himself from voting on any proposal in which his spouse had an interest. The board agreed with the board member’s recusal. Because it appears the board was made aware of the board member’s interest in the contract and still approved the contract, there does not appear to be a conflict of interest under the nonprofit corporation statute.

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<sup>87</sup> See Minn. Stat. § 317A.255 subd. 1 (2002).

<sup>88</sup> Minn. Stat. § 317A.255 subd. 1 (b)(2) (2002).

## **Conclusion**

The State Auditor's Office thanks the Hospital District for its assistance in our review. The Hospital District should always remember that it is a local government unit that receives and controls public funds. As such, the Hospital District should take steps to ensure that its decision making process and its decisions are clear to the public. The Hospital District should also follow statutory procedures to prevent accusations of conflicts of interest and misdealing. The State Auditor's Office believes that when a local government unit is open in its decision making process the concerns of citizens can be addressed at the initial phase of the process. An open decision making process may result in a better understanding of the goals of the governing board and the impact of potential decision on the citizens before the final decision is made.

A hospital district is granted broad discretion in determining how to spend its resources. The goal of the Hospital District should be to provide the most cost effective health care services to its area. The Hospital District should also attempt to operate its facilities with a minimum dependence on taxpayers' funds. However, the analysis should focus on the present situation and the long-term viability and feasibility of providing health care services to the area.

It is the understanding of this office that the Hospital District is analyzing the feasibility of combining its hospital in Starbuck with the hospital in Glenwood. In analyzing this potential merger, the Hospital District should continue to focus on providing the most cost effective way to provide quality health care services to the area. Ultimately, this is the Hospital District's decision to make based upon what it believes is best for its citizens.

Finally, the State Auditor's Office recognizes that running health care facilities is becoming increasingly complex. The State Auditor's Office encourages the Hospital District to continue to look to experts in the field when making decisions on how to run its health care facilities.

If you have any questions regarding this letter, feel free to contact me at 651-297-8290 or Deputy State Auditor/General Counsel Carla Heyl at 651-297-3673.

Sincerely,

Kyle R. Hartnett, Attorney  
State Auditor's Office

Mr. Tom Theroult  
September 29, 2004  
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Cc:

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Western Pope County Hospital District

Mr. Bruce Harvey, Comptroller  
Minnewaska Regional Health Systems

Mr. John Dahlseng, Board Member  
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