

STATE OF SOUTH DAKOTA )  
 ) SS  
COUNTY OF HUGHES )

IN CIRCUIT COURT  
SIXTH JUDICIAL CIRCUIT

STATE OF SOUTH DAKOTA, )  
 )  
Plaintiff, )

CIV. NO. \_\_\_\_\_

v. )

**COMPLAINT**

MID CENTRAL EDUCATIONAL )  
COOPERATIVE, Armour School )  
District, Burke School District, )  
Colome School District, Corsica )  
School District, Ethan School )  
District, Gregory School District, )  
Kimball School District, Mt. Vernon )  
School District, Plankinton School )  
District, Platte-Geddes Community )  
School District, Stickney School )  
District, Wessington Springs School )  
District, White Lake School District, )  
Wolsey-Wessington School District. )  
 )  
Defendants. )

COMES NOW Plaintiff, the State of South Dakota, by and through its undersigned counsel, and for its cause of action against Defendants states and alleges as follows:

**Preface**

The South Dakota Department of Education ("Department") entered into contracts with Mid Central Educational Cooperative ("MCEC") whereby MCEC agreed to provide services pursuant to the Gaining Early Awareness and Readiness for Undergraduate Programs ("GEAR UP") grant. MCEC's failure to comply with its contractual obligations caused the Department to terminate MCEC's contract. The Department later informed MCEC that other state contracts would not be renewed. The South Dakota Department of Legislative Audit conducted a Special Review along with the FY 2015 Single Audit of MCEC and issued findings on May 19, 2017, related to GEAR UP. The audits found that the MCEC Governing Board and Director did not provide adequate oversight of the financial activity of the cooperative. MCEC is contractually obligated to indemnify the State for any liabilities and damages due to MCEC's failure to comply with its contractual obligation. The State is entitled to compensation from MCEC and the underlying Member Schools for any and all liability or damages suffered by the State.

### Nature of Action

The State of South Dakota brings this action in equity to require the named school districts to contribute funds necessary for MCEC to meet its obligations with the State, to require MCEC to comply with and specifically perform certain terms required under contracts between the Department and MCEC, and to indemnify the State as provided for in said contracts, to wit:

- (1) Indemnify the State for any expenses the State incurred as a result of MCEC's failure to comply with the GEAR UP matching requirements;
- (2) Provide any and all records to the State regarding match documentation for the years 2011 to 2015;
- (3) Indemnify the State for expenses the State incurred as a result of the actions by MCEC, its directors, employees, agents, and consultants;
- (4) Reimburse the State the sum of \$97,544.14; and
- (5) Correct the deficiencies described in the May 19, 2017, audit reports.

### Facts

1. Plaintiff is the State of South Dakota.
2. Defendant Mid Central Educational Cooperative ("MCEC") is an educational cooperative with its principal place of business in Platte, South Dakota.
3. Educational cooperatives are organizations created to provide services to their member school districts.
4. MCEC consists of the following Member School Districts ("Member Schools"): Armour, Burke, Colome, Corsica, Ethan, Gregory, Kimball, Mt. Vernon, Plankinton, Platte-Geddes, Stickney, Wessington Springs, White Lake, and Wolsey-Wessington.
5. MCEC has a governing board which is made up of a school board member from each of the Member Schools.
6. On or about June 15, 2010, the Member Schools entered into an Agreement ("Agreement") regarding MCEC. A copy of the Agreement is attached hereto, labeled as Exhibit A and incorporated herein by reference.
7. Pursuant to the Agreement, the Member Schools are required to contribute pro-rata shares of amounts needed to fund MCEC and the Member Districts have a continuing financial obligation to MCEC.

8. The Director of MCEC is the chief executive officer of the governing board and is responsible for the administration and advisory functions of the governing board.

9. On or about between June 2011 and March 2016, Dan Guericke was the Director for MCEC.

10. Beginning in 2012, Guericke, on behalf of MCEC, entered into yearly contracts with the South Dakota Department of Education ("Department") regarding the South Dakota Gaining Early Awareness and Readiness for Undergraduate Programs ("GEAR UP") grant.

11. The initial contract between the Department and MCEC was approved by the MCEC board on or about March 14, 2012.

12. GEAR UP is a federal grant program designed to help low-income students obtain a secondary school diploma and succeed in postsecondary education.

13. GEAR UP is funded with federal money and federal regulations require that 50 percent of GEAR UP program costs come from cash or in-kind match from non-federal sources.

14. GEAR UP federal funding was passed through the Department to MCEC on a reimbursement basis for allowable expenses, pursuant to contracts entered into between the Department and MCEC.

15. The GEAR UP federal grant is a multi-year grant which commenced on or about September 26, 2011, and ends on or about September 25, 2018.

16. A true and correct copy of the Department of Education, State of South Dakota Letter of Agreement for Consultant Services, Contract Number 2015A-306, between the State and Defendant for the term September 26, 2014, to September 25, 2015, is attached hereto, labeled as Exhibit B and incorporated herein by reference.

17. During the term of the GEAR UP grant, MCEC submitted invoices to the Department for reimbursement of services and expenses under the GEAR UP grant.

18. During the initial GEAR UP grant contract year with MCEC, the Department monitored invoices and documents submitted by MCEC for reimbursement under the GEAR UP grant.

19. On or about April 17, 2012, a Dropbox box application was created for MCEC to submit items to the Department including billing invoices, copies of contracts, receipts, payment requests, payroll information, matching documentation, and grant time forms.

20. On or about August 28, 2012, Department personnel provided United States Department of Education GEAR UP Matching Guidance to MCEC.

21. On or about September 1, 2012, the Department began random sampling of claims submitted by MCEC in order to determine whether or not claims submitted by MCEC were appropriate and sufficiently documented.

22. On or about between September 1, 2012, and May 13, 2013, the Department's review of invoices and supporting documents submitted by MCEC determined that MCEC sought reimbursement for ineligible expenses and the Department denied payment for these claims.

23. On or about May 13, 2013, the Department began reviewing all items submitted by MCEC for reimbursement.

24. MCEC, an entity receiving federal funds in excess of \$500,000, is required to comply with audit requirements under the Single Audit Act of 1984, as amended in 1996.

25. The Single Audit Act provides that MCEC, as a grantee of federal funds, is subject to one audit of all its federal programs versus separate audits of each federal program.

26. On or about December 3, 2013, Schoenfish & Co, Inc., an independent audit firm retained by MCEC to conduct MCEC's single audit, issued findings for MCEC for fiscal year 2013, which includes the period of time between July 1, 2012, and June 30, 2013.

27. The single audit report was received by the South Dakota Department of Legislative Audit on January 17, 2014, and the South Dakota Department of Education received a copy of the audit report on February 14, 2014.

28. The findings for fiscal year 2013 included the following findings related to the GEAR UP grant:

**"Finding 2013-001:** A material weakness in internal controls was noted due to a lack of proper segregation of duties for revenues. This comment applies to Fund for the Improvement of Education, CFDA No. 84.214; Gaining Early Awareness for Undergraduate Programs, CFDA No. 84.334; Teacher Quality Partnership Grants, CFDA No. 84.336; College Access Challenge Grant Program, CFDA No. 84.378; Special Education – Grants to States, CFDA No. 84.027; and Special Education – Preschool Grants, CFDA No. 84.173, and affects the reporting compliance requirement category.

**Criteria:** Proper segregation of duties results in increased reliability of reported financial data and decreased potential for the loss of public assets.

**Condition:** A limited number of employees process all revenue transactions from beginning to end. They also receive money, issue receipts, record receipts; post receipts in the accounting records, prepare bank deposits, reconcile bank statements, and prepare financial statements.

**Effect:** As a result, there is an increased likelihood that errors could occur and not be detected in a timely manner by employees in the ordinary course of performing their duties.

29. MCEC responded to this finding by indicating: "The Mid Central Educational Cooperative Board President, Lloyd Persson, is the contact person responsible for the corrective action plan for this comment. This comment is due to the size of Mid Central Educational Cooperative, which precludes staffing at a level sufficient to provide an ideal environment for internal controls. We are aware of this problem and are attempting to provide compensating controls."

30. As a result of MCEC's response, the Department requested additional details from MCEC on the corrective action plan and on August 25, 2014, MCEC informed the Department that MCEC would conduct additional training, develop and utilize a fiscal checklist, and have MCEC's independent auditor review changes to the system.

31. On or about April 1, 2014, the system to submit invoices and supporting documentation was changed from Dropbox to Egnyte.

32. On or about August 26, 2014, MCEC indicated to the Department that it was working with its independent audit firm, Schoenfish & Co., Inc., to develop appropriate internal control measures.

33. On or about November 20, 2014, Schoenfish & Co, Inc. issued audit findings for MCEC for fiscal year 2014, which included the periods of time between July 1, 2013 and June 30, 2014.

34. The single audit report was received by the South Dakota Department of Legislative Audit on March 5, 2015, and the South Dakota Department of Education received a copy of the audit report on March 20, 2015.

35. The findings for fiscal year 2014 included the following related to the GEAR UP grant in the Summary of the Independent Auditor's Results:

"Federal Awards:

e. Our audit did not disclose any audit findings that need to be disclosed in accordance with the Office of Management and Budget Circular A-133, Section .510(a)

f. The federal awards tested as major programs were:

- |   |      |
|---|------|
| 1. Gaining Early Awareness and Readiness for Undergraduate Programs<br>No. 84.334 | CFDA |
| 2. Teacher Quality Partnership Grants<br>No. 84.366                               | CFDA |
| 3. College Access Challenge Grant Program   | CFDA |

No. 84.378

4. Special Education Cluster:

a. Special Education – Grants to States

CFDA

No. 84.027

b. Special Education – Preschool Grants

CFDA

No. 84.173”

36. Over the course of the GEAR UP grant, the Department implemented increasing levels of expenditure review and compliance monitoring for the GEAR UP grant.

37. Because of the Department’s increased expenditure review, the Department continued to deny reimbursement for certain costs submitted by MCEC.

38. Over the course of the GEAR UP grant, the Department provided technical assistance to MCEC in order to correct issues regarding questionable or undocumented costs.

39. Despite the technical assistance provided by the Department, MCEC continued to submit questionable or undocumented costs for reimbursement.

40. On or about March 25, 2015, the South Dakota Department of Legislative Audit issued the 2014 Single Audit for the State of South Dakota which included audit findings regarding GEAR UP and MCEC. A true and correct copy of the audit findings for FY 2014 including the Department’s corrective action plan is attached hereto, labeled as Exhibit C and incorporated herein by reference.

41. On or about August 25, 2015, the Department addressed the 2014 fiscal year audit findings with the South Dakota Government Operations and Audit Committee.

42. Dan Guericke and Scott Westerhuis were present at the August 25, 2015, South Dakota Government Operations and Audit Committee meeting.

43. On Wednesday, September 16, 2015, Melody Schopp, Secretary of the South Dakota Department of Education, informed Guericke that the State intended to terminate the Contract with MCEC for the GEAR UP program.

44. On September 21, 2015, Secretary Schopp provided written notification of the Department’s intent to terminate the Contract with MCEC for the GEAR UP program. A true and correct copy of the Notice of Termination is attached hereto, labeled as Exhibit D and incorporated herein by reference.

45. The September 21, 2015, letter to MCEC informed MCEC that the reason for the non-renewal and termination of the Contract was because MCEC continually failed to oversee the fiscal requirements of the grant and failed to comply with the terms of the grant award.

46. The September 21, 2015, termination notice specifically informed MCEC that MCEC’s deficiencies included:

- a. Lack of supporting documentation and improper documentation for match, resulting in a significant shortfall in match;
- b. Lack of fiscal capacity, including lack of fiscal control and improper governmental accounting procedures;
- c. Lack of knowledge of Generally Accepted Accounting Principles (GAAP) or failure to implement GAAP procedures;
- d. Lack of internal controls;
- e. Conflict of interest and failure to disclose related parties;
- f. Lack of project oversight;
- g. Lack of oversight on school subgrants; and
- h. Lack of documentation for grant activities under OMB A-87.

47. MCEC was aware of its contractual obligation to provide the necessary federal match and sufficient documentation of such non-federal match.

48. On or about November 23, 2015, MCEC was notified through its counsel that pending amounts would not be paid to MCEC until MCEC complied with the requirement to provide the Department the necessary match documentation.

49. Currently, MCEC has \$ 994,902.98 in pending claimed vouchers with the South Dakota Department of Education.

50. The South Dakota Department of Education had determined that \$ 376,757.04 of those claims lack sufficient documentation or are not valid claims under the GEAR UP grant.

51. After reviewing pending vouchers, the South Dakota Department of Education determined that \$ 618,145.94 may be due and owing MCEC for services provided under the Contract. This amount has not been paid to MCEC.

52. The State asserts that any funds possible due and owing MCEC could be due and owing the state for indemnification and as such the State is willing to deposit those funds with the court, pursuant to SDCL 15-6-67.

53. On May 19, 2017, the State of South Dakota Department of Legislative Audit issued a Special Review of Mid Central Education Cooperative and the Mid Central Educational Cooperative Audit Report For the Fiscal Year Ended June 30, 2015 (collectively referred to as "Audits"). A true and correct copy of those Audits are attached hereto, labeled as Exhibit E and F respectively and incorporated herein by reference.

54. The Audits found that the MCEC Governing Board and Director did not provide adequate oversight of the financial activity of the cooperative.

55. The Audits found that MCEC did not comply with the matching requirements of the GEAR UP grant.

56. Money was appropriately reimbursed to MCEC under the GEAR UP Grant even though money may have ultimately been misappropriated from MCEC's bank account as referenced in Audit Finding No. 2015-009.

57. Should future audits or investigations determine that the State is due and owing funds because of MCEC's contractual breach, the State will seek to amend this Complaint.

58. The Contract, at paragraph 4, contains the following provisions:

Provide \$4,316,431.00 of the project's matching requirements, as shown in the Gear Up Match Budget in Attachment C.

59. MCEC failed to provide all monies for matching requirements.

60. The Contract, paragraph 5, contains the following provisions:

Documentation of matching contributions must contain adequate source documentation for the claimed cost sharing, provide clear valuation of in-kind matching, and provide support of cost sharing by grant partners. Matching contributions must be valued in accordance with relevant Office of Management and Budget (OMB) circulars and the Education Department General Administrative Regulations (EDGAR).

61. MCEC failed to appropriately document matching contributions.

62. The Contract, paragraph 16, contains the following language:

The Grant Partner will adopt and use proper methods of administering this program, including the enforcement of any obligations imposed by law for carrying out this program and the correction of deficiencies in program operations that are identified through audits, monitoring or evaluation.

63. MCEC failed to properly administer the fiscal requirements of the grant by failing to correct deficiencies in program operations identified through audits, monitoring, and evaluation.

64. MCEC's written response to the May 19, 2017, Audits demonstrates that MCEC will not correct the deficiencies identified in the Audit.

65. MCEC's written response to the May 19, 2017, Audits demonstrates that MCEC does not intend to fulfill its continuing obligations under the Contract.

66. The Contract, paragraph 17, contains the following language:

The Grant Partner understands and agrees that granted funds are to be used for purposes set forth in the application, and that the work will be performed in accordance with: P.L.



105-244, Title IV, Part A, Subpart 2 Chapter 2 of the Higher Education Act of 1965, as amended, OMB Circulars A-87 and A-133, and EDGAR as applicable. The undersigned is authorized to commit Grant Partner to abide by the attached Certified Assurances incorporated herein as Attachment D.

67. MCEC is required to reimburse the State the sum of \$97,544.14 constituting the following:

- a. \$65,000.00 for billing regarding Stacy Phelps;
- b. \$18,094.83 for overbilled salaries;
- c. \$11,324.70 for services without the required personal activity reports;
- d. \$1,795.61 for travel expenses without MCEC's approval; and
- e. \$1,329.00 for unsupported food expenses.

Audit Finding No. 2015-002 Exhibit F.

68. The Department previously authorized reimbursement of the above listed items based upon documentation MCEC submitted to the Department, but the South Dakota Department of Legislative Audit's review of additional MCEC internal records not otherwise disclosed by MCEC to the Department, provides for the required reimbursement of the listed items.

69. The Contract, paragraph 18, contains the following language:

The Grant Partner agrees to hold harmless and indemnify the State of South Dakota, its officers, agents and employees, from and against any and all actions, suits, damages, liability or other proceedings which may arise as a result of performing services hereunder. This section does not require the Grantee to be responsible for or defend against any claims or damages arising solely from acts or omissions of the State, its officers, or employees.

70. In September 2015, law enforcement agencies began investigating MCEC and its agents.

71. In conjunction with those investigations, the South Dakota Division of Criminal Investigation served subpoenas on the State.

72. The State bore all costs of responding to subpoenas issued by State authorities.

73. The State bore all costs of responding to requests for documentation from the United States Department of Education, Office of Inspector General.

74. The State retained attorneys in order to examine any potential claims for liability as a result of the actions of MCEC.

75. The State, at the time of filing this action, has incurred legal fees and associated costs arising out of or related to the Contract.

**Specifically Perform the Consulting Contract and Provide the Required Matching Documentation**

76. Pursuant to paragraph 5 of the Contract, MCEC is to provide adequate source documentation of matching contributions including clear valuation of in-kind matching, all valued in accordance with relevant Office of Management and Budget (OMB) circulars, and the Education Department General Administrative Regulations (EDGAR).

77. MCEC failed to provide the necessary matching documentation.

**Specifically Perform the Contract and Reimburse the State for any Lacking Match Required under the Contract**

78. Pursuant to paragraph 4 of the Contract, MCEC is to provide \$ 4,316,431.00 of the project's matching requirements, as shown in the GEAR UP Match Budget.

79. MCEC failed to provide the necessary matching requirement as required by the Contract.

**Specifically Perform the Consulting Contract and Correct any Deficiencies in its Operation of the GEAR UP Program Identified Through Audits, Monitoring, or Evaluation**

80. Pursuant to Paragraph 16 of the Contract, MCEC has a contractual obligation to adopt and use proper methods of administering the GEAR UP program, including the enforcement of any obligations imposed by law for carrying out the GEAR UP program and to correct any deficiencies in program operations that are identified through audits, monitoring, or evaluation.

81. MCEC failed to correct the deficiencies in its administration of the GEAR UP program.

82. MCEC failed to provide the necessary match documentation.

83. MCEC is required to reimburse the State as a result of any current or future audit finding indicating that monies are due and owing the United States Department of Education because of insufficient match documentation.

**Duty to Indemnify the State**

84. Pursuant to Paragraph 17 of the Contract, MCEC has a contractual duty to use grant funds for purposes set forth in the application and in accordance with federal regulations.

85. Pursuant to Paragraph 18 of the Contract, MCEC has a contractual duty to hold harmless and indemnify the State for any and all damages, liability, or other proceedings which may arise as a result of MCEC performing services under the Contract.

86. MCEC is required to indemnify the State for costs incurred by the state including legal fees and associated costs arising out of or related to the Contract.

87. MCEC is required to indemnify the State the sum of \$97,544.14.

88. MCEC is required to indemnify the State as a result of any current or future audit finding indicating that monies are due and owing the United States Department of Education because of insufficient match documentation.

#### **Contribution**

89. The Member Schools engaged in a joint venture when the Member Schools created MCEC.

90. MCEC and the Member Schools engaged in a joint venture when MCEC entered into contracts with the State.

91. MCEC is the agent of the Member Districts.

92. MCEC is the alter ego of the Member Districts.

93. Pursuant to the Agreement between MCEC and the Member Districts, the Member Districts are required to contribute a pro-rata share of amounts needed to fund MCEC and the Member Districts assumed a continuing financial obligation to MCEC.

94. The Member Districts are liable to the State for any unsatisfied obligation of MCEC.

#### **PRAYER FOR RELIEF**

WHEREFORE, Plaintiff prays that this Court grant judgment in favor of the State and against MCEC as follows:

A. For MCEC to pay \$4,316,431.00 to the State for the projects matching requirements or any such project matching requirement deficiency as later determined;

B. For MCEC to pay \$97,544.14 to the State;

C. For MCEC to provide any and all documentation to the State regarding matching contributions;

D. For costs and attorney's fees incurred by the State as described above, as well as the State's costs and attorney's fees expended in this action;

E. For the Member Districts to contribute and satisfy any obligation of MCEC; and

F. For such other relief as the Court may deem appropriate.

Dated this 28<sup>th</sup> day of June, 2017.

MORENO, LEE & BACHAND, P.C.

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