



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

State Money Provided to the Minnesota Orchestral Association

Special Review

June 13, 2013

Report 13-10

FINANCIAL AUDIT DIVISION
Centennial Building – Suite 140
658 Cedar Street – Saint Paul, MN 55155
Telephone: 651-296-4708 • Fax: 651-296-4712
E-mail: legislative.auditor@state.mn.us
Web site: <http://www.auditor.leg.state.mn.us>
Through Minnesota Relay: 1-800-627-3529 or 7-1-1



OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

June 13, 2013

Senator Roger Reinert, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Michael Henson, President and Chief Executive Officer
Minnesota Orchestral Association

Sue Gens, Executive Director
Minnesota State Arts Board

Kathryn Clark Sieben, Commissioner
Department of Employment and Economic Development

This report presents the results of our special review of the use of state money by the Minnesota Orchestral Association for fiscal years 2010, 2011, 2012, and 2013 (through March 2013). The association received money from the state's General Fund and the Arts and Cultural Heritage Fund through the Minnesota State Arts Board. The association also received money from the state Bond Proceeds Fund through the Department of Employment and Economic Development.

This special review was conducted by James Riebe, CPA (Audit Manager), Brad White, CPA, CISA, CFE (Audit Manager), and Kayla Borneman, CPA (Auditor-in-Charge).

We received the full cooperation of the Minnesota Orchestral Association, Minnesota State Arts Board, and Department of Employment and Economic Development's staff while performing this special review.

Handwritten signature of James R. Nobles in black ink.

James R. Nobles
Legislative Auditor

Handwritten signature of Cecile M. Ferkul in black ink.

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

Table of Contents

	<u>Page</u>
Summary	1
Introduction	3
Scope and Objective	4
Background	4
Methodology	9
Conclusions	11
1. The Minnesota Orchestral Association complied with applicable legal requirements related to the grant money it received from fiscal year 2010 through fiscal year 2012 from the Minnesota State Arts Board	11
2. It is uncertain how much money the Minnesota Orchestral Association will be allowed to use from its 2013 Minnesota State Arts Board grant. It is also uncertain which costs may be paid with 2013 grant money. The terms of the grant agreement may allow the association to use money for costs it incurred during the time the Minnesota Orchestra did not perform due to the association’s “lockout” of the orchestra musicians. The association and the Minnesota State Arts Board have different interpretations of which costs are eligible for reimbursement under the 2013 grant agreement.....	12
3. The payment process for the costs related to the Orchestra Hall renovation project included adequate internal controls to ensure that money appropriated from the Bond Proceeds Fund was used in accordance with applicable finance-related legal requirements. We did not identify any payments for costs that did not comply with applicable legal requirements	14
4. In his testimony to legislative committees in 2010, the president of the Minnesota Orchestral Association made brief and generally positive remarks about the association’s financial condition, and legislators did not ask for additional information. While there are indications that the president and some board members had significant concerns about the association’s financial condition, it is not clear that a presentation of those concerns to legislative committees would have affected the Legislature’s decision to support the Orchestra Hall renovation project	15
Response from the Minnesota State Arts Board	19

Report Summary

Background

In response to a request from legislators, the Office of the Legislative Auditor (OLA) conducted a special review of money the State of Minnesota provided the Minnesota Orchestral Association in fiscal years 2010 through 2013. The state money included grants from the Minnesota State Arts Board for the association's general operations (as well as other targeted purposes) and bond proceeds for costs related to the renovation of Orchestra Hall. Legislators expressed concern that this investment of public money is threatened by a protracted contract dispute between the association and the orchestra musicians. The association instituted a "lockout" of the musicians in October 2012, and the contract disputes remains unresolved.

Conclusions

Based on the scope and objectives of our review, we reached the following conclusions:

1. The Minnesota Orchestral Association complied with applicable legal requirements related to the grant money it received from fiscal year 2010 through fiscal year 2012 from the Minnesota State Arts Board. ([Page 11](#))
 2. It is uncertain how much money the Minnesota Orchestral Association will be allowed to use from its 2013 Minnesota State Arts Board grant. It is also uncertain which costs may be paid with 2013 grant money. The terms of the grant agreement may allow the association to use money for costs it incurred during the time the Minnesota Orchestra did not perform due to the association's "lockout" of the orchestra musicians. The association and the Minnesota State Arts Board have different interpretations of which costs are eligible for reimbursement under the 2013 grant agreement. ([Page 12](#))
 3. The payment process for the costs related to the Orchestra Hall renovation project included adequate internal controls to ensure that money appropriated from the Bond Proceeds Fund was used in accordance with applicable finance-related legal requirements. We did not identify any payments for costs that did not comply with applicable legal requirements. ([Page 14](#))
 4. In his testimony to legislative committees in 2010, the president of the Minnesota Orchestral Association made brief and generally positive remarks about the association's financial condition, and legislators did not ask for additional information. While there are indications that the president and some board members had significant concerns about the association's financial condition, it is not clear that a presentation of those concerns to legislative committees would have affected the Legislature's decision to support the Orchestra Hall renovation project. ([Page 15](#))
-

State Money Provided to the Minnesota Orchestral Association

Introduction

This special review is in response to a letter, dated March 7, 2013, from nearly 100 legislators, requesting that the Office of the Legislative Auditor (OLA) audit the Minnesota Orchestral Association.¹ The association is a private, nonprofit organization established to provide music performances and music-related educational experiences. The association has historically fulfilled its mission primarily through classical music performances by the Minnesota Orchestra in Orchestra Hall, located in downtown Minneapolis. In addition, the association conducts concert tours and other educational and outreach activities throughout the state.

In recent years, the association has received grants from the Minnesota State Arts Board to support the association's general operations (as well as other more targeted purposes) and state bond money to help fund a renovation of Orchestra Hall. In their letter to OLA, legislators expressed concern that this investment of public money is threatened by a protracted contract dispute between the Minnesota Orchestral Association and the musicians of the Minnesota Orchestra. The contract dispute between the association and the musicians resulted in the association instituting a "lockout" of orchestra musicians on October 1, 2012, and the Minnesota Orchestra has not performed under the auspices of the association since that date.²

Legislators asked OLA to "audit the books of the orchestra" and review the 2010 testimony of the association's president to legislative committees when the association requested state money to help renovate Orchestra Hall. In response to the request from legislators for an audit, we told legislators that OLA would proceed with a special review, but would do so "cautiously." We indicated that it would be inappropriate for OLA to become involved in issues related to the dispute between the Minnesota Orchestral Association and the musicians. We also noted that OLA's legal authority to audit the Minnesota Orchestral Association is limited. OLA has statutory authority to audit how private organizations use public money, but OLA does not have authority to audit every aspect of an organization's financial affairs just because it received public money.

¹ OLA uses the term "special review" for examinations that were not scheduled audits or evaluations and which are designed to address specific concerns or allegations presented to OLA by legislators, citizens, or other interested individuals.

² Before the "lockout," the Minnesota Orchestral Association had planned for the Minnesota Orchestra to perform concerts at other venues while Orchestra Hall was being renovated. During the "lockout," some members of the orchestra have performed concerts at various locations, but those concerts were not organized or funded by the Minnesota Orchestral Association.

Scope and Objective

We limited the scope of our review of the Minnesota Orchestral Association to an examination of issues related to money provided by the State of Minnesota to the association in fiscal years 2010, 2011, 2012, and 2013 (through March 2013). The objective of our review was to address the following questions:

- Did the Minnesota Orchestral Association comply with applicable legal requirements related to grant money the association received from the Minnesota State Arts Board?
- Will the Minnesota Orchestral Association be allowed to use money from its 2013 Minnesota State Arts Board grant for costs incurred during the “lockout” of orchestra musicians?
- Did the payment process for the costs related to the renovation of Orchestra Hall include adequate internal controls to ensure that money appropriated from the state’s Bond Proceeds Fund was used in accordance with applicable finance-related legal requirements? Have payments been made in compliance with the finance-related legal requirements?
- What information about its financial condition did the Minnesota Orchestral Association provide legislative committees in 2010 when it requested state financial support for the renovation of Orchestra Hall?

Background

Minnesota State Arts Board Grants to the Minnesota Orchestral Association

During fiscal years 2010 through 2013, the Minnesota State Arts Board annually granted money to the association from its General Fund appropriations and Arts and Cultural Heritage Fund appropriations, as shown in Table 1. The board’s General Fund appropriations were for grants to arts organizations, and its Arts and Cultural Heritage Fund appropriations were to “support Minnesota artists and arts organizations in creating, producing, and presenting high-quality arts activities; to overcome barriers to accessing high-quality arts activities; and to instill the arts into the community and public life in this state.”³ As with certain other arts organizations, the board’s grants to the Minnesota Orchestral Association for fiscal years 2012 and 2013 were for “operating support” and combined money from the two funds (General Fund and Arts and Cultural Heritage Fund) into a single grant for each fiscal year.

³ See, for example, *Laws of Minnesota* 2011, First Special Session, chapter 6, article 4, section 2, subdivision 3.

The board's "operating support" grant agreements with the Minnesota Orchestral Association allowed the association to use grant money for the "activities described in the grantee's application," but also enumerated various restrictions. Specific restrictions include, for example, prohibitions against using grant money to pay debts, make political contributions, or support events not open to the public. More generally, the board's grant agreements noted that use of money from the Arts and Cultural Heritage Fund must be used to "supplement and not substitute for traditional funding sources," which is a requirement of the Legacy Amendment.⁴ The grant agreements also noted that use of money from Legacy funds (including the Arts and Cultural Heritage Fund) must comply with various requirements in state law, such as to support projects or programs that have measurable outcomes, support projects, programs, or activities that take place in the state of Minnesota, and prohibit administrative, indirect, or institutional overhead costs unless those costs were directly related to and necessary for the projects, programs, or activities supported by money from the Arts and Cultural Heritage Fund.⁵

In addition to the operating support grants, the Minnesota State Arts Board made other grants to the Minnesota Orchestral Association from the Arts and Cultural Heritage Fund. For both fiscal years 2011 and 2012, the Arts Board awarded a "touring" grant of \$100,000 to support the cost of outstate performances. For fiscal year 2011, the Arts Board awarded an "arts access" grant of \$40,478 to help the association broaden arts opportunities for underserved groups. Table 1 summarizes the Minnesota State Arts Board's grant awards and payments to the Minnesota Orchestral Association for fiscal years 2010 through 2013.

Table 1
Minnesota State Arts Board Grants to the
Minnesota Orchestral Association
By Fiscal Year

	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>
Operating Support - General Fund	\$ 415,741	\$ 415,741	\$ 375,957	\$357,184
Operating Support - Arts & Cultural Heritage Fund	594,140	594,140	593,327	604,704
Touring – Arts & Cultural Heritage Fund	0	100,000	100,000	0
Arts Access – Arts & Cultural Heritage Fund	0	40,478	0	0
Total Awarded	<u>\$1,009,881</u>	<u>\$1,150,359</u>	<u>\$1,069,284</u>	<u>\$961,888</u>
Total Grant Payments	<u>1,009,881</u>	<u>1,150,359</u>	<u>1,069,284</u>	<u>792,853</u>
Unpaid Grant Awards (as of March 31, 2013)	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$169,035¹</u>

¹ The fiscal year 2013 Operating Support grant agreement provides for a May 20, 2013, Arts & Cultural Heritage Fund payment of \$151,176 and an August 20, 2013, General Fund payment of \$17,859.

Source: State Grant Agreements and State of Minnesota's accounting system for fiscal years 2010-2013.

⁴ In Article XI, section 15, of the *Minnesota Constitution*, the amendment is titled "Outdoor Heritage, Clean Water, Parks and Trails, and Arts and Cultural Heritage," but it is commonly called the Legacy Amendment.

⁵ See, for example, *Laws of Minnesota 2011*, First Special Session, chapter 6, article 4, section 2, subdivision 2.

Appropriation from the State's Bond Proceeds Fund for the Renovation of Orchestra Hall

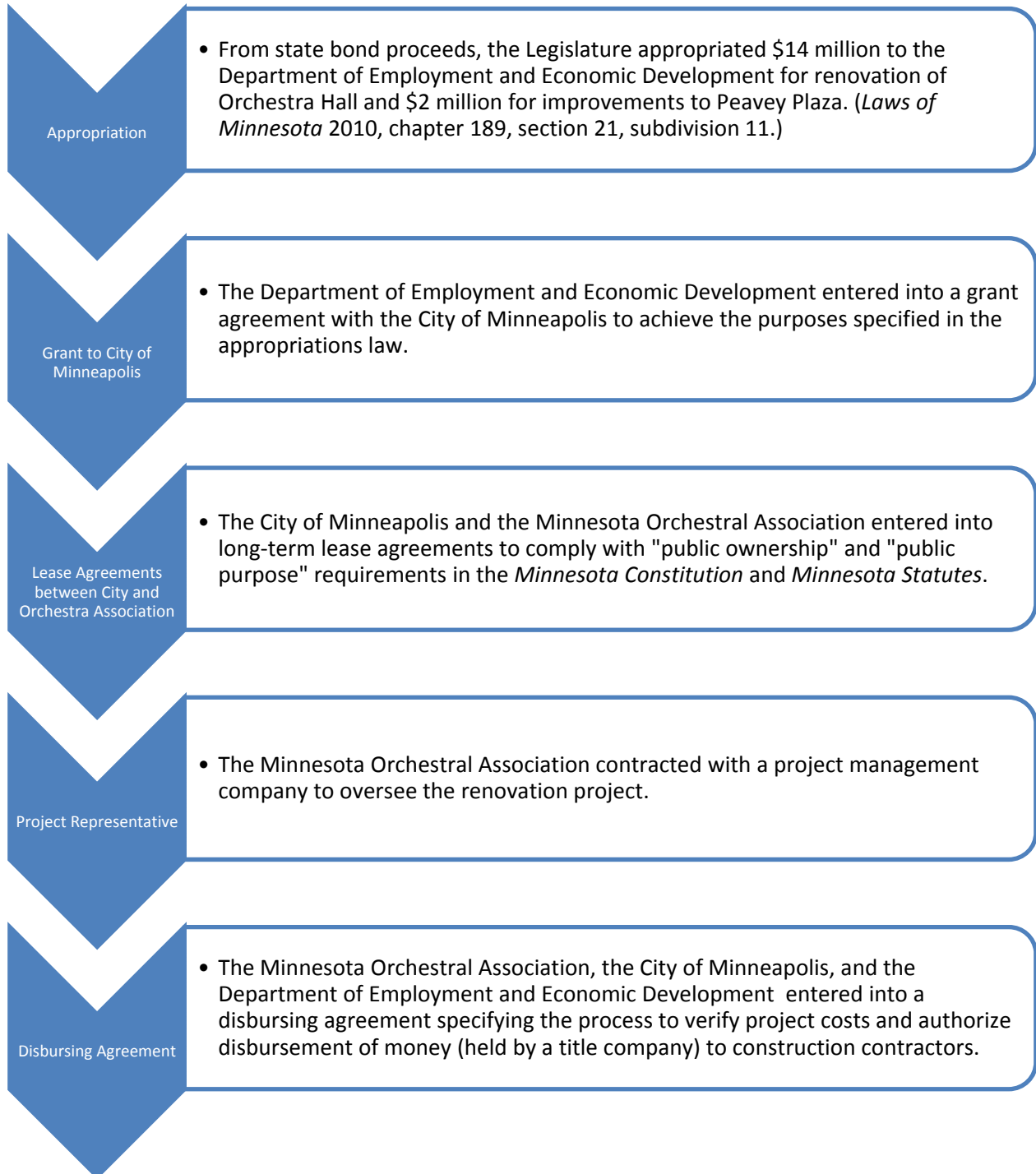
In 2010, the Minnesota Legislature appropriated \$16 million from the state's Bond Proceeds Fund to the Department of Employment and Economic Development for a grant to the City of Minneapolis, with \$14 million dedicated for eligible costs related to a renovation of Orchestra Hall and \$2 million for a renovation of Peavey Plaza, which adjoins Orchestra Hall.⁶ The appropriation required that the commissioner of the Department of Employment and Economic Development determine that at least an equal amount from nonstate sources was dedicated to the project, which is estimated to have a total cost of \$52 million. Through March 2013, the state paid \$8,781,820 in costs related to the project. The project is expected to be completed in August 2013.

Exhibit 1 illustrates the roles and relationships among the key entities involved with financing and overseeing the Orchestra Hall renovation project. Exhibit 2 illustrates the process for review of Orchestra Hall renovation costs and payment authorizations.

⁶ *Laws of Minnesota* 2010, chapter 189, section 21, subdivision 11.

Exhibit 1

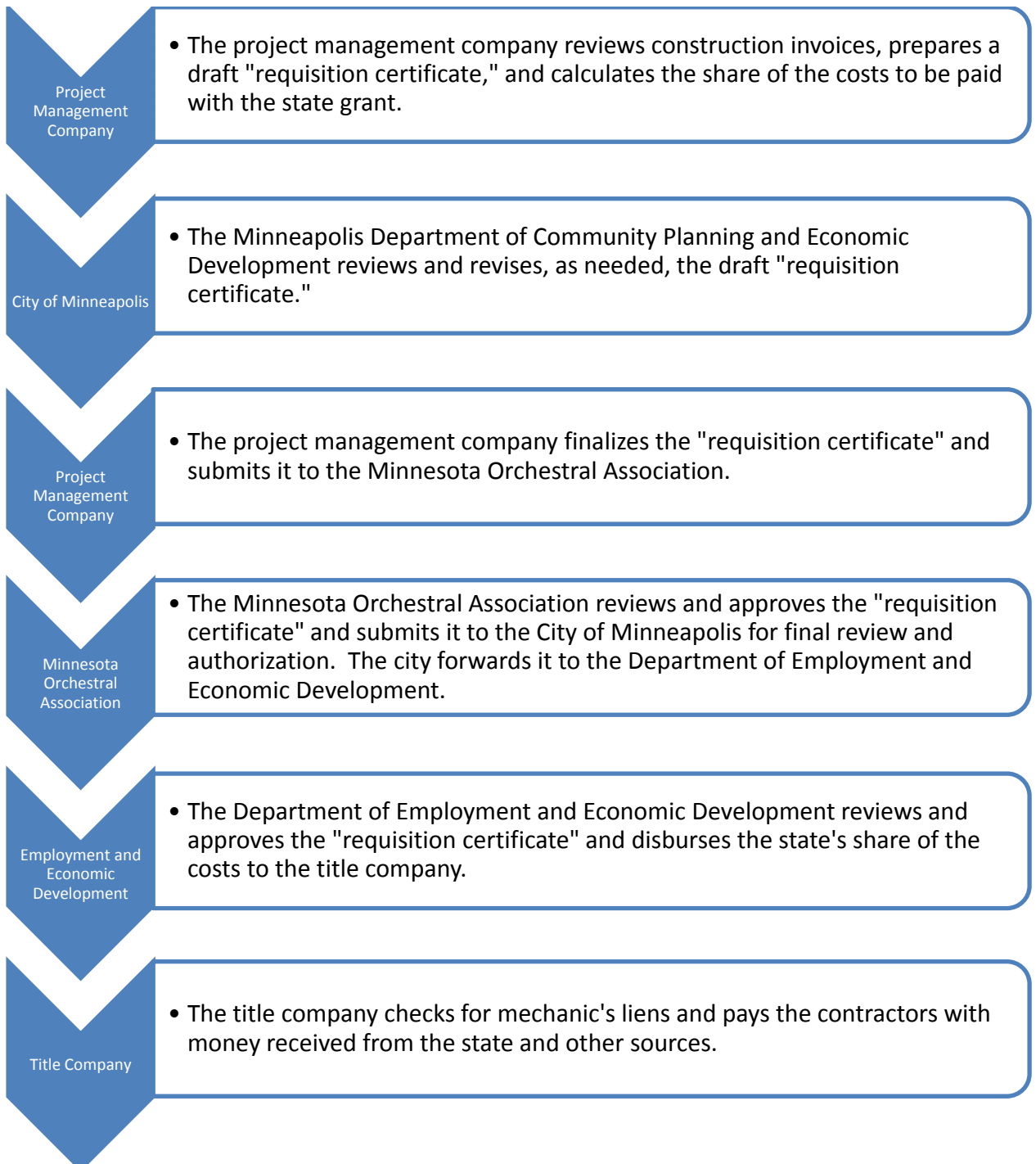
Roles and Relationships Among Entities Involved in the Renovation of Orchestra Hall



Source: OLA review of documentation provided by the Department of Employment and Economic Development, Minnesota Orchestral Association, and the City of Minneapolis.

Exhibit 2

Process for Review of Orchestra Hall Renovation Costs and Payment Authorization



Source: OLA review of documentation provided by the Department of Employment and Economic Development, Minnesota Orchestral Association, and the City of Minneapolis.

Methodology

To meet the objectives of our review, we performed a variety of procedures, including the following:

- We reviewed legal requirements and documents related to compliance with finance-related legal requirements.
- We interviewed representatives of the Minnesota Orchestral Association, Minnesota State Arts Board, Department of Employment and Economic Development, City of Minneapolis, Nelson Tietz & Hoye (a real estate consulting and project management company hired to oversee the Orchestra Hall renovation project), and First American Title Insurance Company (a title company hired to disburse payments to contractors for work performed on the renovation project).
- We obtained and reviewed financial information related to the Minnesota Orchestral Association's use of state grant money from the Minnesota State Arts Board.
- We reviewed our previous testing of the association's use of state grant money through April 2012 (this testing was part of a prior audit of the Minnesota State Arts Board).⁷ We determined that the previous testing was sufficient to address the focus of this review, and we did not perform further testing of the association's use of grant money before May 2012.
- We examined the association's support for use of grant money from the Arts Board after April 2012 and reviewed the association's final grant reports to the Arts Board.
- We traced the Arts Board's fiscal year 2013 (through March 2013) operating support grant payments to the Minnesota Orchestral Association into the bank account where the association is holding the money until the resolution of the contract dispute with the orchestra musicians.⁸
- We examined and tested a variety of documents related to the use of state bond proceeds to ensure compliance with constitutional and statutory requirements (and bond counsel's interpretation of the requirements). We tested payments made through March 2013 from the appropriation of state

⁷ Office of the Legislative Auditor, Financial Audit Division Report 12-19, *Minnesota State Arts Board*, issued September 20, 2012.

⁸ The association stated to the Arts Board and a legislative committee that it would "sequester" money from its 2013 Arts Board grant in a separate bank account and not use any of the money for its administrative costs associated with the contract negotiation with the orchestra musicians. However, as we discuss in Conclusion 2, there is considerable uncertainty about whether the association will be allowed to use money from the 2013 Arts Board grant and for which costs.

bond proceeds by examining support for significant items identified through our analytical procedures and for three of the eight payments selected for detailed testing. We also tested documentation supporting payments made from the Bond Proceeds Fund by the Department of Employment and Economic Development for the state's share of Orchestra Hall renovation costs.

Conclusions

1. **The Minnesota Orchestral Association complied with applicable legal requirements related to the grant money it received from fiscal year 2010 through fiscal year 2012 from the Minnesota State Arts Board.**

In a previous audit of the Minnesota State Arts Board's grants, we tested all of fiscal year 2010 and 2011 grant payments to the Minnesota Orchestral Association and all of the fiscal year 2012 grant payments made through April 2012. During this special review, we examined the final fiscal year 2012 grant payments (made after April 2012) and the final reports submitted to the Arts Board.

While we concluded that all payments complied with the applicable requirements of state laws and grant agreements, we also found that, like other arts organizations that received operating support grants from the Arts Board, the Minnesota Orchestral Association was not required by the grant agreements to separately account for its use of grant money. The board's grant agreements with the Minnesota Orchestral Association included a schedule showing when the board would pay "for services performed," but did not require a list of specific services performed or an accounting of their costs. Like the other organizations, the association added Arts Board grant money to other money available for general operations. As a result, we were not able to determine which specific costs were paid with the grant money. Our audit was limited to tracing the grant funds into the association's accounting and bank records and discussing with management their understanding about how the funds were to be used.

The Minnesota State Arts Board describes the purpose of its operating support grants program as providing general operating support to high quality, established arts organizations that produce, present, or exhibit works of art.⁹ Although the association was unable to show us exactly how it used grant money, it also clearly had sufficient general operating costs to support that it had used the money in accordance with the purposes of the grant.

In addition, the board's 2012 grant agreement prohibited the use of Arts and Cultural Heritage money for "indirect costs or other institutional overhead charges" unless those costs were "directly related to and necessary for" the accomplishment of the grant, mirroring the requirement in the 2011 appropriation law.¹⁰ However, we could not distinguish between the kinds of costs that would support general operations and the kinds of costs that would be considered prohibited indirect, institutional, or overhead. Although the association identified

⁹ Minnesota State Arts Board, "Grants to Organizations"
<http://www.arts.state.mn.us/grants/organizations.htm>

¹⁰ *Laws of Minnesota* 2011, First Special Session, chapter 6, article 4, section 2, subdivision 2.

\$47,466 of administrative costs in its final report for the fiscal year 2012 operating support grant, and management explained to us that they calculated the amount as 8 percent of the grant from the Arts and Cultural Heritage Fund, we found no basis to conclude that these costs were not allowable within the context of a grant for general operating support.

- 2. It is uncertain how much money the Minnesota Orchestral Association will be allowed to use from its 2013 Minnesota State Arts Board grant. It is also uncertain which costs may be paid with 2013 grant money. The terms of the grant agreement may allow the association to use money for costs it incurred during the time the Minnesota Orchestra did not perform due to the association's "lockout" of the orchestra musicians. The association and the Minnesota State Arts Board have different interpretations of which costs are eligible for reimbursement under the 2013 grant agreement.**

As of May 2013, the Minnesota Orchestral Association had not used its 2013 grant money; instead, it set aside the \$792,853 received by April 2013 from the Arts Board in a separate bank account.¹¹ The association considers this money "sequestered," but there are no legal restrictions limiting the association's access to the money.¹² The association set aside the money in response to concerns raised by legislators and the Minnesota State Arts Board that the association would use the money to pay for costs associated with the lockout or the contract negotiations. In December 2012, the association wrote in letters to legislators and the Minnesota State Arts Board that it would not use the money "until the contract negotiation is completed." At a February 2013 legislative hearing, the president of the association stated the following: "To be clear, no state funds have been or will be used to fund these negotiations. We will only access state funding once we have an agreement in place and we are again performing concerts for the community." Despite these statements, no amendment to the grant agreement between the Minnesota State Arts Board and the Minnesota Orchestral Association has been executed. The grant agreement states that any amendment must be in writing and signed by the parties who made the original contract.

¹¹ As of April 2013, the Minnesota State Arts Board had not paid the Minnesota Orchestral Association all of the fiscal year 2013 operating support grant. The grant agreement's payment schedule included a \$151,176 payment on May 20, 2013, and a final \$17,859 payment on August 20, 2013.

¹² 2013 legislation included in the Minnesota State Arts Board's appropriation language that addressed the consequences to an arts organization if a lockout occurs. It states, "If a 2013 fiscal year grantee uses grant funds during a lockout, then the commissioner of management and budget shall report on all such uses to the Office of the Legislative Auditor and shall recommend actions that may be taken by the Minnesota State Arts Board to offset such expenditures with reduction in future grants to the organization given by the Minnesota State Arts Board." *Laws of Minnesota* 2013, chapter 137, article 4, section 2, subdivision 3(a).

We asked the association's management whether they believed they had incurred costs that would be allowable under the grant, and they asserted that they had. We posed the same question to the executive director of the Minnesota State Arts Board, and she thought that the association would have to return all or most of the grant funds because it had not incurred allowable costs. While it is uncertain what the actual position of either entity may ultimately be, we closely examined the grant agreement to see whether it clearly stated the Arts Board's expectations that the association had to meet to keep the grant money.

We found that, as had been true in earlier years, the 2013 operating support grant agreement did not clearly identify the costs allowable to be paid for with the grant. The \$961,888 grant agreement (funded through both the General Fund and the Arts and Cultural Heritage Fund) stated that the association could use grant funds to support the activities described in the grant application. The grant application identified the association's following three goals for its use of the grant money:

- *Maintain tradition of artistic excellence and performance at the highest level. This goal will be achieved through artistically excellent concerts at the Minneapolis Convention Center Auditorium during 2012-2013, and in Orchestra Hall after the summer 2013 re-opening. Touring statewide, nationally, and internationally, recording, and broadcasting will also showcase the Minnesota Orchestra as a world-class symphony orchestra.*
- *Ensure broad community access to our programs. Continued and new initiatives will prevent economic, geographic, and perceptual barriers from keeping people from participation in Minnesota Orchestra concerts and programs. These include significant ticket discounting efforts, free community concerts, education programs, and the new Greater Minnesota residency program, Common Chords.*
- *Create a new business model that balances artistic quality and financial viability. The Minnesota Orchestral Association recently completed a new strategic plan for fiscal years 2012-2015. This plan combines realistic, new revenue streams with a restructuring of organization-wide expenses to achieve financial equilibrium that balances artistic quality and financial viability.*

The application also explained how the association would achieve each goal. For example, to meet the goal to "create a new business model," the application stated that it would "begin to implement the strategic business plan in all aspects of the organization, returning the organization to financial equilibrium," and in fiscal year 2013, it would "achieve an optimal balance between artistic quality and financial sustainability to maintain an innovative, world-class orchestra." Neither the grant agreement nor the application required the association to achieve all of the goals or allocated the grant amount between the goals.

The association identified for us about \$5.5 million of costs incurred from October 2012¹³ through March 2013 that it believed were allowable under the grant. Those costs included some payments to musicians for unemployment (related to layoffs before the lockout) and workers' compensation benefits, the conductor's salary and benefits, some contractually required costs related to performances that did not occur, salary and benefits for administrative employees, general administrative costs (including costs the association identified as related to its dispute with the musicians), and building operations and maintenance costs.

The grant agreement also included a termination clause, which allows the Minnesota State Arts Board to terminate the contract "upon written notice to the grantee from the board in the event the grantee fails to comply with one or more of the conditions set forth in this grant agreement." As of the end of May 2013, the Minnesota State Arts Board had not notified the association that it would be terminating the grant.

Finally, the grant agreement stated that the association "agrees to return to the board all funds not spent at the end of the grant period," which is June 30, 2013. We do not know whether the Minnesota State Arts Board would consider grant money held in the association's bank account "unspent" if the association had incurred costs that met a goal of the grant.

3. The payment process for the costs related to the Orchestra Hall renovation project included adequate internal controls to ensure that money appropriated from the Bond Proceeds Fund was used in accordance with applicable finance-related legal requirements. We did not identify any payments for costs that did not comply with applicable legal requirements.

For each of the eight payments made through March 31, 2013, totaling \$8,781,820, we verified the mathematical accuracy (including the calculation of the state's share) of the requisition certificate created to summarize and request payments for renovation costs incurred by the construction contractors. We also verified that each requisition certificate had all the appropriate reviews and approvals required by the disbursing agreement. We verified that the Department of Employment and Economic Development had correctly entered each payment into the state's accounting system.

We analyzed the summary spreadsheets supporting each requisition certificate (which listed costs incurred by each contractor or vendor) to identify key items that required additional testing because they appeared to be duplicate invoices, invoices that seemed high compared to other invoices, or seemed out of the

¹³ The grant agreement was not effective until September 26, 2012, when the last of the required signatures was obtained.

ordinary. For each of these key items, we reviewed the invoices supporting those costs.

We selected three of the eight payments for detailed testing. We selected the first and second payments because of the increased risk due to the initial implementation of the disbursing agreement's requirements, and we selected the seventh payment because it was the largest payment. The three payments totaled about 27 percent of the total of the renovation costs paid through March 2013. For each of these payments, we reviewed all supporting invoices and other documentation included in the disbursement requests. We ensured that the costs included only qualified capital costs in the total used to determine the state's portion; qualified capital costs included construction costs, design fees, signage, legal fees, and "soft" costs, such as project management costs, and excluded lobbying, fundraising, moving, and interim space costs.

We did not find a basis to question any costs paid with state bond proceeds.

- 4. In his testimony to legislative committees in 2010, the president of the Minnesota Orchestral Association made brief and generally positive remarks about the association's financial condition, and legislators did not ask for additional information. While there are indications that the president and some board members had significant concerns about the association's financial condition, it is not clear that a presentation of those concerns to legislative committees would have affected the Legislature's decision to support the Orchestra Hall renovation project.**

As discussed above, in 2010 the Legislature appropriated \$14 million to help fund the renovation of Orchestra Hall in Minneapolis and \$2 million to help fund the renovation of Peavey Plaza, which adjoins Orchestra Hall. We were asked to examine the testimony presented in legislative committees by Michael Henson, president and chief executive officer of the Minnesota Orchestral Association requesting the state money. Some legislators have raised concerns that Mr. Henson did not adequately disclose the association's financial challenges to legislative committees but has more recently used those challenges to justify a request that orchestra musicians agree to significant salary reductions and other contract concessions.

In response to those concerns, we examined Mr. Henson's testimony before three legislative committees in January 2010: (1) the House Cultural and Outdoor Resources Finance Division on January 20, 2010; (2) the Senate Economic Development and Housing Budget Division on January 21, 2010; and (3) the House Higher Education and Workforce Development Finance and Policy Division on January 27, 2010.

Mr. Henson gave similar presentations to each committee, providing background on the history and accomplishments of the Minnesota Orchestra before discussing

the proposed renovation of Orchestra Hall. He explained that the project would (1) expand and improve the lobby, which at the time accommodated only a third of the auditorium's capacity; (2) modernize the auditorium, including the replacement of seats; and (3) renovate and improve the adjoining Peavey Plaza.

Mr. Henson presented a generally positive picture of the Minnesota Orchestral Association's finances, and he was not asked substantive questions about the association's financial condition. In his first two presentations Mr. Henson said, "On the financial front, we have announced balanced budgets over the last three consecutive years, and we are facing the current economic downturn with a degree of stability." In his third presentation, Mr. Henson replaced "a degree of stability" with "some fortitude and consistency of planning." Mr. Henson noted that prior renovation proposals for Orchestra Hall were much more expansive and said the association had "tested and rescaled the scope of the whole project in light of the challenging economy. The result is a very focused and feasible project." Legislators asked few substantive questions, either about the renovation plans or the Minnesota Orchestra's finances.

Mr. Henson did not indicate to legislators that he and some association board members were beginning to have significant concerns about the association's financial condition. For example, minutes from an association's board meeting on February 19, 2009, indicate that Mr. Henson told board members that the association was projected to have a deficit in fiscal year 2009 between \$1 million and \$2 million, and the deficit for fiscal year 2010 was projected to be between \$4 million to \$5 million. The minutes for that meeting also indicate that the chair of the association's finance committee said:

...in recent years we have tinkered successfully with our business model but now we have to accept the responsibility for something more than tinkering with the model and we have to make thoughtful and difficult decisions. If the deficit is between \$3 million and \$5 million in fiscal 2010, it will be of the same size range for the next two years of the musicians' contract. This is a serious liquidity issue, and the MOA [Minnesota Orchestral Association] already has \$11 million in debt. Our job is to leave behind a sustainable business.

In this and other board meetings, there were expressions of concern about sharing this more pessimistic picture of the association's financial condition with outside audiences. For example, following the report from the chair of the finance committee noted above, the meeting minutes indicate that another board member "...reminded everyone that what is said today cannot go out of this room." And, according to minutes from the association's board meeting on April 23, 2009, Mr. Henson indicated he thought there was "tension between managing the media problem and addressing the stressed business model within the orchestral profession." However, the association did begin to share more information about

its “stressed business model.” For example, minutes from the association’s annual business meeting on December 1, 2010, indicate that a member of the association’s finance committee said the following:

Although we are reporting a balanced budget, we should not forget that the continued budget cuts were not enough to overcome the steep decline in revenues. As such, the board approved at its October 27, 2010, meeting, a total draw amount of \$7.6 million from the endowment to achieve the break-even results.

This more pessimistic assessment of the association’s financial condition was especially pronounced when, in November 2011, the association released a strategic business plan, *Vision for a Sound Future*. Summing up its financial situation, the association said: “For more than 10 years, the Minnesota Orchestral Association has had an unsustainable financial structure.” It also noted that 80 percent of its expenses in 2012 were from concert-related costs, of which 63 percent were musicians’ salaries and benefits. The plan concluded that the association could not continue to rely on revenue from its endowment and trusts to close the gap between expenses and earned income and contributions.

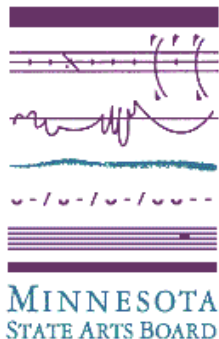
The association’s strategic plan proposed the following five actions to “achieve financial sustainability”:

- Implement ambitious but realistic earned and contributed revenue increases.
- Use the renovation of Orchestra Hall to attract new audiences and broaden revenue streams.
- Re-scope concert series to align supply and demand.
- Launch a new major gifts initiative to fund significant artistic projects.
- Raise funds for a new endowment fund, with conservative limits for draws to protect donor contributions.

In agreeing to conduct this review, we told legislators that OLA would not make judgments about the association’s strategic plan or financial projections that are in large part the basis for the contract dispute between the association and the musicians. We have presented relevant parts of the plan simply to further illustrate that, according to the association’s own characterizations, the association has had serious financial challenges for a considerable period of time.

As previously indicated, we examined Mr. Henson’s testimony at the request of legislators. While noting that his testimony about the association’s financial condition was limited and generally positive, we do not offer a judgment about what Mr. Henson should have said or what legislators should have asked. There simply is no objective standard by which we could make that judgment. Furthermore, it is not clear how a more complete—and less positive—presentation about the association’s financial challenges would have affected the

association's request that the Legislature support the Orchestra Hall remodeling project. More information about the association's financial challenges might have caused some legislators to be more cautious toward the project, but it also might have persuaded others to be more supportive.



June 10, 2013

James R. Nobles
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
Saint Paul, Minnesota 55155-1603

Dear James Nobles,

The Minnesota State Arts Board appreciates the careful and thorough attention the Office of the Legislative Auditor has given to the special review of the Minnesota Orchestral Association's (MOA) use of State funds during fiscal years 2010 through 2013. We are pleased that your office found and reported that the MOA "complied with applicable legal requirements related to the grant money it had received from fiscal year 2010 through fiscal year 2012 from the Minnesota State Arts Board."

As noted in your report, the Arts Board has made payments to the Minnesota Orchestral Association for a fiscal year 2013 Operating Support grant. We understand those funds have been sequestered by the MOA. Once the grant period concludes, on June 30, 2013, the Arts Board will begin the process of determining which of those unused funds could be expended for allowable costs and which may need to be returned to the Arts Board, as the grant contract requires.

We appreciate the opportunity to respond to this report, and will be happy to answer any questions that may be prompted by this response.

Sincerely,

Sue Gens
Executive Director

Park Square Court
Suite 200
400 Sibley Street
Saint Paul, MN
55101-1928

(651) 215-1600
(800) 866-2787

MN Relay 7-1-1

msab@arts.state.mn.us
www.arts.state.mn.us