

**EXAMINATION OF THE
BLUEGRASS AREA DEVELOPMENT DISTRICT**



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March 4, 2014

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The Auditor of Public Accounts (APA) has completed its examination of the Bluegrass Area Development District (BGADD). This letter summarizes the procedures performed and communicates the results of those procedures.

Examination procedures included interviewing staff concerning BGADD's environment and operating activities, reviewing expenditure transactions associated with BGADD for the time period of May 2010 through September 2013, and reviewing certain additional financial activity related to BGADD's federal grant activities for fiscal years 2011 through 2013.

The purpose of this examination was not to provide an opinion on the financial statements, but to ensure appropriate processes are in place to provide strong oversight of financial activity of BGADD and to review specific issues brought to the attention of this office.

Detailed findings and recommendations based on our examination are presented in this report to assist all parties involved for improving procedures and internal controls. Overall, these findings identify serious concerns with regards to lack of appropriate policies and procedures leading to excessive and/or unnecessary expenditures, possible noncompliance with federal grant requirements, a lack of proper oversight, and a failure to report potential criminal acts to law enforcement. Due to the seriousness of these matters, this report will be referred to the Kentucky Attorney General, the Kentucky State Police, the Kentucky Department for Local Government, the Kentucky Education and Workforce Development Cabinet, the Kentucky Cabinet for Health and Family Services, the Federal Bureau of Investigation, the U.S. Department of Health and Human Services and the U.S. Department of Labor.

We appreciate all the cooperation we received during the examination, especially from the staff and the BGADD Executive Committee. If you have any questions or wish to discuss this report further, contact me or Libby Carlin, Assistant Auditor of Public Accounts.

Sincerely,

A handwritten signature in black ink, appearing to read "Adam H. Edelen".

Adam H. Edelen
Auditor of Public Accounts

C: Linda Magee, Bluegrass Area Development District Board Chair

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Examination of the Bluegrass Area Development District

Examination Objectives

On July 3, 2013, we notified the Bluegrass Area Development District (BGADD) that matters had come to our attention which warranted further review from our office. The purpose of the APA examination was to determine if BGADD funds are administered in a manner to ensure BGADD objectives are met and accountability and transparency exist. The examination was not to perform a financial statement audit of BGADD.

BGADD Background

BGADD was created per KRS 147A.050-147A.140 for the purpose of developing a partnership with local governments to assist in regional planning for economic growth in the Commonwealth.

BGADD's mission is to enhance the economy of communities in its area through planning to maximize resources, projects to promote development and programs to improve the quality of life for the citizens of the region.

Findings and Recommendations

Finding 1: BGADD Governance Practices Are Not Conducive To Proper Oversight.

During the review of BGADD, questionable oversight activities prompted the evaluation of current board governance practices. These procedures, along with other testing throughout the examination, identified governance concerns related to compliance with its by-laws, as well as transparency and accountability weaknesses due to problems meeting the intent of open meetings and open records laws. The evaluation included

interviews with BGADD Board members and employees, and reviews of meeting minutes, BGADD documented policies, and BGADD by-laws.

Recommendation: BGADD should strengthen agency controls to ensure that established policies and procedures are followed, including agency by-laws. BGADD should further ensure that the roles of the committees are clearly defined and all transactions receive proper review and approval prior to action being taken.

Finding 2: BGADD Engaged In Activities That Were Beyond Its Statutory Authority And/Or Activities That Appeared To Create Conflicts Of Interest.

The examination identified numerous concerns related to certain activities of BGADD. Auditors identified several organizations either created by a former BGADD executive director or others which appeared to be mechanisms used by BGADD to expand into activities that do not appear to be within the scope of BGADD's statutory authority.

Recommendation: BGADD should adequately document and evaluate potential conflicts of interest as required by BGADD's policy and federal regulations. Conflicts of interests in relation to BGADD's fiscal agent responsibility with the Workforce Investment Board should be eliminated since it is unable to fully exclude its Board Chair from matters involving the Workforce Investment Act funds.

Finding 3: 3: BGADD Did Not Report Possible Criminal Violations To Law Enforcement Authorities.

In Finding 2, the examination reported concerns regarding the

Executive Summary (Continued)

BGADD's authority to operate an offender re-entry program, Steppin' To A New Beat (STANB). BGADD employed an individual to act as a "re-entry specialist" to manage this program. Allegations of possible misconduct by this employee prompted BGADD to retain a law firm to conduct an investigation into the allegations in April 2013. Auditors requested a copy of the investigation, which was provided by BGADD. Auditors noted numerous concerns in the report, prompting further examination of the matters noted.

Recommendation: We recommend BGADD report the findings of the investigation into the actions of its former employee to law enforcement authorities immediately. Due to the auditors' concerns over these matters, this finding will be referred to the Kentucky Office of the Attorney General, the Kentucky State Police and the Federal Bureau of Investigation. We further recommend BGADD determine the amounts due to federal programs for unallowable costs, and implement internal controls that would prevent other employees from utilizing BGADD resources for non-BGADD activities.

Finding 4: BGADD Violated Procurement Policies. Auditors received concerns that appropriate procurement procedures were not followed at BGADD. The examination identified instances in which certain transactions did violate BGADD procurement policies.

Recommendation: BGADD should ensure all contracts for services are properly procured in accordance with established policies and procedures. Also ensure reasonable procedures are in place to avoid conflicts of interest in contracting for services.

Finding 5: BGADD Did Not Have Internal Controls In Place To Prevent Excessive And Unnecessary Expenditures, Including Travel And Business Reimbursements. Allegations were brought to the attention of the APA related

to excessive or unallowable expenditures by BGADD, prompting auditors to perform procedures to review credit card expenditures, reimbursed travel costs, and other expenditures.

Recommendation: We recommend the BGADD Board clarify and follow existing BGADD policies to eliminate excessive or unnecessary spending. Revised policies should provide further guidance to ensure transactions and travel allowances are reasonable in amount, necessary, and properly supported by receipts or other appropriate documentation. The Board should consider eliminating the travel allowance for the executive director in favor of a reimbursement policy which would improve monitoring of total travel costs and reduce the risk of waste, fraud, or abuse.

Finding 6: Significant Noncompliances Were Identified Related To Management Of Federal Grants. During the examination, auditors found numerous instances in which BGADD did not properly account for or manage its federal grants. Federal grants are critical to BGADD's mission, and, therefore, it is critical that the agency has significant expertise in federal grant management. Auditors acknowledge that BGADD receives a federal compliance audit in accordance with OMB Circular A-133 each year, and that the purpose of the APA examination is not to opine on federal compliance. However, many of the weaknesses noted appear to be matters of noncompliance that should be addressed in the next audit of BGADD.

Recommendation: BGADD should implement policies and procedures to comply with state and federal regulations to demonstrate proper fiscal responsibility of public funds. This should include reconciling draw downs to actual expenditures which are allowable for the federal program reimbursing the agency. Accounting ledgers should show a clear and direct link to the amount of requests for reimbursement.

Finding 7: BGADD Paid Bonuses To Employees. During the examination of BGADD, testing of payroll expenditures identified that selected employees received year-end bonuses. Inquiry into these bonuses determined that they were funded with unobligated grant funds. BGADD staff indicated management referred to the bonuses as “One Time Salary Adjustments” because they were aware that bonuses are not allowable costs for federal grants. Bonuses are also not permitted by the Kentucky Constitution for public employees.

Recommendation: The BGADD Board should not approve the payment of employee bonuses. The BGADD Board and employees should review federal regulations governing allowable costs, both direct and indirect, and treat salary adjustments in accordance with those requirements. Specifically, BGADD should adhere to 2 CFR 225 and consistently assign direct and indirect costs when incurred for the same purpose and like circumstances. BGADD should maximize the use of unobligated balances for the participants of the federal programs it administers. Salaries adjustments may be planned and approved, but there should not be an incentive for staff to underfund or under-serve grant participants as part of this plan.

Finding 8: BGADD Utilized An Outdated Accounting System Leading To A Lack Of Internal Controls Over This System. The financial activities of BGADD are accounted for using a system named RESULTS, which was designed in the 1980s. The RESULTS system utilized by BGADD came with a standard business systems package, including accounts receivable, accounts payable, etc.; however, BGADD modified the software for its purposes. Auditors learned this was the case for the majority of RESULTS clients. The accounting system is used for recording, processing, and transmitting financial transactions, as well as supporting the financial planning and budgeting activities, and financial statement preparation.

Recommendation: We recommend BGADD implement internal controls over the financial accounting system that ensure that assets are safeguarded, transactions are processed in accordance with applicable laws and regulations, transactions are properly recorded, reconciled, processed and summarized to permit the preparation of reliable financial data.

Conclusion

The findings indicate a weak control environment within BGADD which promoted unnecessary and/or excessive spending, inefficient operations, and noncompliance with state and federal regulations.

Background

Impetus and Objectives of the Examination

On July 3, 2013, the Auditor of Public Accounts (APA) notified the Bluegrass Area Development District (BGADD) that a special examination would be conducted in order to address concerns received by the APA. Based on allegations noted, the examination focused on several key areas - expenditures associated with the Trent Boulevard property, federal grant accounting, potential conflicts of interest involving BGADD management, and whether the overall environment at BGADD is conducive for proper fiscal management. The purpose of this examination was not to perform a financial statement audit of BGADD, but instead to determine whether funds, including federal funds, are administered in a way to ensure BGADD objectives are met and that the proper level of accountability and transparency exists for activities funded with taxpayer dollars.

Scope and Methodology

The scope of the BGADD examination was a review of transactions and activities from July 1, 2010 through September 30, 2013, although the review of information earlier or later than this timeframe was performed as needed to fully examine specific transactions or events. To address the examination objectives, the APA conducted numerous interviews with BGADD employees, Board members and others with direct knowledge of BGADD requirements and administration. In addition, auditors reviewed and analyzed financial documents, reports, contracts, and minutes from Board meetings. Auditors also extended requests to interview the former director of BGADD through contact information provided by BGADD and through an attorney that had performed work for BGADD, but received no response.

BGADD Structure and Mission

BGADD is one of Kentucky's 15 Area Development Districts (ADD). According to KRS 147A.050-147A.140, ADDs were created for the purpose of developing a partnership with local governments to assist in regional planning for economic growth in the Commonwealth. BGADD is located in Lexington, Kentucky and is the largest ADD in the state with a service region made up of 17 counties in Central Kentucky.

BGADD states its mission is to enhance the economy of communities in its area through planning to maximize resources, projects to promote development and programs to improve the quality of life for the citizens of the region. BGADD is staffed by an executive director and approximately 86 additional employees. The primary work of the staff is to carry out the directions of the Board for area development and to assist local governments and other entities in its region with grant administration and other needs.

Background

The Board of BGADD is comprised of 75 Directors. Each county in the BGADD region is represented on the Board by its Judge/Executive and the Mayor of its county seat. The Board also includes two citizen members from each county, as well as three at-large citizen members from throughout the region. These citizen members are appointed by the Board's elected officials. The Board serves as the governing and policy-making body of BGADD. The Executive Committee of the BGADD Board carries out the policies of the BGADD Board of Directors and directs the activities of the Executive Director and staff of BGADD. The members of the Executive Committee are appointed by the BGADD Board Chair. The Executive Committee is comprised of 17 people, of which, nine are elected officials and eight are citizen board members.

BGADD not only administers state and federal grants of local governments, but also receives state and federal funds directly. In fiscal year (FY) 2012, BGADD expended a total of \$24,473,078, with approximately 90% of those expenditures related to federal and state grants. The majority of BGADD's federal funding comes from the U.S. Department of Labor and the U.S. Department of Health and Human Services. In addition, BGADD receives local contributions from fees paid by local governments in the BGADD region. During FY12, local contributions totaled \$107,000. Because BGADD's operations rely so heavily on federal funding, and also because local governments in its service area rely on BGADD for administration of certain federal grants, compliance with federal regulations is critical.

Findings and Recommendations

Finding 1: BGADD Governance Practices Are Not Conducive to Proper Oversight

During the review of BGADD, questionable oversight activities prompted the evaluation of current board governance practices. These procedures, along with other testing throughout the examination, identified governance concerns related to compliance with its by-laws, as well as transparency and accountability weaknesses due to problems meeting the intent of open meetings and open records laws. The evaluation included interviews with BGADD Board members and employees, and reviews of meeting minutes, BGADD documented policies, and BGADD by-laws.

BGADD By-Laws

BGADD's by-laws state, "The AR&F [Administrative Review and Finance] Committee shall review and approve all operating policies and procedures for the District and submit them for approval to the Executive Committee. In addition, the AR&F Committee shall work with the executive director to develop and monitor the district budget and assist the executive director with routine day-to-day business operation decisions."

The by-laws further state, "The purpose of the Executive Committee is to provide the Board of Directors with orderly management of routine business. It shall be within the Executive Committee's authority and power to oversee and/or conduct the normal and recurring business of the Board including approval of the payment of: authorized staff salaries, official travel expense, expenditures for office supplies and materials, telephone and utility bills, rent payment, if any, authorized employee insurance and retirement benefit premium, and withholding taxes.... Expenditures not generally covered by the items listed above shall require prior authorization for payment by the Executive Committee...."

The examination noted matters that should have been addressed and acted upon by the Executive Committee were instead addressed by the AR&F Committee. It appeared that the former executive director frequently sought approval from AR&F for business and fiduciary actions that were not routine, day-to-day expenditures or other actions. The Executive Committee would often be informed of the action taken after the fact. The failure to follow written by-laws resulted in questionable expenditures that were not pre-authorized by the Executive Committee as required.

Findings and Recommendations

One significant example noted is BGADD's purchase of property on Trent Boulevard for approximately \$600,000. This property was purchased by BGADD to operate an offender re-entry program to assist former felons in obtaining employment. The property purchase was approved by BGADD's AR&F Committee, and BGADD's Executive Committee was informed only after the purchase of the property. The examination also identified that the purchase of the property was made without acquiring an appraisal or other determination of the building's value. Auditors also noted \$34,919 in additional expenditures charged to the Trent Boulevard account, although unrelated to the purchase of the property, that were not approved by the Executive or AR&F Committees.

Testing also identified that the AR&F Committee granted approval for \$200,000 in improvements for the Trent Boulevard property. However, the expenditures for improvements exceeded \$500,000, indicating BGADD exceeded the amount approved by the AR&F Committee by more than \$300,000.

Open Meetings and Open Records Laws

BGADD also failed to comply with the Open Records Act. Auditors obtained documentation that suggests the former executive director may have attempted to circumvent the Open Records Act. One example related to an incident in which a citizen requested information from the Bluegrass Workforce Investment Board (WIB) regarding BGADD's purchase of Trent Boulevard. The request was denied by BGADD, stating that the request was not on the approved forms and the request was interrogatory in nature. This incident was reviewed by the Kentucky Office of the Attorney General (OAG), which issued OAG Opinion 12-ORD-107 finding that an entity cannot require Open Records Requests to be submitted on a particular form and that the request of the citizen was not interrogatory in nature and described the records requested with particularity.

Additionally, auditors noted that the schedule for regularly held Board meetings was only available in a magazine publication created by BGADD, which is distributed to all members of the Board and others only when requested to be on the mailing list. It is questionable as to whether provisions of open meeting laws requiring public notification of meetings is met when meeting schedule information is only provided to individuals other than Board members upon request. KRS 61.800 states, "the formation of public policy is public business and shall not be conducted in secret...."

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The examination also identified that meeting minutes did not provide necessary detail of actions and communication leading up to final decisions of the Board. AR&F Committee meeting minutes were nonexistent for a five month period, from July 2012 to November 2012. Auditors were unable to determine whether meetings were held but not documented, or if the AR&F Committee failed to meet during that time. In either instance, a noncompliance exists either due to the failure of the Committee to meet at least monthly as required in the BGADD by-laws, or from failing to maintain meeting minutes to document the matters addressed and actions taken by the Committee.

Open Meeting Laws and the Open Records Act are safeguards that aid in keeping the public informed. Not complying with Open Meeting Laws and the Open Records Act impairs transparency and accountability by preventing the public from having information related to public activities funded by taxpayer dollars.

No Reporting Mechanism for Concerns and Allegations

There appears to be no mechanism for employees or members of the public to confidentially report concerns and allegations. Without some mechanism for confidential reporting, BGADD or its Board may miss opportunities to address serious concerns before they become larger issues. Confidentiality is an important component to encourage communication and avoid concerns of potential retaliation.

Policies and Procedures

Based on the exceptions discussed above, BGADD did not adhere to established agency procedures and guidelines. Good internal controls dictate that Board members should actively engage in basic stewardship responsibilities and adhere to stated policies and procedures to encourage and demonstrate good business practices supporting the mission of BGADD. A comprehensive set of formal and appropriately communicated policies, coupled with current, complete, and well-documented procedures, are essential to an effective system of internal controls for any organization. A well-designed policy manual is essential in today's complex, competitive and regulation-ridden work environment. With an adequate policy manual, agency employees will be better able to act effectively, decisively, fairly, legally and consistently.

Recommendations

We recommend the following:

- BGADD should strengthen agency controls to ensure that established policies and procedures are followed, including agency by-laws. BGADD should further ensure that the roles of the committees are clearly defined and all

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transactions receive proper review and approval prior to action being taken.

- BGADD Board members should re-acquaint themselves with the by-laws, and implement practices to ensure they are followed. Following by-laws minimizes disputes and disruption caused by challenges to established rules. The Board may facilitate a good working relationship between the Board and the executive director, ensuring that each group understands its roles, defined functionality, and limitations.
- BGADD should immediately implement procedures to ensure that Open Records and Open Meeting laws are followed. BGADD has a role in which a lack of accountability and transparency not only impairs its reputation, but also of its members using the agency for administrative assistance.
- All committees of the BGADD Board should conduct meetings at least as often as required in BGADD's by-laws. BGADD Board and its committees should ensure that sufficiently detailed, accurate meeting minutes are prepared and retained.
- In addition to publicizing meeting schedules in its limited distribution publication, BGADD should also publish notifications of Board and committee meetings in an easily accessible, broad distribution media outlet (i.e. newspaper, BGADD website), as required by KRS 61.820.
- The BGADD Board should establish policies and procedures to receive, investigate, and resolve concerns related to the organization, including anonymous concerns. In addition, where applicable, the Board's policy should include a reference to KRS 61.102 notifying employees of their rights to protection against retaliation for reporting violations to certain authorities. A whistleblower policy should be adopted and distributed to employees. The policy should include reporting procedures and management's responsibility to address issues reported.

Finding 2: BGADD Engaged In Activities That Were Beyond Its Statutory Authority And/Or Activities That Appeared To Create Conflicts Of Interest

The examination identified numerous concerns related to certain activities of BGADD. Auditors identified several organizations either created by a former BGADD executive director or others which appeared to be mechanisms used by BGADD to expand into activities that do not appear to be within the scope of BGADD's statutory authority. Those organizations that were created by BGADD officers are depicted in Appendix A.

Findings and Recommendations

Steppin' To A New Beat

In June 2010, BGADD began a program called Steppin' To A New Beat (STANB). This program was an offender re-entry program to address the basic needs of felons who have been released or were soon to be released from incarceration. The STANB program was designed to assist ex-offenders by offering classes geared toward providing support and skills for successful transition outside of jail. In 2013, the STANB program added a housing component to provide active participants with transitional housing. To facilitate the housing component, BGADD purchased property to be renovated, which is further described in Finding 4.

Auditors questioned why BGADD would be involved in an offender re-entry program. The examination identified that the OAG had already addressed these concerns. OAG Opinion 13-004 opined that BGADD did not have the authority to operate an offender re-entry program on its own or on behalf of any other entity. Such a program would only be acceptable if BGADD administered it on behalf of a local government that had requested assistance through a memorandum of agreement. No memorandum of agreement existed.

Related Parties

As noted above, additional activities of BGADD that were matters of concern involved entities that appeared to be closely related to BGADD. Accounting guidance defines the phrase *related parties*, in part, as:

- Affiliates of the entity;
- Principal owners of the entity and members of their immediate families;
- Management of the entity and members of their immediate families;
- Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests.

The special relationship inherent between related parties may also create potential conflicts of interest. Also, as previously noted, BGADD's relationship with these entities created concerns as to whether BGADD is utilizing these organizations to expand its scope beyond that authorized by law.

Bluegrass Industrial Foundation

One relationship that was a cause of concern during the examination is BGADD's relationship with the Bluegrass Industrial Foundation, Inc. (BIF). BIF was incorporated in 1982 as a Kentucky non-profit

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corporation, with the registered agent being an individual that acted as BGADD's executive director from 1971 through 2005. Auditors noted that as far back as 2002, BGADD and BIF were audited together. Also, BGADD and BIF share board members.

BGADD currently leases office space from BIF for \$258,054 per year. Auditors were provided a lease agreement beginning in July 2005, although BGADD moved to its current location in 1994. The BGADD could not provide documentation of the leasing arrangement between BGADD and BIF from 1994 to 2005, but due to the relationship between BGADD and BIF, auditors requested documentation from BIF regarding the sources of funds for the purchase of the property. The documentation provided indicated the sources of funds for the building's purchase are as follows:

<u>Source</u>	<u>Amount</u>
Cash, BIF	\$ 75,000
Area Development Fund Grant (From KY Department for Local Government)	450,000
Loans:	
Central Bank & Trust Co., (collateralized by BGADD certificates of deposit)	650,000
Mortgage note from Republic Savings Bank	425,000
Total Purchase Price	<u>\$ 1,600,000</u>

Based on this documentation, it appears \$1,100,000 of the purchase price was from sources approved or collateralized by BGADD. In a letter dated March 30, 1993, the Kentucky Department for Local Government (DLG) approved the BIF's application to obtain \$450,000 in area development funds (ADF) under the provisions of KRS 42.350 to 42.370, and informed the BIF that by utilizing these funds it is required to operate and maintain the property for a public purpose for the life of the property. KRS 42.350 describes the types of capital projects that may be funded by ADF grants, and also describes the method for application and approval stating, "The board of directors of each area development district shall determine from among the capital project proposals submitted by eligible beneficiary agencies, the capital projects to be proposed to be constructed or acquired out of the fund. The area development districts shall submit to the commissioner of the Department for Local Government the capital projects selected for construction for acquisition within the districts." Therefore, based on this statute it

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appears the BGADD Board was required to approve the application for a proposal, which ultimately was a proposal submitted by an entity which the BGADD executive director created.

Auditors were provided a resolution of the BGADD Board authorizing the BGADD chairman and secretary to pledge \$650,000 in a certificate of deposit (CD) as collateral for a loan for BIF for the purchase of the property, a portion of which was to be leased to BGADD. This collateralization was provided in order to assist BIF in obtaining a loan for the property below market interest rates. Documentation examined from BGADD to its auditors indicated the CDs were funds that had been accumulated from local contributions and stated, "Initial discussions with the BGADD Finance Committee indicate the board feels this would be a wise use of their local funds and would benefit all programs the BGADD is responsible for by keeping costs down and at the same time giving the ADD additional space it needs for the growth it has had since 1990." This correspondence also indicated that BIF intended to use the revenue it generated from leasing the building space to fund its mission, and therefore the leasing arrangement with BGADD appeared to be a revenue generating activity.

The documentation identified that \$1,100,000 of the \$1,600,000 purchase price for the building was funded through sources available to or approved by BGADD, which raised questions as to the benefit to BGADD. Additional documentation identified that BGADD inquired about the availability of other properties available for lease and two properties were identified for just under the cost per square foot of the BIF property. Also, if BGADD had a concern regarding its ability to finance property on its own, it is questionable why it did not choose to establish an entity for financing, which appears permissible under KRS 58.180. This type of arrangement would be similar to relationships noted in Kentucky counties with public properties corporations, which are financing entities that also share board members with the county fiscal court. Under this type of arrangement, upon discharge of the mortgage, title to the property would vest to BGADD. Instead, the current BGADD lease arrangement does not appear to convey any ownership to BGADD, although lease payments made by BGADD to BIF to date would have more than paid for the property.

Also, BGADD Board minutes indicate that certain BGADD Board members discussed BGADD purchasing its building in recent years. The decision passed unanimously in 2012, and the former executive director was tasked with making an offer to negotiate with the BIF executive director. However, nothing resulted from this action, and

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auditors were unable to identify documentation in subsequent Board minutes explaining the outcome of the offer.

As a result of the lease agreement and the relationship between these entities, the fiscal reality is such that it gives the appearance that BIF was a blended component unit of BGADD. Under accounting standards, blended component units are legally separate entities in which the primary agency, BGADD, has a financial benefit/burden relationship with the entity and can exert significant influence over it. Accounting standards require these types of entities to be reported together to avoid being misleading. There is no question that BGADD had significant influence over BIF since the two entities shared an executive director and certain board members. A financial benefit/burden relationship also appears to be clear given the lease arrangement and also BGADD's risk in collateralizing the BIF mortgage. Ultimately, this gives the appearance that BGADD was leasing space from itself.

Because BGADD's office space is paid in part by federal funds, this lease creates an arrangement in which it appears BGADD could use rent payments to de-federalize grant funds by running them through an entity it created. This risk is further increased due to other transactions identified between BIF and BGADD. In addition to the lease agreement, it was further determined that BIF made loans to BGADD for renovations for the office space leased from BIF, and also for equipment. These loans were not evidenced by written agreements, but were oral agreements between the two agencies. Total payments made by BGADD to BIF for the lease arrangement and verbal loans were \$289,214, \$284,196, and \$266,217, for FYs 2011, 2012, and 2013, respectively, for a total of \$839,627 for the three year period. Detail of payments between BGADD and BIF is presented in Appendix B. These payments were all classified as indirect costs by BGADD, and, therefore, ultimately paid with federal, state, and local funds. The use of BIF funds for renovations and equipment purchases by-passed BGADD's procurement policies, and no documentation existed to provide evidence that renovations or equipment purchased were subjected to bid or quote procedures when required.

As further evidence of the relationship between BIF and BGADD, the two agencies also have an agreement with the Paris-Bourbon County Economic Development Authority (EDA) to staff the EDA. Although this agreement spanned the period FY 09 through FY 12, BGADD staff could only provide auditors a copy of the contract with the EDA for FY 12. Under this agreement, BGADD paid BIF to cover costs for services. Per inquiry with agency personnel, the

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payments to BIF in regards to the agreement with the EDA represented payments resulting from a “contract between BIF, Paris-Bourbon EDA and BGADD. It was for BIF’s effort in expanding existing private sector industries which is outside BGADD’s scope”. Furthermore, per BGADD’s Chief Financial Officer (CFO), the assistance provided by BIF entailed “general marketing, client development, hosting receptions and trade missions”.

Bluegrass Regional Recycling Corporation

Another potential conflict of interest exists between BGADD and the Bluegrass Regional Recycling Corporation (BRRRC). BRRRC is a Kentucky non-profit corporation recognized by the Internal Revenue Service as an IRC 501(c)(3) organization, founded in 1990. The original location of the BRRRC was in Lexington, KY, but currently is located in Richmond, KY. BRRRC operates a recycling program that local governments can participate in. In return, the local governments receive a financial return on the sale of their recyclable materials. BRRRC also operates a career development center and a public training center. Per its website, the career development center was designed and built to meet the requirements of the Kentucky Department of Corrections (DOC). Through this program, BRRRC houses correctional residents and those individuals can earn certifications in the recycling industry.

BRRRC was created as an initiative of BGADD, incorporated by a former executive director of BGADD, with a subsequent BGADD executive director being a member of the BRRRC Board. Also, the registered agent of BRRRC was a BGADD Board member. At the time of incorporation, BRRRC’s address was the same as BGADD. Per the BRRRC by-laws, the BGADD Board Chair appoints BRRRC directors and their terms. The BRRRC Board listed on its website is made up of individuals that also serve as BGADD Board members. The auditors interviewed seven BRRRC Board members and of those, four of them did not know they were on the BRRRC Board or were not sure of how they were appointed to the BRRRC Board. Also, of the BRRRC Board members that were aware of their position on the Board, three were not aware of the function of the BRRRC Board. Auditors learned this may be because the BRRRC Board rarely met. Auditors also noted that BGADD prepared the grant application on behalf of Madison County/City of Richmond to obtain funding for the construction of a new facility for BRRRC. These details indicate BGADD significantly influences the operations of BRRRC, even though BGADD’s financial statements do not report the BRRRC as a component unit or related party of its agency.

During the examination, auditors further determined that BGADD requested BRRRC to subcontract for home-delivered meals in

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Madison County when another subcontractor backed out. The home-delivered meals are funded by BGADD's Aging grant, with BRRC receiving \$37,762 in federal funds for this service. Records indicated no competitive bidding was performed to award this contract.

Bluegrass Tomorrow

Auditors also examined transactions between BGADD and Bluegrass Tomorrow, Inc, which is a Kentucky non-profit corporation recognized by the IRS as a IRC 501 (c)(3). Per its website, Bluegrass Tomorrow is a "coalition of business, education, farming, development, and preservation interests dedicated to developing a regional unified vision focusing on education, land use, job growth, and quality of life innovations for the central Bluegrass Region of Kentucky, which leads to an environment that develops creative talent and where young professionals and entrepreneurship thrive." The former BGADD executive director, two BGADD Board members, and a Workforce Investment Board (WIB) member, are on the Executive Committee At-Large for Bluegrass Tomorrow. BGADD's transactions with Bluegrass Tomorrow raised concern after identifying invoices from Bluegrass Tomorrow totaling \$116,593 in payments from BGADD from FY11 through FY13. Of that amount, \$99,784 represented donations/contributions. Federal regulations do not permit donations to be paid using Federal funds, as stated in 2 CFR Part 225, Appendix B, "Contributions or donations, including cash, property, and services, made by the governmental unit, regardless of the recipient, are unallowable."

In addition, Workforce Investment Act (WIA) Youth and WIA Incentive funds were used to pay for two invoices from Bluegrass Tomorrow, totaling \$8,225. The relationship to WIA youth or incentive objectives was not clearly evident based on the invoiced charges, and therefore it is questionable how these invoices were paid as direct charges to these federal programs.

Bluegrass Workforce Investment Board

In addition to the relationships noted above, auditors also examined the roles and responsibilities of BGADD as fiscal agent for the WIB. Section 117 of the Workforce Investment Act of 1998 establishes the creation of a local workforce investment board, in partnership with the Chief Elected Official (CEO). The CEO serves as the local grant recipient for any grant funds allocated to the local area and is liable for any misuse of grant funds. The local fiscal agent shall disburse grant funds for workforce investment activities at the direction of the workforce investment board and shall do so immediately at the direction of the local board. Auditors learned the fiscal agent contract was created by BGADD, and includes a

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statement which establishes the Workforce Investment Areas' chief elected official as the highest ranking officer on the BGADD Board, which is ultimately the BGADD Board chair. Inquiry with individuals with knowledge of this agreement identified that certain members of the WIB did not necessarily agree with this practice of making the BGADD Board Chair also the CEO of the WIB, but felt pressured to sign this agreement.

Throughout the examination, the APA received concerns that BGADD was attempting to strategically position itself to increase its authority over the decision making for WIA funding. Although this is a matter for the BGADD and WIB boards to settle, auditors did objectively weigh the potential conflict of interest. By having the WIB CEO and the BGADD Board chair as the same person, a potential conflict is evident since BGADD has a significant fiscal interest in maintaining a fiscal agent role. Additionally, the WIB CEO makes all appointments to the WIB, meaning in effect, the BGADD chair appoints all members to the WIB's Board giving BGADD significant influence beyond that of a typical fiscal agent. This arrangement would make it difficult for that individual to represent the best interest of the WIB, as well as the BGADD Board. This conflict appears to weaken the WIB's decision making authority by placing more authority in the hands of BGADD.

The conflict is further evidenced in BGADD's failure to consistently share WIA related information with the WIB. For instance, although BGADD has WIA employees on staff to administer WIA grants, those employees and WIB members are not provided sufficient budget information related to WIA funds to monitor activity. WIA federal funds are to be disbursed at the direction of the WIB, but it is difficult for the WIB to make effective decisions for the WIA program when the WIB is not accurately informed of their financial status. Therefore, this weakness impairs the WIB's monitoring and oversight of funds. Designating a fiscal agent (i.e., BGADD) to help carry out its financial duties and grant administration does not relieve the WIB and its CEO of their fiduciary responsibilities to ensure grant funds are used properly and in accordance with federal and state requirements. Therefore, it is important that the WIB have the means necessary to carry out its responsibilities.

Based on the current structure of its relationship with the WIB, it appears BGADD failed to follow federal conflict of interest requirements. 45 CFR Part 74.42 states, "No employee, officer, or agent shall participate in the selection, award or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the

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employee, officer or agent, or any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicted herein, has a financial or other interest in the firm selected for award. The officers, employees, and agents of the recipient shall neither solicit nor accept gratuities, favors, or anything of monetary value from contractors, or parties to sub-agreements. However, recipients may set standards for situations in which the financial interest is not substantial or the gift is an unsolicited item of nominal value. The standards of conduct shall provide for disciplinary actions to be applied for violations of such standards by officers, employers, or agents of the recipients.”

Furthermore, BGADD’s own conflict of interest policy states, “Conflicts of interest may arise in the relations of directors, officers, and management employees with any of the following third parties:

- a. Persons and firms supplying goods and services to BGADD.
- b. Persons and firms from whom BGADD leases property and equipment.
- c. Persons and firms with whom BGADD is dealing or planning to deal in connection with the gift, purchase or sale of real estate, securities or other property.
- d. Competing or affinity organizations.
- e. Donors and others supporting BGADD.
- f. Agencies, organizations, and associations which affect the operations of BGADD.
- g. Family members, friends, and other employees.”

“A conflict of interest may be defined as an interest, direct or indirect, with any persons or firms mentioned in Section 3. Such an interest might arise through:

- a. Owning stock or holding debt or other proprietary interests in any third party dealing with BGADD.
- b. Holding office, serving on the Board, participating in management, or being otherwise employed (or formerly employed) with any third party dealing with BGADD.
- c. Receiving remunerations for services with respect to individual transactions involving BGADD.
- d. Using BGADD’s time, personnel, equipment, supplies, or goodwill for other than BGADD-approved activities, programs, and purposes.

Receiving personal gifts or loans from third parties dealing or competing with the BGADD...”

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“Transactions with parties with whom a conflicting interest exists may be undertaken only if all of the following are observed:

- a. The conflicting interest is fully disclosed;
- b. The person with the conflict of interest is excluded from the discussion and approval of such transaction;
- c. A competitive bid or comparable valuation exists; and
- d. The Administrative Review and Finance Committee has determined that the transaction is in the best interest of the organization.”

Other Related Entities

During the examination, auditors also noted other entities created by BGADD, Global Opportunities for Kentucky, Inc. (administratively dissolved in 2003 by the Secretary of State) and Bluegrass International Trade Association, Inc. These entities listed their principal offices as being the same as BGADD. Based on information reported on the Kentucky Secretary of State’s website, the Bluegrass International Trade Association, Inc. was administratively dissolved. The examination did not review the activities of these two organizations in depth because auditors did not identify payments to these entities from BGADD during the period under review.

Recommendations

We recommend BGADD:

- Adequately document and evaluate potential conflicts of interest as required by BGADD’s policy and federal regulations. In relation to BGADD’s fiscal agent responsibility with WIB, conflicts of interests should be eliminated since it is unable to fully exclude its Board members from matters involving WIA funds.
- Immediately cease the practice of obtaining unwritten loans from BIF, and implement procedures to ensure all procurement of goods and services follow appropriate procurement policies.
- Ensure all the agreements entered into promote the mission of the organization and are not used to enter into activities beyond the scope and mission of the organization.
- Ensure all significant related party transactions are disclosed in its audited financial statements, and all entities over which BGADD has influence are evaluated during its annual audit as potential component units.
- Immediately discontinue the practice of making contributions or donations, especially when utilizing federal funds.
- BGADD should work with the WIB and its grantors to

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determine whether \$8,225 in potential questioned costs should be returned to the federal program.

- BGADD should provide necessary detail to the WIB and employees with WIA programmatic management functions on a regular basis to allow for adequate monitoring and review of WIA expenditures. Line item detail should be provided to allow for reconciliation and evaluation of expenditures.

Finding 3: BGADD Did Not Report Possible Criminal Violations To Law Enforcement Authorities

In Finding 2, the examination reported concerns regarding the BGADD's authority to operate an offender re-entry program, Steppin' To A New Beat (STANB). BGADD employed an individual to act as a "re-entry specialist" to manage this program. Allegations of possible misconduct by this employee prompted BGADD to retain a law firm to conduct an investigation into the allegations in April 2013. Auditors requested a copy of the report on the results of the investigation, which was provided by BGADD. Auditors noted numerous concerns in the report, prompting further examination of the matters noted. These concerns are described below.

Former Employee Used Program Resources For Nonparticipants, Creating A High Fraud Risk

The investigation identified that between January 9, 2013 and April 9, 2013, the former BGADD employee represented, in written correspondence, that approximately ten individuals were participating in the STANB program. These letters were addressed to judges, the Chairman of the Kentucky Parole Board, and to inmates or former inmates. These ten individuals were not actual STANB participants. Even more concerning is that in some instances, the individual's participation in STANB was a condition of their release.

The investigation concluded that eight out of 15 individuals housed at a location under contract with BGADD to provide housing for STANB participants had not been enrolled in the STANB program at any time. WIA funds were utilized to fund eight beds at this housing location in the amount of \$12,000 annually. Thus, federal funds were used for individuals not in the program. This not only creates a questioned federal cost of \$6,400 for the eight beds utilized by nonparticipants, but also draws into question the propriety of using any BGADD funds to pay for housing for the individuals.

In addition, the investigation identified the STANB employee signed as "director" on a document called a Participation Agreement with various individuals who believed they were participants in the STANB program but who were not. By signing this agreement, these individuals agreed to pay a participation fee of \$350/month or a bi-weekly fee of \$150.00. The employee was not a director under

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BGADD's employment, and also the STANB program was federally funded and did not require a participation fee or any other fees. Furthermore, the Participation Agreement utilized was not approved by the WIB. Auditors were unable to determine that any of the funds collected from these individuals were deposited into STANB accounts, or any other accounts under control of BGADD. These circumstances indicate a significant fraud risk, since the unapproved applications were utilized and non-required fees were collected but not deposited into program accounts. Because these funds were not accounted for in BGADD funds, no determination could be made about the length of time fees were collected by individuals or the total amount collected.

Even more concerning is that individuals who believed they were participants in the STANB program signed a Consent to Drug Test. The WIB does not conduct drug testing of its participants and, therefore, the Consent to Drug Test form was not an authorized form for STANB.

BGADD Attempted To Halt An Internal Investigation Identifying Possible Criminal Violations

Correspondence obtained from BGADD indicated that the former executive director requested for the investigation into these allegations of the former STANB employee to cease after it got underway. However, the firm performing the investigation notified BGADD that it was unable to do so because of possible criminal violations identified. Auditors determined that BGADD apparently did not report any of the possible criminal violations identified in the investigation to authorities. By not reporting these possible violations to authorities in a timely manner, it provided opportunity for the individual to continue similar activity with the public, and kept law enforcement authorities unaware of these concerns.

Auditors also learned that the former STANB employee had been placed on administrative leave during the internal investigation discussed above, on or around April 24, 2013. While on administrative leave, the employee was required to return the keys that provided access to BGADD offices. On May 16, 2013, 22 days after being placed on administrative leave, the former BGADD executive director returned the keys to the STANB employee. However, the employee's entry into the building was not monitored. Details of the employee's building access identified the employee entered the building 16 times. Subsequently, BGADD determined that the files of 268 STANB participants were taken. This poses a serious concern since the files contain personal identifying information, including information regarding the individuals' criminal history. This action was reported to police by BGADD, and it appears the case is still pending.

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Recommendations

We recommend BGADD report the findings of the investigation into the actions of its former employee to law enforcement authorities immediately. Due to the auditors' concerns over these matters, this finding will be referred to the Kentucky Office of the Attorney General, the Kentucky State Police and the Federal Bureau of Investigation due to the federal funds involved. We further recommend BGADD determine the amounts due to federal programs for unallowable costs, and implement internal controls that would prevent other employees from utilizing BGADD resources for non-BGADD activities.

Finding 4: BGADD Violated Procurement Policies

Auditors received concerns that appropriate procurement procedures were not followed at BGADD. The examination identified instances in which certain transactions did violate BGADD procurement policies.

Trent Boulevard Property

As noted in Finding 2, BGADD purchased a property at Trent Boulevard during FY12 with the intention of using the property to operate an offender re-entry program. Auditors examined transactions related to the purchase and improvements to the property. The examination of these transactions identified the following:

- Finding 1 describes appropriate authorizations were not obtained for the purchase of the Trent Boulevard property. Also, the AR&F Committee approved \$200,000 in improvements for the property, although BGADD expended more than \$500,000 in total improvements which is almost as much as it paid for the entire building.
- Payments totaling approximately \$465,000 were made to a single heating, ventilation, and air conditioning (HVAC) vendor. No written contract existed with the HVAC vendor and no evidence existed that a description of the services to be performed or an estimate of the cost was provided. BGADD utilized an emergency procurement clause to provide justification for not properly procuring the services. However, the emergency procurement and the associated basis for need did not follow BGADD's procurement policy. Documentation indicated the emergency procurement was applied retroactively, occurring only after more than \$169,000 had been paid to the HVAC vendor. In addition, no limitations were established on the emergency procurement, and no bidding occurred after the emergency situation ended.
- BGADD did not have any invoices to support \$63,000 of the payments made to the HVAC vendor noted above.

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- The HVAC vendor utilized was a business owned and operated by a member of the WIB, creating a possible conflict of interest.

Per BGADD's procurement policy, non-competitive negotiations may be used for procurements in excess of \$20,000 when bidding or competitive negotiations are not feasible. BGADD may purchase goods and services through non-competitive negotiations when it is determined in writing by the Chief Financial Officer or his or her designee that competitive negotiation or bidding is not feasible and that (1) an emergency exists which will cause public harm as a result of the delay caused by following competitive purchasing procedures, or (2) the product or service can be obtained from only one source, or (3) the contract is for the purchase of perishable items purchased weekly or on a more frequent basis, or (4) only one satisfactory proposal is received through RFP or RFQ, or (5) a unit of government is willing and able to provide the good or service. The policy further states that bids will only be accepted from those contractors who have a proven record of ability to successfully complete the scope of work being bid.

Small Purchase Procedures

The BGADD's small purchase policies provide specific instruction for purchases between \$500 and \$2,500, as well as for purchases between \$2,500 and \$20,000. Also per BGADD's procurement policy, purchase requisitions must be completed for the purchases of any equipment or special supplies. A department supervisor should sign the requisition to document his or her approval of the request. The request should then be forwarded to the chief financial officer (CFO) and then to the executive director.

Upon receiving the requisitions, the CFO is to obtain the necessary price quotes or estimates from vendors depending on cost. For purchases costing between \$500 and \$2,500, the CFO should obtain three over-the-telephone quotations for rate, price, etc. A memorandum should be prepared setting forth the date calls were made, the parties contacted and prices obtained. Purchases between \$2,500 and \$20,000 require written estimates but no legal advertisement is required. BGADD should solicit written responses from at least 3 vendors, and if no such responses are available, a statement explaining the procurement should be prepared and filed.

The examination identified that approximately \$51,000 in additional expenditures were coded to the account established for the Trent Boulevard project. Of those expenditures reviewed, \$6,510 was expended for security cameras and equipment, \$10,260 for work to the property, such as conduit and downspout installations, \$11,174

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for mowers and trimmers, and \$1,820 for mowing services. Supporting documentation did not exist to evidence that BGADD followed its established small purchase policies for these items. For instance, there was no purchase requisition on file for equipment purchases, and there was no written evidence that price quotes or estimates were obtained. Also, it is unclear why BGADD purchased more than \$11,000 in mowing equipment, but subsequently utilized contracts for mowing services.

Aging Grants

Auditors also identified concerns regarding the procurement for the senior citizen centers for the administration of federal Aging grants. Examination of the AR&F Committee meeting minutes for December 7, 2011, indicated the BGADD former executive director requested the Committee to consider adding a clause to the Non-Competitive Negotiations Procurement Procedures. The change in procurement procedure language was for the purpose of allowing BGADD to purchase goods and services through non-competitive negotiations when it is determined in writing by the Chief Financial Officer that competitive negotiation or bidding is not feasible and that a unit of government is willing and able to provide the good or service. The minutes indicate the former executive director stated that he would like to change this clause because BGADD was ready to put Aging contracts out to bid. The former executive director also stated he had informed the region's senior centers of ways that they could be considered as being under the local government direction for the purposes of obtaining grants. According to the former executive director, if the senior center would allow the head of the local government (mayor or judge/executive) to appoint fifty-one percent of the members on the senior citizen center board, this would allow BGADD to consider the senior centers a unit of government. BGADD could then pass the Aging grant funding to the local government, and then that government could contract directly with the senior center, thereby avoiding the bidding process. Ultimately, the AR&F Committee approved this change, and BGADD began utilizing this policy as a mechanism to avoid bid procedures.

BGADD currently contracts with six local governments under this arrangement. If senior centers were established as part of local government initially, or had a change in local control that established it as part of the local government, then the methodology adopted by BGADD may be reasonable. However, BGADD appeared to define non-profits as government agencies based solely on board appointments instead of functional reporting relationships, and advised non-profits in this manner based only with the motivation to avoid bid requirements.

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Auditors attempted to determine whether local governments under agreement with BGADD had actual fiscal or operational influence over senior centers. At least one instance was noted in which the local government had no control over the senior center, yet signed an agreement with BGADD on behalf of the senior center.

This methodology also caused technical concerns related to the grant administration. Agreements with the local governments technically created the local government as a “subrecipient” of the federal Aging grant. As the subrecipient of the grant funds, the local government would be responsible for identifying contractors or other subrecipients to administer the grant and also for monitoring those contractors or subrecipients. However, in actual practice, the local government is not treated as a subrecipient by BGADD with the exception of justifying a failure to bid for services. Per review of BGADD’s FY12 audit report, the local governments are not listed on the Schedule of Subrecipients that accompanies the Schedule of Expenditures of Federal Awards (SEFA), and instead BGADD has identified the senior centers as its subrecipients.

Also, the contract between BGADD and the local government is vague in that it does not clearly convey the responsibilities of the local government. The pass-through grant funds are not disbursed to the local government, but instead are sent directly to the senior center, with BGADD retaining the administrative portion of the grant funds. In addition, all monitoring of the senior citizen center is conducted by Aging staff at BGADD, even though the contract with the local governments indicates they are responsible for proper administration of the grant. Under this arrangement, BGADD is actually retaining all duties of the grant administrator, including selecting the senior citizen center to carry out the functions of the grant, although the contracts with local governments do not make that clear.

In addition to the confusion noted above, this methodology of contracting with local governments for the Aging grants passed through to senior centers leads to even more serious administrative problems for the local governments. The contract between BGADD and the local government indicates the local government is required to follow the requirements of OMB Circular A-133 for reporting grant expenditures. Subrecipients are required to report grants received on their Schedule of Expenditures of Federal Awards, even if those grants are passed through to other entities. Because these grants should be listed by the local governments due to their contracts with BGADD, the total amount of those awards should be considered in determining whether the local government triggered a federal single audit. This creates a potential that the Aging grants

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passed through the local government could trigger an audit, even though the local government does not receive any funding from Aging grants to defray the cost of the audit.

Recommendations

BGADD should:

- Ensure all contracts for services are properly procured in accordance with established policies and procedures.
- Ensure reasonable procedures are in place to avoid conflicts of interest in contracting for services.
- Obtain proper authorizations for purchases.
- Implement procedures to review all Aging contracts, considering the agency's objectives in passing through Aging funds. If BGADD intends to maintain administration over the grants, it should consider revising its current practice of contracting with non-profit senior centers through local governments that do not have any financial or operational control over those centers. If Aging contracts are maintained with local governments, those governments should be given the rights and responsibilities of subrecipients, including decision regarding eligibility and contract/subrecipient entities, monitoring, etc. This also means the local governments should have the ability to retain administrative funds, if allowable per the grant, to defray the cost of the additional responsibilities.

Finding 5: BGADD Did Not Have Internal Controls In Place To Prevent Excessive And Unnecessary Expenditures, Including Travel And Business Reimbursements

Allegations were brought to the attention of the APA related to excessive or unallowable expenditures by BGADD, prompting auditors to perform procedures to review credit card expenditures, reimbursed travel costs, and other expenditures. The examination procedures included testing of the BGADD American Express and the BGADD VISA credit cards held by the former executive director and his executive assistant from May 2010 through September 2013, and all travel/business expenditure reimbursements and travel allowances paid the former executive director.

Travel Allowance

The former executive director received a monthly travel allowance in the amount of \$750 per month for in-district travel. This allowance amount was approved by the AR&F Committee to provide the former executive director funds to cover expenditures such as in-district transportation, cell phone costs, and parking costs. For the timeframe reviewed, the monthly allowance paid totaled \$26,250. The policies did not indicate procedures for periodic review of the executive director's actual travel to ensure the allowance continued to be reasonable. However, the most significant concern regarding the allowance was the identification of

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other costs reimbursed to the former executive director in addition to this expense allowance. For example, as noted below, auditors identified the former executive director had breakfast and lunch meals paid by BGADD during times he was not in travel status.

Credit Card and Travel Reimbursements

Testing related to two BGADD credit cards and travel/business reimbursements of the former executive director resulted in evidence of misuse. The examination of the credit cards and the travel reimbursements paid to the former executive director identified BGADD incurred charges totaling \$669,179. Of that amount, \$427,183 was charged on BGADD credit cards and \$241,996 was reimbursed to the former executive director for the use of his personal credit card. Auditors questioned a total of \$513,770 of these expenditures.

Misuse includes instances of excessive and questionable expenditures. Questionable expenditures were considered expenditures without an apparent business purpose and/or lacked adequate supporting documentation. Auditors also noted excessive expenditures, which may be valid expenditures, but the amount expended either individually or in total did not meet a prudent person test. A summary of the questionable expenditures identified by category is presented in Appendix A. Detailed questionable transactions were too voluminous to present in this report, although auditors presented one expenditure category related to food purchases as an example in Appendix B.

A majority of expenditures noted were paid using state and federal funds. Examples of egregious spending noted during the examination include:

- 61 transactions totaling \$4,802 were identified for breakfast and/or lunch meetings while the former executive director was not in travel status. Meeting locations were primarily in or around Lexington, where the BGADD office is located. Documentation suggests that some of these meals were identified as committee meetings, although no evidence of an agenda, minutes, or other records were identified.
- Airline, hotel, and meals totaling \$15,753 for individuals that were not employees of BGADD (including spouses and the former executive director that resigned from BGADD in 2005). BGADD does not have a policy in place addressing reimbursement of expenditures for non-BGADD employees, spouses, or guests.
- Hotel and meal charges related to out-of-state travel for additional days beyond what was required for conference

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attendance (i.e., Friday - Sunday stays were identified for conferences held on Monday).

- Hotel charges for stays in the same town as the employee's workstation.
- Unnecessary/unallowable fees (i.e. excessive baggage fees, foreign transaction fees).
- Excessive meal expenses, with instances noted for meals up to \$100 per person on average.

BGADD Credit Card Policies state that BGADD authorizes revolving credit cards to be issued to the executive director and the executive assistant under the condition that only legitimate expenses of BGADD are charged to the cards.

Also, the Travel and Business Expense Policies for BGADD state:

1. All expenses must be accompanied by a receipt or supporting documentation. Receipts for meals should describe who attended and the business purpose.
2. Reservations should be made in such a manner as to secure the best available rate.
3. Non-Reimbursable Expenses include, but are not limited to: credit card interest charges and excess baggage charges.

Other Questionable and/or Personal Expenditures

In addition to the examples noted previous, auditors noted that BGADD funds were utilized to pay for expenditures that appeared to be for questionable purposes or were for personal purposes. For example, testing identified expenditures for per diem overages, such as when employees would have conference stays at resort or spa hotels with costs exceeding the per diem limitations. Also, expenditures were identified for retirement gifts and/or dinners, and personal transactions for the former executive director. One such personal expense of the former executive director were payments for domain names he registered (mopedriders and yournamehere). Inquiry with BGADD employees indicated there was intent to bill the former executive director for the domain names, but he moved after his employment with them ended and his new contact information was unavailable.

Another expenditure that appeared unusual was a reimbursement that was paid in 2010 for a trip that was taken to Alaska for a conference in 2008. Upon inquiry, BGADD staff indicated that a review of a spreadsheet detailing all transactions of the trip identified that the former executive director had not been reimbursed for two vehicle rentals originally paid on his personal credit card. However, auditors identified documentation that indicated the vehicle rentals were identified as personal costs due to

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the use of those vehicles for transporting non-BGADD employees or Board members. Also, there is a concern that these costs had already been reimbursed as part of a lump sum reimbursement paid to the former executive director further explained below.

\$20,000 Lump Sum Reimbursement

The examination also identified that the former executive director was paid a \$20,000 lump sum payment on June 3, 2010 without adequate supporting documentation. Auditors obtained a memo dated June 3, 2010, in which the former executive director requested reimbursement for 20 years of accumulated charges and interest on his personal credit card which he stated was related to his work with BGADD. Auditors were informed that the AR&F Committee approved this payment during the June 3, 2010 meeting; however, the meeting minutes do not document the Committee's discussion or approval of this payment. The memo is signed by an individual that was the chair of the AR&F Committee at the time, but no additional authorization from other Committee members was identified. Also, the former executive director did not provide receipts, detailed credit card statements, or other support to justify the \$20,000 in accumulated charges. The payment and memo are presented in Appendix E.

Additional Transactions Without Supporting Documentation

In addition to the concerns noted above, testing identified 435 transactions, totaling \$136,137, lacking adequate documented support. For example, invoices frequently were not itemized, particularly for meals, or did not exist at all.

During the review of credit card expenditure activity, a review was also performed of the funding sources for the payments to determine if accounts were properly charged. In testing the credit card expenditures, it was noted that the payments would be split between multiple account codes, including indirect cost codes. As a result, questions arose in regards to the amounts charged to indirect cost codes. Amounts charged as an indirect cost are allocated among the different programs within BGADD and paid using federal, state, and local funds. The examination identified \$159,068 charged to indirect travel and \$114,543 charged to indirect board training. Although valid expenditures of the former executive director and certain board training costs may be appropriately identified as indirect cost, the concerns presented in this finding indicates these excessive and questionable expenditures were also likely paid in part by federal and state funds through the use of indirect cost codes. Auditors found no documentation to support charging indirect cost codes for the various credit card and reimbursed charges noted above. Finding 5 details additional concerns related to charges coded to indirect costs.

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Overall Weaknesses in Internal Controls for Expenditures

Overall, testing concluded BGADD had lax oversight over spending, which includes but is not limited to inadequate policies for credit card and travel expenditures. The weaknesses in these internal controls, coupled with a lack of review of expenditures by the Board's Executive Committee increase the risk that unreasonable, excessive, and unallowed expenditures may occur. This is especially risky for BGADD given the amount of federal funds the agency administers, with those funds having significant compliance requirements governing their use.

Proper internal controls dictate the Executive Committee should closely monitor expenditures to ensure proper controls are in place over financial management. This is especially important in difficult budget times. The BGADD by-laws state that it is within the Executive Committee's authority and power to oversee and/or conduct the normal and recurring business of the Board, including approval of the payment of: authorized staff salaries, official travel expense, expenditures for office supplies and materials, telephone and utility bills, rent payment, authorized employee insurance and retirement benefit premium, and withholding taxes. The by-laws also state that payments which have not received prior approval shall be considered for post approval by the Executive Committee, and expenditures not generally covered by the items listed above shall require prior authorization for payment by the Executive Committee.

Recommendations

We recommend the BGADD Board clarify and follow existing BGADD policies to eliminate excessive or unnecessary spending. Revised policies should provide further guidance to ensure transactions and travel allowances are reasonable in amount, necessary, and properly supported by receipts or other appropriate documentation. The Board should consider eliminating the travel allowance for the executive director in favor of a reimbursement policy which would improve monitoring of total travel costs and reduce the risk of waste, fraud, or abuse.

Also, we recommend policies limit credit card use to purposes authorized by the Board, and establish and communicate penalties for employees that do not adhere to the policies.

Finally, we recommend the Executive Committee members begin reviewing expenditure detail to more effectively and efficiently oversee expenditures paid by BGADD.

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Finding 6: Significant Noncompliances Were Identified Related To Management Of Federal Grants

During the examination, auditors found numerous instances in which BGADD did not properly account for or manage its federal grants. Federal grants are critical to BGADD's mission, and, therefore, it is critical that the agency has significant expertise in federal grant management. Auditors acknowledge that BGADD receives a federal compliance audit in accordance with OMB Circular A-133 each year, and that the purpose of the APA examination is not to opine on federal compliance. However, many of the weaknesses noted below appear to be matters of noncompliance that should be addressed in the next audit of BGADD.

Overall, this finding identifies serious concerns that BGADD could be using WIA and other grants as a cash flow mechanism to fund operations and other grant expenditures during the year. The grant accounting methodologies used not only create compliance concerns related to the federal programs, but also significantly increase the risk of error and misappropriation. Although this examination did not perform procedures sufficient to opine on federal program compliance, testing did identify a high risk that the agency may have compliance problems associated with allowable costs, and is likely not compliant with subrecipient reporting requirements since reports submitted to the state do not agree to actual activity recorded in the general ledger at the time they are prepared. Failure to comply with federal and state requirements can lead to the loss in the agency's opportunity to receive federal funding.

WIA Reimbursement Process and Federal Reports

As noted earlier, BGADD is the contracted fiscal agent for WIA grants on behalf of the WIB. WIA grants are reimbursement-basis grants, meaning expenditures must occur in advance and the agency must request reimbursement. BGADD obtains reimbursement for grant expenditures from the Kentucky Education Cabinet's Office of Employment and Training (OET) through a draw down process, which is common for reimbursement type grants.

Auditors tested draw down procedures, and also inquired with both OET and BGADD employees. The results of these procedures indicated that BGADD does not follow appropriate procedures when requesting federal funds from the state. Additionally, the examination identified that reports summarizing the BGADD's federal fund utilization throughout the year do not reflect actual WIA-related activity.

Testing procedures identified that BGADD's draw downs of WIA funds exceeded the amounts the agency had expended for the grant. For example, testing identified for the August 2013 draw, BGADD drew down \$167,082 related to WIA funds, although accumulated

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expenditures for WIA grants for the period were only \$ 35,664, for a difference of \$131,418. Therefore, adequate expenditure amounts did not exist to support the amount requested for reimbursement.

Further review of the excess amounts drawn down confirmed that BGADD failed to inform the state of the excess funds received by not completing and submitting the necessary Applicable Credit forms required when excessive funds are reimbursed to the agency. Therefore, BGADD did not report the excess funds, or return them. Instead, BGADD utilized these funds for other non-WIA related expenditures, which is not permissible under its subgrantee contract with the state. For example, one draw down cycle included an amount for reimbursement of \$93,300. This amount is stated on the reimbursement form as direct expenditures for the Adult Program Grant. However, auditors noted that the requested amount was not a true reimbursement for actual amounts expended. Upon receipt, the funds were instead charged to direct costs for multiple different programs. Testing indicated this is a common occurrence, and funds drawn down were utilized both for other federal programs and non-federal expenditures. Had BGADD used these funds for only other WIA-related grants, the state could have adjusted the balances between the various grants. However, it is not an acceptable use of the funds to utilize them on other non-WIA related expenditures.

Additionally, the analysis of federal reports compared to BGADD's general ledger identified that BGADD did not properly segregate reporting of WIA-related Trade Grants. BGADD's subgrantee contract with OET indicates all Trade Grant reimbursements should be reported on a separate Department of Training and Re-Employment (DTR) Form than all other WIA grant fund reimbursements. BGADD failed to file a separate DTR form for Trade Grant reimbursements associated with Trade Grant expenditures. Inquiry with BGADD staff identified that Trade Grant expenditures were allocated into a different program number on the DTR Form filed for all other WIA grant funds requested for reimbursement. Therefore, the Trade Grant expenditures may have been used to inflate the expenditures for other WIA-related grants to justify an increase in the reimbursement amounts.

During the examination, BGADD staff made numerous references that they view the different WIA grant funds as "one big pot of money" during the year, and that adjustments would be made at the end of the fiscal year to clean up the line item discrepancies created during the year. The line item discrepancies are created by BGADD's practice of totaling expenditures and requesting reimbursement from various grant numbers, even if they are

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unrelated to the actual expenditures. Auditors noted that BGADD maintains a spreadsheet that identifies the amounts available to draw down from its various grants, regardless of the amount of actual expenditures it has related to those grants. BGADD employees indicated that all the grant activity “balances in the end”. However, upon further evaluation, auditors determined that when comparing true programmatic grant expenditures to the federal fund balances maintained by the state as being available for reimbursement to BGADD, the amounts did not reconcile.

Program Income for Aging Contracts

Finding 4 also identifies concerns related to BGADD’s contracting for Aging grants with senior centers, among other procurement issues. The examination also identified other concerns related to contracts the Kentucky Department of Aging and Independent Living has with BGADD. As noted, BGADD purchased property at Trent Boulevard for use in an offender re-entry program. Review of the details surrounding the Trent Boulevard property identified that funding for the purchase of and improvements to the property were derived from local contributions and program income from the Consumer Directed Option (CDO) federal program, which is a Medicaid related grant, which BGADD receives through a contract with the Department of the Aging and Independent Living. Local contributions are actually the fees paid by local governments in the BGADD region to promote regional solutions to local issues and support the overall operating costs of providing a forum for member governments to come together to explore solutions to issues of regional significance. The federal CDO program allows qualified recipients to choose their own providers for non-medical in-home and community based services through Kentucky’s Medicaid Waivers Programs.

BGADD generates program income from the CDO program through charges for payroll processing for members, as well as from per person fees earned for face to face visits with participants. The CDO program considers these funds to be program income, meaning income earned by the administration of the federal program. Federal compliance requirements dictate that program income funds must be used by the agency for the federal program from which the income was derived. Therefore, these funds are restricted for use in the CDO program. 2 CFR Part 225, Appendix B states, “Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the awarding agency. Capital expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit of cost of \$5,000 or more have the prior approval of the awarding agency. Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or

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useful life are unallowable as a direct cost except with prior approval of the awarding agency.”

The federal portion of the funds used for the property came from the CDO/Medicaid grant funds, which is not related to the offender re-entry program for which the property purchase was intended. In total, \$650,000 in CDO/Medicaid grants contracted through the Department of Aging was used for the purchase of Trent Boulevard property and related improvements. Based on questions raised in Finding 2 regarding BGADD’s authority to operate a re-entry program, it also does not appear that the property’s procurement and improvements were a good use of BGADD’s revenue from local contributions.

Indirect Cost Allocations

Based on various expenditure tests, concerns were noted regarding BGADD’s indirect costs. Indirect cost pools are developed to equitably divide administrative and overhead expenditures that benefit multiple objectives to the various cost centers within an agency. Federal programs limit indirect costs charged to the programs to percentages that have been calculated to be associated with the federal share of those costs. Conversely, direct charges to federal grants are costs associated only with carrying out specific federal programs that do not benefit other cost objectives.

Errors and abuses of indirect cost pools can occur when agencies attempt to charge certain costs as both direct charges of a specific program and also as indirect costs, or when costs related to non-federal objectives are included in indirect cost pools to use federal funds to help defray those costs. Common costs included in indirect cost pools are rent, utilities, copy services when shared among various cost centers, salaries and benefits for executive directors and other administrative-only type positions. Any costs that would otherwise not be allowed under federal awards, such as donations, entertainment, etc., may not be included in indirect cost pools to share the costs with federal programs.

Auditors noted rent for BGADD’s office building is charged to Indirect Building Usage. In reviewing the indirect cost allocations, it was noted that charges for WIA employees who work in off-site locations 100% of the time are included in the indirect cost calculation for BGADD’s rent, even though WIA grants are also charged directly for the off-site work stations of those employees. Furthermore, the amount of rent that WIA is responsible for also came into question. The WIA occupies a small portion of the space at the BGADD office due to the majority of the workers being off-site, yet WIA pays approximately \$80,000/yr of the \$258,054/yr rent charge, or more than 31%. Per the Financial Monitoring Guide tool

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utilized by WIA, one procedure was designed to provide assurance that “space paid by the program is only for its fair share based on occupancy”, but WIA’s occupancy does not appear to be nearly one-third of the space rented.

Other concerns involving questionable costs included in BGADD’s indirect cost pools relate to questionable expenditures noted in Finding 5. During testing of credit card transactions and travel costs, the examination identified that travel charges for the former executive director and his spouse, other BGADD employees, such as the executive assistant, BGADD Board members and their spouses, and various guests were charged to indirect travel or indirect board travel. Specific charges of concern included meal reimbursements, in which instances were noted in which the meal cost averaged \$100/person, excess baggage fees, ticket transfer fees, and excessive lodging charges. Whereas auditors acknowledge that some of the costs listed may be appropriate for indirect costs, such as travel for the executive director, charges for questionable or unreasonable expenditures, such as those for spouse travel, meals, and unreasonable expenditure amounts, should not be allowable expenditures. Including such costs as indirect costs gives the appearance that BGADD tried to conceal those costs, and these excessive charges drive up the total amounts allocated to all cost objectives.

Also noted in Finding 5 were numerous charges to indirect meeting expense for Board meetings, breakfast meetings, and lunch meetings. Again, although reasonable expenses associated with BGADD Board meetings may be allowable indirect charges, it was not clear why breakfast or lunch expenses associated with meetings in or around Lexington on regular work days would be a necessary or reasonable business expense, not to mention an indirect cost shared among federal programs. Even though many of the meals were identified as meetings, in the majority of the cases the individuals in attendance, purpose of the meeting or agenda were not documented.

Criteria for Federal Costs

Federal Register 2 CFR Part 225, Appendix A states:

To be allowable under Federal awards, costs must meet the following criteria:

- Be necessary and reasonable for proper and efficient performance and administration of Federal awards.
- Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit.
- Be adequately documented.

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To be reasonable, consideration shall be given to:

- Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal Award

Federal Register 20 CFR Part 667, which specifically relates to WIA grants, states:

- All procurement contracts and other transactions between Local Boards and units of State or Local governments must be conducted only on a cost reimbursement basis. A Local Board may transfer up to 20 percent of a program year allocation for adult employment and training activities, and up to 20 percent of a program year allocation for dislocated worker employment and training activities between the two programs. However, before making any such transfer, a Local Board must obtain the Governor's approval.

State of Kentucky Contract with BGADD for WIA funding states:

- BGADD must provide monthly reconciliation of WIA related actual cost in the books of account;
- Reimbursement is based upon actual, allowable cost;
- BGADD will maintain a financial management system that shall provide:
 - accurate, current, and complete disclosure of the financial results of the functions/services performed;
 - records that identify the source and application of funds for activities/functions/services performed. These records shall contain information pertaining to federal and/or state funds received, obligations, unobligated balances, assets, liabilities, expenditures, and income;
 - effective control over and accountability for all funds, property and other assets. BGADD shall safeguard all such assets and shall assure that they are used solely for authorized purposes;
 - assurance that no other funds or assets of the agency shall be co-mingled with the funds provided for these programs.

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Recommendations

We recommend BGADD:

- Implement policies and procedures to comply with state and federal regulations to demonstrate proper fiscal responsibility of public funds. This should include reconciling draw downs to actual expenditures which are allowable for the federal program reimbursing the agency. Accounting ledgers should show a clear and direct link to the amount of requests for reimbursement.
- BGADD should improve its expertise in relation to requirements of federal grants, and costs that may be charged to direct and indirect cost objectives. Although auditors recognize that BGADD prepares an annual indirect cost allocation plan, it is unlikely that detail of individual costs within each cost pool is closely monitored for allowability.
- Future audits of BGADD's indirect cost allocation plan should test the components of costs for these types of concerns. Due to the concerns noted in this finding, we are referring this finding to the Department for Local Government, which approves BGADD's indirect cost allocation plan, and to the Kentucky Cabinet for Health and Family Services, Bluegrass WIB, and Kentucky Education Cabinet - OET due to concerns related to grants administered by those agencies.

Finding 7: BGADD Paid Bonuses To Employees

During the examination of BGADD, testing of payroll expenditures identified that selected employees received year-end bonuses. Inquiry into these bonuses determined that they were funded with unobligated grant funds. BGADD staff indicated management referred to the bonuses as "One Time Salary Adjustments" because they were aware that bonuses are not allowable costs for federal grants. Bonuses are also not permitted by the Kentucky Constitution for public employees.

BGADD employees stated that the agency's base salaries make up 90% of the original budget amount, and at year-end any unobligated federal grant funds are calculated per grant to determine the total available for the bonus payments for selected employees. Employees indicated the thought behind this process was to incentivize employees to control expenses on performance based contracts. However, this creates a high risk that employees and management have an incentive to underfund or under-serve eligible grant participants in order to ensure that funds are available for bonuses. Auditors did not examine grant applications during the examination, but this methodology draws into question whether federal need was overstated to serve participants in order to provide for these bonus payments. This methodology also calls into

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question whether employee bonuses were being charged to grants directly that would otherwise be not related to that particular grant. For example, documentation reviewed showed that the bonus paid to an employee whose salary was normally charged as an indirect cost 100% of the time, was charged as a direct cost to the WIA and Aging grants.

To determine the employees receiving bonuses, a spreadsheet, called “Payroll Bonus Reports”, was sent to managers requesting their opinions as to who should receive an adjustment bonus, as well as the amount the manager recommends. The former executive director would then consider the managers’ recommendations, and make the final decisions regarding the employees selected and amount to be provided. The executive director would then present the bonuses to the AR&F Committee for approval as one-time salary adjustments. These payments should have been reviewed by the Executive Committee.

Auditors learned that in the past the former executive director only presented the year-end total unobligated grant funds to the AR&F Committee for approval to disburse as one time salary adjustments, and did not present the details of the employees receiving bonuses. However, it was mentioned that the AR&F Committee began to question the salary adjustments and in recent years, the former executive director presented the information in more detail, such as employee name and amount.

BGADD Created a False Payroll to Support Bonuses

Upon receiving approval from the AR&F, the bonus payments were processed through payroll disbursements. However, unlike salary adjustments that adjust pay rate for a normal pay cycle, these payments were disbursed separately from the normal payroll distributions that occur throughout the year. BGADD’s normal payroll cycle occurs bi-weekly, creating 26 normal payroll cycles per year. The bonus payments were made in an off-week, thereby creating an extra 27th payroll cycle. The distinction between bonuses and salary adjustments is important. In order to receive a raise, or salary adjustment, the agency should have a policy identifying its salary adjustment policy and establish criteria used for awarding those raises. Also, those salary adjustments should be based on change in rate of pay and evidenced by actual hours worked. Bonuses are typically one-time payments by employers, and although they may be performance based for past work, they typically are not evidenced by specific hours worked. In this situation by BGADD, the 27th payroll created by the agency was not for actual hours worked as evidenced by a timesheet or other reporting mechanism. The additional payroll run was only a mechanism for making the payment.

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BGADD Managed W-2s

Auditors were also informed that W-2's were "managed" by the former executive director. Auditors noted the "Payroll Bonus Reports" spreadsheets clearly stated that W-2's are monitored each year to confirm that the total payroll payment processed to each employee annually (as stated on their W-2) will never be less than the year prior. Although it is not clear why this policy existed, it is possible that it is to conceal bonus payments made to federally funded employees since a "salary adjustment" may appear to be questionable if the employee's salary fell below that same level the following year.

Also, auditors noted that the bonuses paid are direct charges to the federal grants. However, the salaries of certain employees at BGADD are primarily paid through indirect costs. Federal requirements do not permit the same costs to be treated as both direct and indirect, and, therefore, this mechanism draws into question the direct charges to federal programs for the bonuses of administrative personnel. More information is explained related to BGADD's accounting for federal indirect costs in Finding 6.

Weakness in controls over payroll policies and procedures and failure to comply with federal and state grant requirements, resulted in questionable federal expenditures, and an appearance that management looked for ways to circumvent compliance requirements instead of establishing policies and procedures to ensure compliance. Also, it is troubling that federal funds that should be used for intended programmatic purposes are managed in this way, especially given that many of the federal programs administered by BGADD are intended to help individuals in need, such as Aging and Workforce Investment grants.

The Kentucky Constitution does not allow the award of bonuses to public servants. Additionally, OMB A-133 Compliance requirements state that for reporting purposes, procedures should include reporting all unobligated grant funds. Finally, 2 CFR 225 - Appendix A states that costs must be accorded with consistent treatment. A cost may not be assigned as a direct cost if any other cost incurred for the same purposes in like circumstances has been allocated as an indirect cost.

Recommendations

We recommend:

- The BGADD Board should not approve the payment of employee bonuses.
- The BGADD Board and employees should review federal regulations governing allowable costs, both direct and

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indirect, and treat salary adjustments in accordance with those requirements. Specifically, BGADD should adhere to 2 CFR 225 and consistently assign direct and indirect costs when incurred for the same purpose and like circumstances.

- BGADD should maximize the use of unobligated balances for the participants of the federal programs it administers. Salaries adjustments may be planned and approved, but there should not be an incentive for staff to underfund or under-serve grant participants as part of this plan.
- All salary payments should be evidenced by appropriate supporting documentation for hours worked and should be properly recorded.

Finding 8: BGADD Utilized An Outdated Accounting System Leading To A Lack Of Internal Controls Over This System

The financial activities of BGADD are accounted for using a system named RESULTS, which was designed in the 1980s. The RESULTS system utilized by BGADD came with a standard business systems package, including accounts receivable, accounts payable, etc.; however, BGADD modified the software for its purposes. Auditors learned this was the case for the majority of RESULTS clients. The accounting system is used for recording, processing, and transmitting financial transactions, as well as supporting the financial planning and budgeting activities, and financial statement preparation. Furthermore, financial information is used to generate program efficiency measures and performance outcomes. This information can dictate the need to revise spending plans and/or the need to reallocate funds among service providers or strategies. During FY 11, FY 12, and FY 13, BGADD accounted for \$25,406,593, \$24,473,078, and 24,115,050, respectively, in local, state, and federal expenditures. The results of the examination identified several weaknesses with the accounting system, as noted below.

Lack of Segregation of Duties

Because the majority of the clients using the software require modifications of the software, auditors learned that BGADD owns the source code for the accounting system and the former executive director was the only person that knew how to generate reports during his tenure, which resulted in a lack of segregation of duties. Owning the source code provided the former executive director the capability to perform various functions, such as system edits and program changes. This level of access also provided the means and opportunity to manipulate the accounting, budgeting, and planning data without any form of oversight by another person. Therefore, the former executive director had the ability to introduce changes into the system that were not approved or documented. This lack of segregation of duties creates a significant fraud risk for the agency, increasing the risk that waste, fraud, or abuse could occur without being detected.

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Lack of Expertise by Current BGADD Employees

During the examination, BGADD provided a list of the routine reports that they have the capability to generate from the accounting system. If these routine reports do not have all information needed, accounting personnel utilize Excel spreadsheets to piece together various system reports in order to obtain all needed financial information. Because the employees do not have a strong working knowledge of the system, and because the system is a customized system, there is a significant risk that reports could be in error or incomplete. Further evidence of the limited knowledge of the staff occurred when within 24 hours after resigning from BGADD, the former executive director was hired by BGADD on contract to provide support, although BGADD soon decided against the contract arrangement. The lack of segregation of duties noted above also increases the risk that reports could have been created with improper source code resulting in either intentional or unintentional omissions of information, but no other employees have sufficient background with the system to mitigate that risk.

During the examination, BGADD employees acknowledged that the system is antiquated, lacked work efficiency, and that it was time consuming to study manuals to learn how to perform non-routine tasks. Given the availability of high quality off-the-shelf and program-supported accounting packages, the reason BGADD continued to use an antiquated and impractical system is not known.

Failure to Close Year-End Books Timely

Auditors also determined that BGADD keeps its accounting books open for a long period of time after the end of the fiscal year. The examination identified it took periods ranging from three to five months after the end of the fiscal year to close the books, meaning BGADD posted activity impacting its June 30 fiscal year as late as November of the following fiscal year. For example, the books for FY12 were closed in November 2012, approximately five months past the fiscal year end. BGADD's final close for FY13 was completed in October 2013, four months past fiscal year end.

This type of delay in closing its books to activity affects the BGADD's budgeting process because accurate information is not available until months into the next fiscal year, causing the need for numerous year-end adjustments. Also, the delay creates problems related to the period of availability for BGADD's federal programs. For example, auditors were informed that it was not unusual for a federal program administrator within BGADD to be told there was program funding available at year end and to try to spend the funds down. Purchase orders (POs) would then be created to spend down the old year federal funds, but then the program administrator would be told that funds were not actually available so all the POs

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approved would need to come from the new year grant funds. Since grant funds are for expenditures during specified periods, this confusion makes it difficult for program administrators to ensure compliance. This is especially concerning when program administrators are not always involved in the budget monitoring process for federal funds, as noted in Finding 6.

The weaknesses noted above could affect BGADD's ability to ensure that financial data is recorded, processed, and reported in an accurate and reliable manner. In addition, the weaknesses relating to segregation of duties, software changes, and system access significantly impact BGADD's ability to ensure that information resources are sufficiently safeguarded.

Management has a responsibility to design and implement internal controls that provide reasonable assurance regarding the reliability of financial reporting. Internal control is a management process for keeping an entity on course in achieving its business objectives. This internal control system should ensure resources are guarded against waste, fraud, and abuse, and should also ensure reliable data can be maintained and fairly disclosed. This includes having internal controls that help deter, prevent, detect, and correct errors and irregularities throughout the process.

Recommendations

We recommend BGADD:

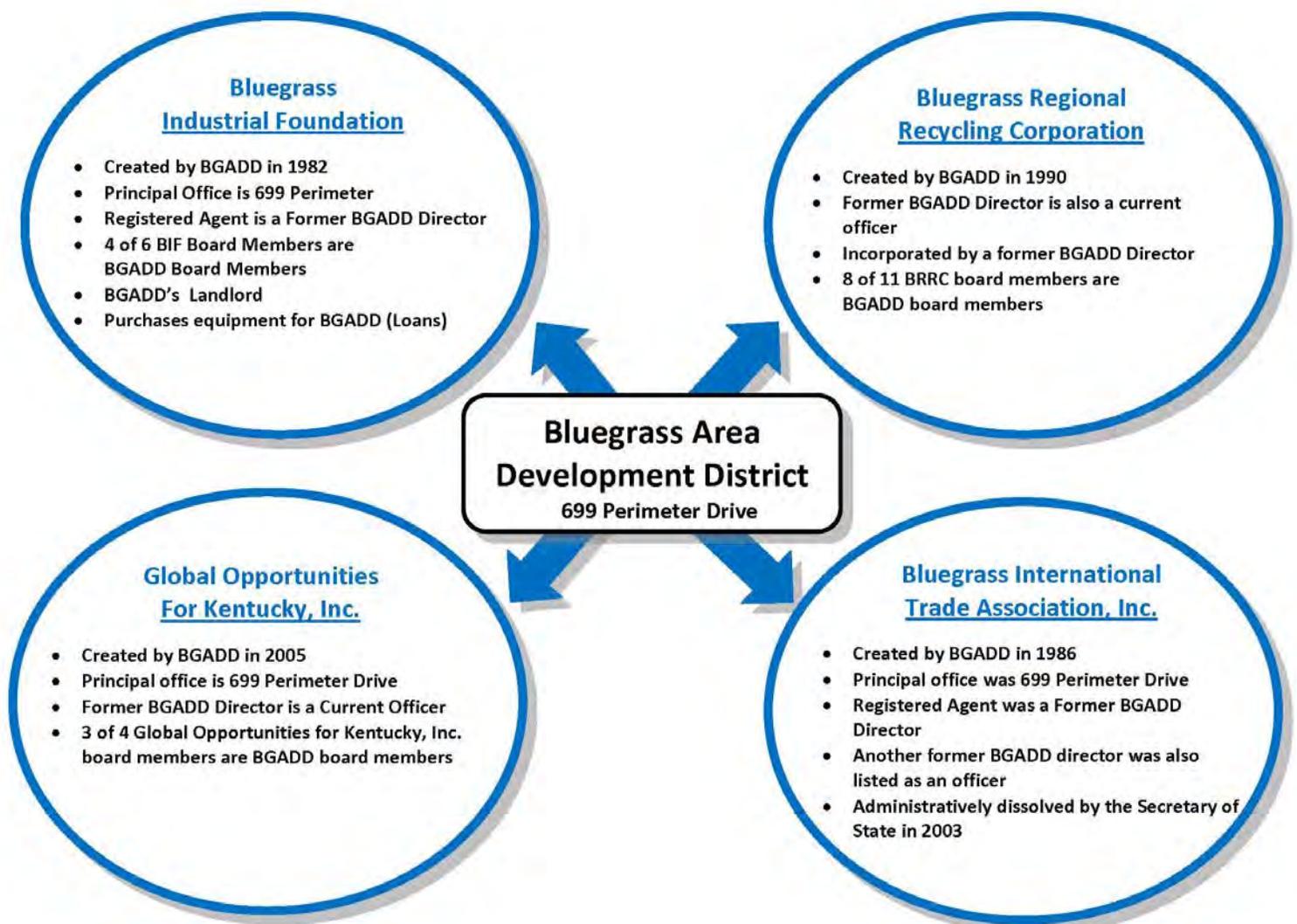
- Implement internal controls over the financial accounting system that ensure that assets are safeguarded, transactions are processed in accordance with applicable laws and regulations, transactions are properly recorded, reconciled, processed and summarized to permit the preparation of reliable financial data.
- Establish year-end reporting procedures to ensure timely reporting of financial information.
- Either update its accounting systems to meet the needs of the agency, and reduce its risk of waste, fraud, and abuse related to unauthorized changes in the system's source code or provide adequate training for existing staff ensuring proper segregation of duties.

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APPENDICES

Appendix A - Entities Created by BGADD Appearing to Expand Its Scope

This exhibit depicts entities having a former BGADD executive director as its registered agent and/or officer. These entities appear to expand the scope of BGADD beyond those functions established by statute. Also, the Kentucky Office of the Attorney General found that a program, Steppin' to a New Beat (STANB), was not within the agency's scope. STANB was not a separate entity, but was a program of BGADD, and therefore is not depicted below. Other entities were identified in Finding 2 as having financial relationships with BGADD that may create conflicts of interest or were provided financial resources from BGADD, but were not established by BGADD.



Appendix B - Payments to the Bluegrass Industrial Foundation from the Bluegrass Area Development District

Expenditure Type	FY 2011		FY 2012		FY 2013		Totals By Expenditure Type
Building Renovations	\$	16,110	\$	16,110	\$	8,163	\$ 40,382
Computer Equipment	\$	15,050	\$	10,032			\$ 25,082
Building Rent	\$	258,054	\$	258,054	\$	258,054	\$ 774,162
Totals	\$	289,214	\$	284,196	\$	266,217	\$ 839,626

Appendix C - Questionable Credit Card Expenditures and Travel/Business Expense Reimbursements

Expenditure Type	FY 2011	FY 2012	FY 2013	FY 2014	Total
Airline Tickets	\$ 59,240.00	\$ 57,176.36	\$ 48,608.32	\$ 3,481.20	\$ 168,505.88
Conferences/Trainings	1,233.00	7,115.81	10,411.09	1,050.00	19,809.90
Equipment/Software	592.41	12,968.39	2,069.93	2,538.49	18,169.22
Fees (Parking, Excess Baggage, etc)	6,510.24	6,464.72	5,127.85	1,212.00	19,314.81
Food	25,371.19	21,210.98	15,914.47	333.72	62,830.36
Hotels/Lodging	97,342.19	58,581.16	51,232.10	-	207,155.45
Mileage Reimbursement	-	-	451.56	183.38	634.94
Miscellaneous	214.16	1,588.01	934.34	44.77	2,781.28
No Receipt	15.00	678.62	2,102.99	4,464.05	7,260.66
Rental Cars/Fuel	2,244.17	4,100.57	962.48	-	7,307.22
Totals	\$ 192,762.36	\$ 169,884.62	\$ 137,815.13	\$ 13,307.61	\$ 513,769.72

The table above represents amounts considered questionable during the examination based on our review of the BGADD American Express card, VISA card, and travel/business expense reimbursements paid to the former executive director. A total of \$669,179 in expenditures was reviewed, with \$513,769.72 in transactions considered to be questionable. Auditors considered transactions "questionable" if the supporting documentation was missing or insufficient, if the business purpose of the expense was not evident, if expenses were paid for non-BGADD employees or board members, and if expenditures appeared excessive in amount. In some instances, auditors did not have sufficient detail to segregate allowable amounts in a transaction from questionable amounts. In those instances, auditors included the entire transaction in the amount considered to be questionable, which lead to a high percentage of questionable transactions.

Also, due to the large volume of transactions, the details of these expenditures were not included in this report. However, examples of transactions related to the "Food" category above are presented in Appendix D of this report for illustrative purposes.

Appendix D - Detail Transactions for Questionable Credit Card Expenditures and Travel/Business Expense Reimbursements for the "Food" Category

Fiscal Year	Date	Vendor Name	Amount	Description	Auditor Comments
2010	05/19/2010**	Clays Downtown	62.59	Meeting	No detailed receipt.
2010	05/22/2010**	Alonzo's Oyster Bar	245.55	Travel	Includes non-BGADD employees/board member.
2010	05/25/2010**	Monty's Rawbar	125.53	Travel	Includes non-BGADD employees/board member.
2010	05/26/2010**	Chop House	197.49	Unknown	No detailed receipt.
2010	06/1/2010**	Y.O. Ranch Steakhouse	287.59	Travel	No detailed receipt.
2010	06/12/2010**	Mem Blue Note Café	7.59	Travel	No detailed receipt.
2010	06/14/2010**	Lola Bistro	444.57	Travel	No detailed receipt. Includes non-BGADD employees/board members
2010	06/15/2010**	Momocho	280.64	Travel	No detailed receipt. Includes non-BGADD employees/board members
2010	06/16/2010**	John Q's	300.50	Travel	No detailed receipt. Includes non-BGADD employees/board members
2010	06/17/2010**	Cleveland Chop House	257.55	Travel	No detailed receipt. Includes non-BGADD employees/board members
2010	06/23/2010**	Chop House	185.12	Executive Committee Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2010	06/29/2010**	Chop House	33.94	Meeting	No detailed receipt. Employee not on travel status.
2010	06/3/2010**	Chop House	51.24	Finance Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2010	06/3/2010**	Mondellis Bake Shop	7.50	Finance Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2010	06/30/2010**	Chop House	91.59	Travel	No detailed receipt.
2010	06/4/2010**	Cantina Laredo	13.32	Travel	No detailed receipt.
2010	06/6/2010**	Cantina Laredo	14.29	Travel	No detailed receipt.
2010	06/8/2010**	Blue Note Café	18.30	Travel	No detailed receipt.
2010	06/9/2010**	Papa John's	53.00	Meeting	No detailed receipt.
2010	06/9/2010**	Stella Sola	489.06	Travel	No detailed receipt. Includes non-BGADD employees/board members
2011	07/07/10	Jeff Ruby's	270.00	Unknown	No detailed receipt.
2011	07/20/10	Johnny's Half Shell	565.18	Travel	No detailed receipt. Includes non-BGADD employees/board members
2011	07/21/10	Ten Penh	946.44	Travel	No detailed receipt.
2011	07/22/10	Hvatt Regency	559.44	Travel	No detailed receipt.
2011	07/23/10	Chop House	53.11	Unknown	No detailed receipt.
2011	08/23/10	Ruth's Chris Steak House	285.25	Travel	No detailed receipt.
2011	08/24/10	Sam and Harry's Steakhouse	44.45	Travel	No detailed receipt.
2011	08/27/10	Top of the Market Dining	1,015.59	Travel	No detailed receipt.
2011	08/28/10	Urban Bar and Grill	426.64	Travel	No detailed receipt.
2011	08/28/10	Peohe's	1,336.06	Travel	No detailed receipt. Includes non-BGADD employees/board members
2011	08/29/10	Rockin' Baja Lobster	411.01	Travel	No detailed receipt. Includes non-BGADD employees/board members
2011	08/29/10	The Prado at Balboa Park	339.80	Travel	No detailed receipt. Includes non-BGADD employees/board members
2011	08/30/10	The Grill	58.39	Travel	No detailed receipt. Includes non-BGADD employees/board members
2011	08/30/10	Tom Ham's Lighthouse	668.26	Travel	No detailed receipt. Includes non-BGADD employees/board members
2011	09/01/10	Harbor's Edge	311.31	Travel	No detailed receipt. Includes non-BGADD employees/board members
2011	09/08/10	Jeff Ruby's	473.76	Travel	Includes non-BGADD employees/board member.
2011	09/09/10	Vincenzo's	609.64	Local Issues Conference	Includes non-BGADD employees/board member.
2011	09/13/10	Ed's Seafood Shed	51.21	Travel	Includes non-BGADD employees/board member.
2011	09/22/10	Chop House	137.85	Unknown	No detailed receipt.
2011	10/05/10	Papa John's	146.15	Meeting	No detailed receipt.
2011	10/08/10	Olive Garden	25.73	Meeting	No detailed receipt.
2011	10/12/10	Oceanaire	591.62	Travel	No detailed receipt.
2011	10/12/10	Old Ebbitt Grill	141.99	Travel	No detailed receipt.
2011	10/13/10	Longworth Food Court	43.60	Travel	No detailed receipt.
2011	10/13/10	Longworth FoodCourt	21.70	Travel	No detailed receipt.
2011	10/13/10	Ten Penh	443.52	Travel	No detailed receipt.
2011	10/14/10	Clyde's	110.00	Travel	No detailed receipt.
2011	10/14/10	Johnny's Half Shell	245.90	Travel	No detailed receipt.
2011	10/19/10	Blue Note Café	60.85	Travel	No detailed receipt.
2011	10/20/10	1820 Mkt. Street	92.62	Travel	No detailed receipt.
2011	10/21/10	15/Fifteen	213.79	Travel	No detailed receipt.
2011	10/22/10	Blue Note Café	49.48	Travel	No detailed receipt.
2011	10/24/10	Oceanaire	261.28	Travel	No detailed receipt.
2011	10/26/10	Burger King	6.52	Unknown	Unknown purpose. Employee not on travel status.
2011	11/05/10	Sutton's	48.64	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	11/12/10	Big Boy	15.64	Meeting	No detailed receipt. Employee not on travel status.
2011	11/16/10	Chop House	71.67	Unknown	Unknown purpose. Employee not on travel status.
2011	11/22/10	Chop House	25.52	Meeting	No detailed receipt. Employee not on travel status. Includes non-BGADD employees/board members.
2011	12/03/10	Milio's	228.94	Travel	No detailed receipt.
2011	12/04/10	Timpano Italian Chophouse	294.52	Travel	No detailed receipt.
2011	12/05/10	717 South Restaurant	179.48	Travel	No detailed receipt.
2011	12/06/10	Mitchell's Fish Market	297.09	Travel	No detailed receipt.
2011	12/13/10	Chop House	27.90	Meeting	No detailed receipt.
2011	12/20/10	Chop House	98.45	Finance Committee Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	01/07/11	Chop House	48.65	Meeting	No detailed receipt. Employee not on travel status.
2011	01/10/11	Chop House	51.64	Meeting	No detailed receipt. Employee not on travel status.
2011	01/18/11	Chop House	43.76	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	01/18/11	Texas Roadhouse	34.33	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	01/24/11	The Chop House	87.77	Meeting	No detailed receipt. Employee not on travel status.
2011	02/03/11	Bob Evans	24.20	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	02/05/11	The Caucus Room	402.85	Travel	No detailed receipt.

Appendix D - Detail Transactions for Questionable Credit Card Expenditures and Travel/Business Expense Reimbursements for the "Food" Category (Continued)

Fiscal Year	Date	Vendor Name	Amount	Description	Auditor Comments
2011	02/06/11	Acadiana	287.80	Travel	No detailed receipt.
2011	02/07/11	Marrakesh	161.00	Travel	No detailed receipt.
2011	02/07/11	Renaissance	26.40	Travel	No detailed receipt.
2011	02/08/11	Capital Q	17.60	Travel	No detailed receipt.
2011	02/09/11	Cattlemen's Roadhouse	28.75	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	02/12/11	McCormick & Schmick	137.72	Travel	No detailed receipt.
2011	02/13/11	Ten Penh	175.30	Travel	No detailed receipt.
2011	02/14/11	Hank's Oyster Bar	87.60	Travel	No detailed receipt.
2011	02/15/11	Ruth's Chris Steak House	142.27	Travel	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	02/16/11	B. Smith's	60.55	Travel	No detailed receipt.
2011	02/17/11	Chop House	30.76	Unknown	No detailed receipt.
2011	02/23/11	Chop House	103.33	Executive Committee Meeting	No detailed receipt. Employee not on travel status.
2011	03/04/11	Ruth's	250.00	Travel	Unknown business purpose. Stated as banquet deposit.
2011	03/12/11	Grey Goose	416.84	Sponsorship lunch.	Unknown business purpose.
2011	03/19/11	Boar's Head	101.87	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2011	03/19/11	Ruth's Chris Steak House	523.30	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2011	03/20/11	McCormick & Schmick	602.80	Travel	No detailed receipt.
2011	03/20/11	King Street Blues	85.35	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2011	03/21/11	B. Smith's	604.37	Travel	No detailed receipt.
2011	03/22/11	Ten Penh	830.28	Travel	No detailed receipt.
2011	03/22/11	Thunder Grill	236.80	Travel	No detailed receipt.
2011	03/23/11	Acadiana	566.28	Travel	No detailed receipt.
2011	03/23/11	Martin's Tavern	77.08	Travel	No detailed receipt.
2011	03/28/11	Mondellis Bake Shop	13.00	Finance Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	03/30/11	Chop House	287.17	Executive Committee Meeting	No detailed receipt. Employee not on travel status.
2011	04/11/11	Oceanair	55.68	Travel	No detailed receipt.
2011	04/11/11	Oceanair	212.11	Travel	No detailed receipt.
2011	04/11/11	Old Ebbitt Grill	96.36	Travel	No detailed receipt.
2011	04/12/11	Acadiana	139.00	Travel	No detailed receipt.
2011	04/12/11	Bullfeathers	41.00	Travel	No detailed receipt.
2011	04/13/11	B. Smith's	82.00	Travel	No detailed receipt.
2011	04/20/11	The Chop House	159.48	Finance Committee Meeting	No detailed receipt. Insufficient meeting documentation. Local meals, not on travel status.
2011	04/25/11	Per Diem Meals Reimbursement	71.00	Per diem request	Questionable reimbursement.
2011	04/26/11	Pier 23 Café	75.36	Travel	No detailed receipt.
2011	04/26/11	Postrio	112.27	Travel	No detailed receipt.
2011	04/27/11	Crab Station	47.85	Travel	No detailed receipt.
2011	04/28/11	Fog Harbor	152.00	Travel	No detailed receipt.
2011	04/28/11	The Cliff House	185.00	Travel	No detailed receipt.
2011	04/29/11	Per Diem Meals Reimbursement	71.00	Per diem request	Questionable reimbursement.
2011	05/03/11	Chop House	52.00	Meeting	Insufficient meeting documentation. Employee not on travel status.
2011	05/04/11	Chop House	142.61	Executive Committee Meeting	Insufficient meeting documentation. Employee not on travel status.
2011	05/06/11	Chop House	43.57	Unknown	Unknown business purpose.
2011	05/09/11	Cheddar's Casual Café	20.92	Unknown	No detailed receipt.
2011	05/12/11	Magnolia Tea Room	37.00	Meeting	No detailed receipt.
2011	05/17/11	Columbia Steakhouse	190.00	Unknown	No detailed receipt.
2011	05/17/11	Columbia Steakhouse	92.00	Unknown	Unknown business purpose.
2011	05/18/11	Chop House	26.79	Meeting	Insufficient meeting documentation. Employee not on travel status.
2011	05/19/11	Bob Evans	23.35	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	05/21/11	Hyman's Seafood Co	84.31	Travel	No detailed receipt.
2011	05/22/11	Magnolia's	194.54	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2011	05/25/11	Chop House	143.38	Finance meeting.	No meeting documentation. Employee not on travel status.
2011	06/02/11	Bob Evans	142.93	Unknown	No detailed receipt.
2011	06/12/11	Max & Erma's	61.92	Meeting	No detailed receipt. Includes non-BGADD employees/board members.
2011	06/13/11	Rockin' Baja Coastal Cantina	70.67	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2011	06/15/11	SD Zoo	64.38	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2011	06/15/11	The Tin Fish	71.59	Travel	Unknown business purpose.
2011	06/16/11	California Pizza Kitchen	58.99	Travel	Unknown business purpose.
2011	06/17/11	Wendy's	35.71	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	06/21/11	Bob Evans	33.35	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	06/21/11	Chop House	24.67	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2011	06/22/11	Cheddar's Casual Café	28.90	Meeting	No detailed receipt.
2011	06/22/11	Chop House	204.13	Executive Committee Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2012	07/01/11	Chop House	22.00	Unknown	Unknown business purpose.
2012	07/11/11	Oceanair	287.00	Travel	No detailed receipt. Unknown business purpose.
2012	07/12/11	Spud's Tavern	32.52	Unknown	Unknown business purpose.
2012	07/13/11	J Street	179.77	Travel	No detailed receipt. Unknown business purpose.
2012	07/16/11	Chilli's	53.00	Meeting	No detailed receipt.
2012	07/16/11	Hank's Oyster Bar	183.00	Travel	No detailed receipt.
2012	07/16/11	Martin's Tavern	55.00	Travel	No detailed receipt.
2012	07/17/11	Old Ebbitt Grill	29.43	Travel	No detailed receipt.
2012	07/17/11	Oceanair	505.55	Travel	No detailed receipt.

Appendix D - Detail Transactions for Questionable Credit Card Expenditures and Travel/Business Expense Reimbursements for the "Food" Category (Continued)

Fiscal Year	Date	Vendor Name	Amount	Description	Auditor Comments
2012	07/18/11	Bistro Bistro	195.00	Travel	No detailed receipt.
2012	07/18/11	Monocle on Capitol	70.00	Travel	No detailed receipt. Included non-BGADD employee/board member
2012	07/19/11	BlueDuck	309.00	Travel	No detailed receipt.
2012	07/20/11	The Fairfax Hotel	158.00	Travel	No detailed receipt.
2012	07/22/11	Big Boy	25.52	Meeting	Employee not on travel status.
2012	07/25/11	Azur	210.00	Dinner	No detailed receipt. Unknown business purpose.
2012	07/26/11	Winchall's Restaurant	109.13	Meeting	No detailed receipt. Unknown business purpose.
2012	07/28/11	Olive Garden	467.27	Retirement party	Personal. Excessive - \$59.43 tip, with an additional \$60 tip added.
2012	08/12/11	Chop House	37.80	Meeting	No detailed receipt. Unknown business purpose.
2012	08/15/11	Chop House	32.56	Meeting	No detailed receipt. Unknown business purpose.
2012	08/18/11	Jack Fry's	500.01	Local Issues Conference	No detailed receipt.
2012	08/22/11	Chop House	201.38	Unknown	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2012	08/24/11	Chop House	55.64	Executive Committee Meeting	Insufficient meeting documentation. Employee not on travel status.
2012	08/24/11	Lima Restaurant	93.00	Travel	No detailed receipt.
2012	08/25/11	Old Ebbitt Grill	35.00	Travel	No detailed receipt.
2012	08/25/11	Oceanaire	362.50	Travel	No detailed receipt. Unknown business purpose.
2012	09/01/11	Luncheon/Unknown	15.00	Meeting	No detailed receipt. Employee not on travel status.
2012	09/19/11	Beony's Steak & Seafood	118.00	Travel	Employee also received per diem for this meal.
2012	09/29/11	Applebees	35.95	Unknown	Insufficient meeting documentation. Employee not on travel status.
2012	09/30/11	Olive Garden	293.74	Retirement party	Personal. Excessive - \$37.74 tip, with an additional \$30 tip added.
2012	10/06/11	Per Diem Meals Reimbursement	\$ 230.00	Per diem request	Conference provided breakfast/lunch
2012	10/08/11	Grillfish Restaurant	862.66	Travel	Unknown business purpose.
2012	10/09/11	Groovy's PIZZA	148.00	Travel	Includes non-BGADD employees/board member.
2012	10/09/11	Paul	131.07	Travel	Includes non-BGADD employees/board member.
2012	10/09/11	Paul	11.39	Travel	Unknown business purpose.
2012	10/10/11	Jerry's Famous Deli	271.08	Travel	Includes non-BGADD employees/board member.
2012	10/10/11	Monty's Rawbar	370.21	Travel	No detailed receipt. Includes non-BGADD employees/board members
2012	10/10/11	Yuca Restaurant	1,250.01	Travel	No detailed receipt. Includes non-BGADD employees/board members
2012	10/11/11	Jerry's Famous Deli	297.75	Travel	Includes non-BGADD employees/board member.
2012	10/12/11	Jerry's Famous Deli	258.25	Travel	Includes non-BGADD employees/board member.
2012	10/12/11	Loews Hotel	17.01	Travel	No detailed receipt.
2012	10/20/11	Chop House	33.03	Unknown	No detailed receipt. Unknown business purpose.
2012	10/26/11	Galt House	99.28	Meeting	No detailed receipt. Unknown business purpose.
2014	10/26/11	Proof on Main	285.20	Meeting	Unknown business purpose. Included non-BGADD employees/board members.
2012	11/07/11	Chop House	21.52	Unknown	No detailed receipt. Unknown business purpose.
2012	11/08/11	Rays In The City	425.86	Travel	No detailed receipt.
2012	11/09/11	Morton's The Steakhouse	699.00	Travel	No detailed receipt.
2012	11/10/11	Chilli's	83.00	Travel	No detailed receipt.
2012	12/02/11	Chilli's	68.00	Unknown	No detailed receipt.
2012	12/02/11	Guppy's	163.72	Travel	No detailed receipt.
2012	12/03/11	Columbia	274.32	Unknown	No detailed receipt.
2012	12/04/11	Timpano Italian Chophouse	404.00	Travel	No detailed receipt.
2012	12/05/11	Cassis American Brasserie	337.50	Travel	No detailed receipt.
2012	12/07/11	Chop House	147.00	Unknown	No detailed receipt.
2012	12/08/11	Johnny Carino's	70.00	Unknown	No detailed receipt.
2012	12/16/11	Chop House	50.00	Unknown	No detailed receipt.
2012	12/20/11	Chop House	50.46	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2012	12/30/11	Chop House	19.96	Unknown	Unknown business purpose.
2012	01/03/12	Chop House	72.24	Unknown	No detailed receipt.
2012	01/06/12	Chop House	197.62	Unknown	No detailed receipt.
2012	01/12/12	Loughom	82.45	ADD Directors Meeting	No detailed receipt. Employee not on travel status. Undocumented/unknown business purpose.
2012	01/31/12	Chop House	104.51	Unknown	No detailed receipt.
2012	02/08/12	Garcia's	16.00	ADD Directors Meeting	No detailed receipt. Employee not on travel status.
2012	02/09/12	Loughom	45.00	ADD Directors Meeting	No detailed receipt. Employee not on travel status.
2012	02/09/12	Thai Smile	29.85	ADD Directors Meeting	No detailed receipt. Employee not on travel status.
2012	02/12/12	Bistro	67.00	Unknown	No detailed receipt. Employee not on travel status. Undocumented/unknown business purpose.
2012	02/12/12	DeShea's	25.71	Meeting	No detailed receipt. Employee not on travel status. Undocumented/unknown business purpose.
2012	02/12/12	Kellari Taverna	61.00	Meeting	No detailed receipt. Employee not on travel status. Undocumented/unknown business purpose.
2012	02/13/12	Sea Catch Rest & Raw Bar	315.90	Travel	Unknown business purpose.
2012	02/14/12	America Eats Tavern	145.00	Travel	Unknown business purpose.
2012	02/15/12	B Smith's Restaurant	80.00	Travel	No detailed receipt.
2012	02/15/12	Oceanaire	101.79	Travel	No detailed receipt.
2012	02/17/12	Embassy Lexington	139.85	Unknown	No detailed receipt.
2012	03/02/12	The Chop House	48.81	Travel	No detailed receipt.
2012	03/07/12	Cattlemen's Roadhouse	17.00	ADD Directors Meeting	Employee not on travel status.
2012	03/10/12	Panache Restaurant	160.00	Travel	No detailed receipt.
2012	03/10/12	The Old Ebbitt Grill	82.00	Travel	No detailed receipt.
2012	03/11/12	Oceanaire	413.00	Travel	No detailed receipt.
2012	03/11/12	Point of View Terrace	20.00	Travel	No detailed receipt.
2012	03/13/12	Front Page	143.00	Travel	No detailed receipt.
2012	03/13/12	Marriott	104.00	Travel	No detailed receipt.
2012	03/13/12	The Monocle	94.00	Travel	No detailed receipt.
2012	03/13/12	Cassis American Brasserie	326.25	Travel	No detailed receipt. Includes non-BGADD employees/board members

**Appendix D - Detail Transactions for Questionable Credit Card Expenditures and
Travel/Business Expense Reimbursements for the "Food" Category (Continued)**

Fiscal Year	Date	Vendor Name	Amount	Description	Auditor Comments
2012	03/17/12	Oceanaire	608.00	Travel	No detailed receipt.
2012	03/17/12	Rite Aid	4.60	Travel	Unknown business purpose.
2012	03/18/12	Acadiana	447.48	Travel	No detailed receipt.
2012	03/19/12	B. Smith's Restaurant	594.66	Travel	No detailed receipt.
2012	03/19/12	Morton's	169.00	Travel	No detailed receipt.
2012	03/20/12	America Eats Tavern	457.00	Travel	Excessive. Includes tip of \$69.80.
2012	03/21/12	The Monocle	143.00	Travel	No detailed receipt.
2012	03/21/12	Crystal Gateway	146.05	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2012	03/25/12	Jose Cuervo Tequileria	112.00	Unknown	No detailed receipt.
2012	03/26/12	Willie G's Post Oak	565.70	Travel	No detailed receipt.
2012	03/27/12	Chili's Too	126.01	Unknown	No detailed receipt.
2012	03/27/12	Fox Sports	13.90	Travel	No detailed receipt.
2012	03/28/12	Chop House	118.00	Unknown	No detailed receipt. Insufficient meeting documentation. Unknown business purpose.
2012	04/03/12	Marketplace	68.18	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2012	04/12/12	Cattlemans Roadhouse	13.85	Unknown	No detailed receipt. Unknown business purpose.
2012	04/15/12	Outback	25.86	Travel	No detailed receipt.
2012	04/16/12	Oceanaire	519.46	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2012	04/16/12	The Old Ebbitt Grill	110.00	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2012	04/18/12	Chop House	41.36	Unknown	No detailed receipt.
2012	05/09/12	Chop House	152.20	Unknown	No detailed receipt.
2012	05/18/12	Berrets Taphouse	78.80	Travel	No detailed receipt.
2012	05/19/12	The Cheese Shop	33.48	Travel	No detailed receipt.
2012	05/20/12	Stephanos	27.48	Travel	No detailed receipt.
2012	05/20/12	The Cheese Shop	32.40	Unknown	No detailed receipt. Unknown business purpose.
2012	05/23/12	Bob Evans	39.91	Travel	Insufficient meeting documentation. Employee not on travel status.
2012	06/09/12	Sammy's Bistr	33.18	Travel	No detailed receipt.
2012	06/09/12	Parkshore Grill	313.75	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2012	06/09/12	Renaissance Vinoy Resort	114.92	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2012	06/10/12	Steak N Shake	51.39	Unknown	No detailed receipt.
2012	06/10/12	Parkshore Grill	571.88	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2012	06/11/12	Central Avenue Oyster Bar	395.79	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2012	06/12/12	Lobster Pot	546.16	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2012	06/13/12	Crabby Bills	135.83	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2012	06/14/12	Wendy's	41.87	Meeting	Unknown business purpose.
2013	07/02/12	Chop House	36.21	Meeting	No detailed receipt.
2013	07/05/12	Chop House	36.80	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2013	07/06/12	Fazoli's	120.73	Meeting	No detailed receipt.
2013	07/07/12	Illegal Pete's	53.98	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2013	07/07/12	Oceanaire	386.27	Travel	No detailed receipt. Included non-BGADD employee/board member.
2013	07/09/12	Willie G's Post Oak	269.10	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2013	07/10/12	Buckhorn Exchange	322.06	Travel	Unknown business purpose. Included non-BGADD employees/board members.
2013	07/17/12	Oceanaire	694.42	Travel	No detailed receipt.
2013	07/18/12	Acadiana	794.64	Travel	No detailed receipt.
2013	07/19/12	Bistro	176.82	Meeting	No detailed receipt.
2013	07/19/12	The Old Ebbitt Grill	142.75	Travel	No detailed receipt.
2013	07/23/12	Chop House	78.14	Unknown	No detailed receipt.
2013	07/23/12	Rafferty's	31.99	Unknown	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2013	07/25/12	El Vitral Restaurant	303.87	Travel	No detailed receipt.
2013	08/15/12	St. Charles Exchange	610.56	Travel	No detailed receipt. Unknown business purpose.
2013	08/24/12	Old Ebbitt Grill	38.89	Meeting	No detailed receipt.
2013	09/18/12	Meal Reimbursement	122.00	Per diem request	Questionable reimbursement.
2013	09/24/12	Meal Reimbursement	138.00	Per diem request	Questionable reimbursement.
2013	09/26/12	Rafferty's	54.49	Unknown	No detailed receipt.
2013	10/12/12	Meal Reimbursement	71.00	Per diem request	Questionable reimbursement.
2013	10/13/12	Mirage	793.69	Travel	Includes non-BGADD employees/board member.
2013	10/13/12	Chili's Main	101.43	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2013	10/14/12	Cravings	126.42	Travel	Includes non-BGADD employees/board member.
2013	10/14/12	Cravings	25.28	Travel	Includes non-BGADD employees/board member.
2013	10/14/12	Cravings	262.19	Travel	Includes non-BGADD employees/board member.
2013	10/14/12	Stack at the Mirage	421.17	Travel	Includes non-BGADD employees/board member.
2013	10/14/12	Mirage Paradise Café	160.78	Travel	Unknown business purpose. Included non-BGADD employees/board members.
2013	10/15/12	Boulder Dam Brewing Company	150.45	Travel	Includes non-BGADD employees/board member.
2013	10/15/12	Cravings	221.22	Travel	Includes non-BGADD employees/board member.
2013	10/15/12	Mirage	412.01	Travel	No detailed receipt. Includes non-BGADD employees/board members.
2013	10/15/12	Cravings	40.33	Travel	Unknown business purpose.
2013	10/16/12	Cravings	221.80	Travel	Includes non-BGADD employees/board member.
2013	10/16/12	Cravings	51.86	Travel	Unknown business purpose.
2013	10/17/12	Cravings	69.14	Travel	Includes non-BGADD employees/board member.
2013	10/17/12	Cravings	31.11	Travel	Unknown business purpose.
2013	10/18/12	Marriott	500.00	Catering	Unknown business purpose.
2013	11/01/12	Olive Garden	121.09	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2013	11/01/12	Kroger	25.83	Meeting	No detailed receipt. Unknown business purpose.
2013	11/14/12	Bistro	555.23	Travel	No detailed receipt.

Appendix D - Detail Transactions for Questionable Credit Card Expenditures and Travel/Business Expense Reimbursements for the "Food" Category (Continued)

Fiscal Year	Date	Vendor Name	Amount	Description	Auditor Comments
2013	11/14/12	Center Café	107.95	Travel	No detailed receipt.
2013	11/15/12	Bull Feathers	210.46	Travel	No detailed receipt.
2013	11/15/12	Oceanaire	1,387.08	Travel	No detailed receipt. Included non-BGADD employees/board member.
2013	11/16/12	Tidewater Landing	96.67	Travel	No detailed receipt.
2013	11/28/12	Bearno's Pizza	40.48	Unknown	No detailed receipt.
2013	12/07/12	Central Avenue Oyster Bar	234.00	Travel	No detailed receipt.
2013	12/07/12	The Moon Under Water	101.60	Travel	No detailed receipt.
2013	12/08/12	Columbia Restaurant	208.75	Travel	No detailed receipt.
2013	12/09/12	4th St Shrimp Store	147.00	Travel	No detailed receipt.
2013	12/09/12	Cassis American Brasserie	120.00	Travel	No detailed receipt.
2013	12/10/12	Crabby Bills	154.56	Travel	No detailed receipt.
2013	12/10/12	Parkshore Grill	347.50	Travel	No detailed receipt.
2013	12/11/12	Columbia Café	101.00	Travel	No detailed receipt.
2013	01/08/13	Bob Evans	62.96	Meeting	Employee not on travel status.
2013	01/14/13	La Margarita	25.00	Travel	No detailed receipt.
2013	01/14/13	Maria Mia Mexican	30.00	Travel	No detailed receipt.
2013	01/14/13	Unknown	55.00	Unknown	No detailed receipt. Unknown business purpose.
2013	01/15/13	Iron Cactus	41.00	Travel	No detailed receipt.
2013	01/28/13	The Monocle	60.55	Travel	No detailed receipt.
2013	02/06/13	Marriott	67.15	Unknown	Unknown purpose. Employee not on travel status.
2013	02/07/13	Chop House	39.00	Unknown	Unknown purpose. Employee not on travel status.
2013	02/10/13	Marriott/The Atrium	50.00	Travel	No detailed receipt.
2013	02/11/13	Bistro	76.00	Travel	Unknown business purpose.
2013	02/12/13	Oceanaire	269.00	Travel	Unknown business purpose.
2013	02/13/13	Cattlemen's Roadhouse	22.06	Unknown	No detailed receipt.
2013	02/13/13	Golden Buffet	18.40	Unknown	Unknown business purpose.
2013	02/14/13	Johnny Carinos	16.00	Frankfort, KY	No detailed receipt.
2013	02/21/13	The Chop House	27.00	Unknown	No detailed receipt. Employee not on travel status.
2013	03/01/13	Bluebird - Stanford, KY	109.43	Meeting	No detailed receipt. Unknown business purpose.
2013	03/10/13	Johnny Rockets	51.82	Travel	No detailed receipt.
2013	03/10/13	Bistro	376.00	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2013	03/11/13	San Antonio Bar and Grill	59.12	Travel	No detailed receipt.
2013	03/11/13	Oceanaire	565.00	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2013	03/12/13	Longworth - Washington, DC	3.20	Travel	No detailed receipt.
2013	03/12/13	Longworth - Washington, DC	29.70	Travel	No detailed receipt.
2013	03/12/13	Acadiana	461.23	Travel	No detailed receipt.
2013	03/13/13	Jaleo	145.90	Meeting	No detailed receipt.
2013	03/13/13	Coldstone	22.84	Meeting	No detailed receipt. Unknown business purpose.
2013	03/13/13	Center Café	80.00	Meeting	Unknown business purpose.
2013	03/14/13	Honeybaked Ham	45.00	Unknown	Unknown purpose. Employee not on travel status.
2013	04/22/13	Oceanaire	272.00	Travel	No detailed receipt.
2013	04/23/13	Bistro	163.08	Travel	No detailed receipt.
2013	05/07/13	Ahmad's Persian Cuisine	101.00	Travel	No detailed receipt.
2013	05/09/13	The Twisted Fork	31.00	Travel	No detailed receipt.
2013	05/16/13	Bob Evans	33.45	Meeting	No detailed receipt. Insufficient meeting documentation. Employee not on travel status.
2013	05/17/13	Marketplace Restaurant	72.00	Travel	Includes non-BGADD employees/board member. Unknown business purpose.
2013	05/19/13	Sunset Terrace	145.20	Travel	Includes non-BGADD employees/board member. Unknown business purpose.
2013	05/21/13	The Kitchen of Woodford	257.58	Meeting	Employee not on travel status.
2014	07/16/13	Chop House	21.52	Meeting	Insufficient meeting documentation. Employee not on travel status.
2014	09/10/13	Rafferty's	27.00	Meeting	No detailed receipt. Employee not on travel status.
Total Food Category			\$ 62,830.36		

* FY 2010 transactions appearing in July 2011 credit card statements.

Appendix E - Egregious Reimbursement

BLUEGRASS AREA DEVELOPMENT DISTRICT, INC. 698 PERIMETER DRIVE LEXINGTON, KENTUCKY 40517					CONTROL NO. 042736	
INVOICE NO.	INVOICE DATE	GROSS AMOUNT	DISCOUNT AMOUNT	NET AMOUNT		
	6/3/10	\$20,000.00		\$20,000.00		
VENDOR		CHECK DATE	TOTAL GROSS	TOTAL DISCOUNT	CHECK AMOUNT	CHECK NO.
BLUEGRASS AREA DEVELOPMENT DISTRICT, INC. 698 PERIMETER DRIVE LEXINGTON, KENTUCKY 40517		6/3/10				42736
REPUBLIC BANK & TRUST COMPANY LEXINGTON, KENTUCKY		CHECK DATE 6/3/10		CHECK NUMBER 42736		21-121 630
PAY EXACTLY ***TWENTY THOUSAND DOLLARS AND NO/100		AMOUNT <div style="border: 1px solid black; padding: 5px; display: inline-block;"> \$20,000.00 </div>				
TO THE ORDER OF: <div style="background-color: black; width: 100px; height: 20px; margin-top: 5px;"></div>		BLUEGRASS AREA DEVELOPMENT DISTRICT, INC. VOID AFTER 90 DAYS				
<div style="background-color: black; width: 100%; height: 20px; margin-bottom: 10px;"></div>						
<i>AR+FC passed at meeting on June 3rd, 2010</i>						

Appendix E - Egregious Reimbursement (Continued)



June 3, 2010

Bluegrass Area Development District
Administrative Review & Finance Committee

Committee Members:

I am requesting consideration to be reimbursed for expenses which have accumulated over the last 20 years. The ADD did not have a credit card during the period so I was asked to pay for hotel, meal and airline charges on my personal credit card. I used my American Express exclusively for ADD expenses. Over the years, there were expenses which I was not reimbursed for as well as expenses I was reimbursed for after interest had been assessed on the 30 day balance. This was brought to the attention of the AR&F Committee about a year and a half ago and I continue to pay interest on the outstanding balance. At the time I brought this to the AR& F Committee the outstanding balance was more than \$17,000.

Therefore, I am asking for \$17,000 in unreimbursed business expenses and an additional \$3,000 to cover interest accrued, for a total of \$20,000.

Respectfully,



*Approved
6/3/2010
C. Han*

A black rectangular redaction box covering the signature area.

**BLUEGRASS AREA DEVELOPMENT DISTRICT'S
MANAGEMENT RESPONSE**

isolation, but were carefully executed through the consultation of professional services including CPAs and attorneys, and were done in full transparency and inclusion of local governments, elected officials, professional staff serving in local government and public input from concerned citizens. Additional institutional practices jointly identified by your examination and by the BGADD Board as problematic to good governance that have been decisively changed in the last ten months include:

- Elimination of employee bonuses
- Changes in travel policy to mirror the federal GSA travel regulations
- Review, amendment and enforcement of the BGADD bylaws including the proper use of authority by the Executive and the Administrative Review and Finance Committees
- Review, amendment and enforcement of the Employee Policy Manual

Your examination not only gives credibility to the actions previously taken, but also provides insight to additional changes that will be required. BGADD will continue to be an agent of change until we have eliminated all conflicts of interest, restored strict and effective governance practices and implemented procedures that demonstrate proper knowledge and administration of all public funds. You have my full commitment and the commitment of the entire Board of Directors that we will implement the recommendations provided in the examination and will take additional steps in the future to maintain this public trust.

Sincerely,

A handwritten signature in cursive script that reads "D. H. Duttlinger".

David Duttlinger, P.E., MPA
Executive Director
Bluegrass Area Development District

