



MIKE HARMON
AUDITOR OF PUBLIC ACCOUNTS

March 26, 2019

Mayor Chip Hancock
City of Indian Hills
3905 Brownsboro Road
Indian Hills, KY 40207

RE: Summary of Review Results

Dear Mayor Hancock:

This office received allegations regarding the spending practices of the City of Indian Hills. To address these allegations, we requested information and expenditure documentation to evaluate the facts and circumstances of the activities in question. This review found areas of concern that should be addressed by the City. The purpose of this letter is to communicate these areas with corresponding recommendation(s) so that appropriate actions can be taken.

Based on our review of the documentation provided, the following findings, with recommendations, were identified:

1. The City did not comply with the state's procurement law that requires advertising for projects when costs exceed \$20,000.

As required by KRS 424.260, if a city does not adopt the provisions of the Local Model Procurement Code (KRS 45A.343 to 45A.460), it must advertise for bids related to any contract, lease, or other agreement for materials, supplies, equipment, or nonprofessional services that involve an expenditure in excess of \$20,000, with certain exceptions. According to the City, there are no written procurement policies. The requirements of KRS 424.260 are applicable to the City.

After reviewing the City's disbursement ledgers for fiscal years 2016, 2017, and 2018, we requested advertisements for bids related to vendors that appeared to have been paid over \$20,000. While advertised bids for paving and waste removal were provided, no advertisements were provided for the following expenditures that appear related to projects with expenditures exceeding \$20,000:

- Over \$32,000 was paid to Eagle Sign Company for a residential street signage project. The City's ledger documented a check for \$12,199.72 in July 2016 and another check for



\$19,950.83 in September 2016. The ledger description notes that one payment was for phase 3 and the other check, two months later, for phase 4. Though these were for separate phases, it appears evident that the City was aware that the expense of this project would exceed \$20,000 and should have taken steps to advertise for bids. In total, this vendor was paid over \$36,000 for signage work during FY 2017.

- In FY 2016, Koch's Landscaping was paid over \$51,000 for landscaping work. Although none of the checks exceeded \$20,000, there was one payment on June 1, 2016 for \$19,815.50. In FY 2017, the vendor was paid over \$69,000 that included a payment on June 23, 2017 that exceeded \$22,000. In FY 2018, the vendor was paid over \$55,000, which included a payment of \$21,879.75 on November 16, 2017.
- For snow removal and salting, the City paid Steepleton's over \$22,000 in FY 2016 and over \$31,000 in FY 2018. While weather-related expenditures are difficult to predict, based on two of the past three fiscal years, these expenditures should be advertised because it is known that costs would likely exceed \$20,000. Additionally, this vendor, Steepleton's, is owned by James Graven, who serves as the City's Public Works Director. KRS 61.252 prohibits any officer or employee of a city from contracting with the city for services. Although the City states that this relationship is documented and approved, the disclosure and finding that this contract is in the best interests of the city must be part of the city's official record before the contract is awarded. Based on the documents provided, that did not occur.
- For FY 2016, 2017, and 2018, Gerald Ackermann was paid over \$65,000--\$74,000 and \$77,000, respectively, each year for lawn mowing services.

We recommend the city ensure that an advertisement soliciting bids is published for any project or purchase expected to exceed \$20,000, unless it meets the exceptions contained in KRS 424.260. An advertisement soliciting bids must be published at least once and must include a description of what is to be bid, the time and place for receipt of bids, and any special terms, according to KRS 424.130(1)(b) and KRS 424.140(3). This process will provide an opportunity for competition and transparency.

The City should adopt procurement policies that document the City's procedures for the procurement of goods and services. These policies should address the methods used to advertise and how bids will be accepted. The city's required process to document and approve an allowable exception per KRS 61.252 should also be included in these procurement policies. It is recommended that this exception be reviewed and documented annually to prevent the inherent conflict of interest that exists when an officer or staff benefits financially due to the needs of the City. KRS 61.252 is enclosed with this letter to provide the exception requirements that must be met before an officer or employee contracts with the City to provide services.

2. The City paid bonuses to certain employees, contractors, and subcontractors.

Section 3 of the Kentucky Constitution states that "no grant of exclusive, separate public emoluments or privileges shall be made to any man or set of men, except in consideration of public service." Therefore, a City should only pay its officers and employees for services actually

rendered. According to KRS 83A.070, the compensation of city officers and employees must be set by ordinance. Based on these provisions, the Office of Attorney General Opinion 62-1 states that a city is prohibited from giving any bonus, gift, or extra compensation to city officers or employees over and above that which is fixed in the ordinance establishing their compensation.

In our review of the City's disbursement ledger for fiscal years 2016, 2017, and 2018, we found expenditures labeled as an "Annual Supplemental Income Adjustment" provided to city officers and vendor staff for all three years. These appeared to be Christmas bonuses due to the disbursement ledger documenting the phrase, Merry Christmas, for each payment. The following Figure 1 shows the cumulative amounts received during this three-year period:

Figure 1: Bonuses Received by City Officers and Vendor Employees

Recipient	Total*
Eco Waste Removal Employees (11)	\$ 4,800
City Attorney	1,000
City Police Chief	2,500
Gerald Ackermann (Lawn Mowing)	3,000
City Clerk	3,000
City Treasurer	4,500
City Public Works Director/Citation Officer	5,500
Grand Total	\$24,300

Source: Auditor of Public Accounts based on information provided by the City.

* Total of supplements for fiscal years 2016, 2017, and 2018.

In September 2018, new ordinances were passed related to the positions of Legal Counsel, Citation Officer, City Police Chief, City Treasurer, and City Clerk. These ordinances all state that bonuses and extra compensation may be paid by City Council subject to their decision to appropriate the funds in the annual budget ordinance. The ordinances do not establish dollar amounts. Therefore, the bonuses provided to City officers violates Section 3 of the Kentucky Constitution and KRS 83A.070 that prohibit any extra compensation over and above the amount fixed in the ordinance establishing their compensation as part of a personnel and pay classification plan.

The amounts paid to vendors should be set by contract. Extra compensation is an unnecessary expense without a public purpose.

We recommend the City compensate City officers and employees at their fixed compensation amounts per state law and discontinue the practice of providing extra compensation. Any compensation paid to City vendors should be established by contract to protect the City's revenue from additional, unnecessary expenditures.

3. Independent contractors are used to staff City positions other than police.

Police personnel are the only staff that are paid as an employee, while the City has chosen to pay four other positions as independent contractors. According to the City, there are 7 full-time and 4 part-time police officers that include the police chief and assistant chief. All of these are employees and thus receive W-2s. The City issues 1099-MISC for professional services for the following positions:

- City Treasurer and Accountant
- Public Works Director
- City Clerk
- City Attorney

According to the Internal Revenue Services' (IRS) Publication 15-A, the relationship of the worker and the business must be examined to determine whether an individual should be classified as an employee or independent contractor. The following three categories should be evaluated to make this determination:

1. Behavioral Control – Determined by the facts as to whether or not the city has a right to direct and control how the worker does the task for which the worker is hired.
2. Financial Control – Determined by the facts as to whether the city has the right to control the “business” aspects of the worker’s job. For example, an independent contractor is typically conducting other jobs in the market, is paid a flat fee, and is not reimbursed for business expenses.
3. Type of Relationship – Determined by the facts related to the following: written contracts describing the relationship; employee benefits provided; permanency of the relationship, and whether the worker provides services that are a key aspect of the city.

In situations that have elements that meet the criteria for an employee relationship and an independent contractor relationship, the IRS will assist in making this determination. Publication 15-A states, “If you want the IRS to determine whether or not a worker is an employee, file Form SS-8 with the IRS.”

Related to the misclassification of employees, IRS Publication 15-A states:

Consequences of treating an employee as an independent contractor. If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you are liable for employment taxes for that worker and the relief provision, discussed next, won't apply. See section 2 in Pub. 15 for more information.

Relief provision. If you have a reasonable basis for not treating a worker as an employee, you may be relieved from having to pay employment taxes for that worker. To get this relief, you must file all required federal information returns on

a basis consistent with your treatment of the worker. You (or your predecessor) must not have treated any worker holding a substantially similar position as an employee for any periods beginning after 1977.

We recommend the City review this publication to determine if the City has classified the relationships properly for those three positions. If there are questions, we recommend the City complete Form SS-8 and have the IRS determine the proper relationship. Once the proper relationship is determined, we recommend the City ensure that the proper method of compensation is used for that position.

4. Public funds were used for an annual holiday party that included alcohol purchases.

From our review of selected expenditures, it was clear that there was an annual holiday party. Payments to Equus Restaurant for these parties were over \$4,000 each year and totaled \$13,031 for the three-year period reviewed.

These parties occurred on December 17, 2015, December 15, 2016, and December 14, 2017, but a detailed receipt was only available for the 2017 party, which documented at least \$773 in alcohol purchases. According to the City, the former Mayor reviewed a detailed invoice for the parties in 2015 and 2016, but the invoice retained by the City did not contain any detail.

While these expenditures were approved by the Mayor at the time of payment, public funds were used for the personal benefit of selected officials and staff. KRS 82.082(1) states that cities can perform any power or function "that is in furtherance of a public purpose of city and not in conflict with a constitutional provision or statute." These expenditures seem excessive and we question whether a public purpose was served. Our review of selected expenditures also noted that the City paid \$681 for poinsettias on January 19, 2017 for City Council members and selected staff.

We recommend the City be fiscally responsible with taxpayer funds and ensure that all purchases have a direct public purpose and are not for entertainment purposes to the personal benefit of staff. We also recommend the City develop a formal written policy as to prohibited expenses that will protect the interest of City taxpayers. Finally, we recommend the City refrain from purchasing alcohol with City funds.

5. Expenditures and reimbursements were made without adequate documentation as support.

Based on our review of selected expenditures that totaled \$59,539, we found that \$28,092 (47%) in expenses that did not have adequate, detailed support. For example, a \$5,400 payment was made to caterer Sashee Gaslin for catering services, but the invoice simply stated \$4,000 for food, \$500 for labor, and \$900 tip. There was no breakdown of what exactly was purchased to ensure that City paid the appropriate amounts. As stated in Finding 4, two of the invoices from the holiday parties were not supported by a detailed receipt.

A total of \$16,301 (27%) of the selected expenditures were paid as reimbursements to City officials and staff instead of being paid directly by the City to the actual vendor. We found that \$8,207 of these reimbursements (50%) were not supported by detailed invoices to document that the City was reimbursing the individual for an actual City expense. Of the \$16,301 in reimbursements, \$9,361 had no evidence of any approval prior to payment. Examples include reimbursements for the removal of deer, extra pay for clean-up work, gas expenditures for a plow truck, filing fees, and various Octoberfest payments to vendors that included tips.

Of the expenditures reviewed, payments referencing the Indian Hills' Octoberfest totaled \$16,317. We found that \$8,722 (53%) of these Octoberfest expenditures were not paid directly by the City, but were paid as reimbursements to City officials and staff without any documented approval.

We recommend the City require actual receipts in order to make a direct payment and any reimbursements. This will ensure that the City has a record of the good and services purchased and that the City official or staff is not receiving additional funds except what was actually incurred for City purposes. The City should make efforts to pay expenses directly to the vendor. Any reimbursements should be based on a detailed invoice and not a handwritten note. Also, payments directly to the vendor will prevent the reimbursement of any sales tax that may have been paid by the individual.

We further recommend that the City develop procurement policies that contain the required procedures and documents for the payment and approval of expenditures. These policies should require a detailed receipt for all payments, including reimbursements. These policies should also address circumstances that may not allow for actual receipts to be provided and how these instances will be handled by the City.

Thank you for your attention to this matter. We would also like to thank the City for its cooperation with this review. If you have any questions regarding this letter, please contact me, or Chris Hunt, Executive Director at (502) 564-5841.

Thanks and God Bless,



Mike Harmon
Auditor of Public Accounts

Enclosure: KRS 61.252

c: Indian Hills City Council Members

61.252 Prohibition against city officers and employees contracting with city or city agency for property or services -- Exceptions -- Penalty.

- (1) No officer or employee of any city or city agency shall directly or through others undertake, execute, hold, or enjoy, in whole or in part, any contract made, entered into, awarded, or granted by the officer's or employee's city or city agency, with the following exceptions:
 - (a) The prohibition in this section shall not apply to contracts entered into before an elected officer filed as a candidate for city office, before an appointed officer was appointed to the office, or before an employee was hired by the city or city agency; provided that if the contract is renewable, the prohibition shall apply to any renewal of the contract that occurs after the officer is elected or appointed, or after the employee is hired, unless the provisions of paragraph (c) of this subsection are satisfied;
 - (b) The prohibition in this section shall not apply if the contract is awarded after public notice and competitive bidding, unless the officer or employee is authorized to participate in establishing the contract specifications, or awarding, or managing the contract, in which case the provisions of paragraph (c) of this subsection shall be satisfied;
 - (c) The prohibition in this section shall not apply if the following requirements are met:
 1. The specific nature of the contract transaction and the nature of the officer's or employee's interest in the contract are publicly disclosed at a meeting of the governing body of the city or city agency;
 2. The disclosure is made a part of the official record of the governing body of the city or city agency before the contract is executed;
 3. A finding is made by the governing body of the city or city agency that the contract with the officer or employee is in the best interests of the public and the city or city agency because of price, supply, or other specific reasons; and
 4. The finding is made a part of the official record of the governing body of the city or city agency before the contract is executed.
- (2) Violation of this section is a Class A misdemeanor, and upon conviction, the court may void any contract entered into in violation of this section. Additionally, violation of this section shall be grounds for removal from office or employment, in accordance with applicable provisions of law.

Effective: July 15, 1994

History: Created 1994 Ky. Acts ch. 379, sec. 2, effective July 15, 1994.