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Auditor Edelen releases Bluegrass Area Development District special exam, finds serious, systemic concerns about the agency's financial activities

LEXINGTON, Ky. (March 4, 2014) – Auditor Adam Edelen on Tuesday released a special examination of the Bluegrass Area Development District (BGADD), which depicted an agency with rogue management that conducted activity far outside its scope and without proper oversight, used federal money for questionable purposes and failed to report potential criminal activity to law enforcement.

The examination will be referred to eight agencies, including the Kentucky Attorney General, the Kentucky State Police and FBI.

“For over a decade, the former administration of the Bluegrass ADD took advantage of the fact that the average citizen wasn’t paying close attention to its activities and may not even understand exactly what a development district does,” Auditor Edelen said. “It strayed far from its mission and seemingly convinced itself that because it doesn’t receive direct payments from taxpayers, it doesn’t have to be accountable. But let me be clear: Every penny this agency receives comes from taxpayers, and today is the day we begin holding it accountable.”

ADDs were created to assist local governments in regional planning for economic growth. The BGADD is located in Lexington and serves 17 counties in central Kentucky. It has an annual budget of more than \$24.4 million, 90 percent of which comes from federal and state grants.

The Auditor’s office launched the examination last summer after receiving concerns about certain activity at BGADD. The exam contains eight findings and several recommendations for improvement.

Failure to report possible criminal activity by an employee

One of the most serious findings in the exam is that the former executive director of BGADD attempted to halt an internal investigation identifying possible criminal violations and did not report those possible violations to law enforcement.

The exam found that a former BGADD employee collected money from felons who were participating in the BGADD's felon re-entry program, known as Steppin' To A New Beat, even though the program was federally funded and did not require a fee. The fees were not accounted for in BGADD funds, so auditors were unable to determine how much was collected and for how long. Even more concerning, the exam found that individuals who believed they were participants in the re-entry program signed a consent to drug test even though drug testing wasn't required.

The examination also found that eight individuals housed at a location under contract with BGADD to provide housing for Steppin' To A New Beat participants had not been enrolled in the re-entry program at any time. This created a questioned federal cost of \$6,400.

“We are talking not just about the questionable use of federal dollars, but what appears to be the exploitation of individuals who were trying to re-enter society,” Auditor Edelen said. “Not only did the former BGADD administration not report these suspected activities to law enforcement, it tried to squash its own internal investigation.”

Further, auditors found that the former employee accessed the BGADD offices while she was on administrative leave, and subsequently, took nearly 300 files containing personal information of Steppin' To A New Beat participants were found to have been taken. The BGADD reported this activity to police once the files were noticed as missing.

Engaging in activities beyond its scope

The examination found several organizations either created by a former BGADD director or others that appeared to be mechanisms to expand into activities outside the scope of its statutory authority.

“The ADD looks like an octopus, extending its tentacles far beyond its original statutory authority,” Auditor Edelen said.

One relationship that was a cause of concern during the exam is BGADD's relationship with the Bluegrass Industrial Foundation (BIF). BIF was incorporated by a former BGADD executive director and as far back as 2002, BGADD and BIF were audited together. BGADD and BIF also share board members.

The BGADD has been leasing its office space from BIF since 1994, paying more than \$250,000 a year. Documentation identified that \$1.1 million of the \$1.6 million purchase price for the building was funded through sources available to or approved by BGADD, raising questions as to why BGADD didn't purchase the property itself or establish a financing mechanism in which

the title of the property would vest to BGADD when the mortgage was paid. Instead, the current lease arrangement does not convey any ownership to BGADD, although lease payments made to date would have more than paid for the property and the current arrangement gives the appearance that BGADD is leasing space from itself.

Throughout the exam, auditors received concerns that BGADD was attempting to strategically position itself to increase its authority over the decision making for Workforce Investment Act (WIA) funding. The exam found BGADD has an agreement to act as the fiscal agent for the Workforce Investment Board (WIB), which established the BGADD chair as the CEO of the WIB. By allowing the WIB CEO and BGADD board chair to be the same person, and having the CEO make all appointments to the WIB board, a potential conflict of interest exists.

“The ADD is swimming around in this alphabet soup of organizations, creating an appearance that it is using these groups to de-federalize grant money and skirt rules associated with federal dollars,” Auditor Edelen said.

Other significant concerns identified by auditors

The exam identified serious concerns that BGADD could be using grants as a cash flow mechanism to fund operations and other expenditures. Noncompliance with federal grant requirements could jeopardize the funding and significantly increase the risk of error and misappropriation.

The exam found questionable oversight of financial activities. One significant example is BGADD’s purchase of property on Trent Boulevard for \$600,000. The purchase was approved by the Administrative Review and Finance (AR&F) Committee, and the Executive Committee was informed only after the fact. It appears the former executive director frequently sought approval from the AR&F committee rather than the Executive Committee in conflict with its by-laws.

Auditors also found that BGADD violated its own procurement policies. At the Trent Boulevard property, for example, BGADD made payments of \$465,000 to a heating, ventilation and air conditioning (HVAC) vendor without any bid process, written contract and documentation describing services to be performed or an estimate of the costs. It had no invoices to support \$63,000 worth of payments to the vendor. Auditors learned that the HVAC company was owned and operated by a member of the WIB, creating a possible conflict of interest.

The exam also found excessive and unnecessary expenditures by the BGADD and misuse of BGADD credit cards by the former executive director. Auditors questioned \$513,770 worth of expenditures that either lacked supporting documentation or appeared unnecessary or excessive.

Examples of egregious spending include:

- Meals in or around Lexington
- Travel expenses for individuals who were not employees of BGADD
- Travel expenses beyond what was required for conference attendance

- Hotel charges for stays in the same town as an employee’s workstation

The exam also found that the former executive director was paid a \$20,000 lump sum reimbursement without providing receipts, detailed credit card statements or other support to justify the charges.

“I don’t know what’s more astounding: The fact that someone had the gall to make such a request with zero documentation to back it up or that it got approved,” Auditor Edelen. “This speaks to a mentality that this wasn’t really public money or that the accountability taxpayers expect from public agencies didn’t apply here.”

Auditors identified year-end bonuses paid to selected employees despite a prohibition against bonuses for public employees in the Kentucky Constitution. Bonuses were funded with federal grants intended for specific programs and the BGADD created a fake pay period to support the bonuses.

The exam also found that BGADD used an outdated accounting system that only the former executive director knew how to fully operate. This lack of segregation of duties created a significant fraud risk for the agency.

“This report paints a disturbing picture of an institution that viewed serving the public as secondary to its mission of serving itself,” Auditor Edelen said. “Management deluded itself into thinking it could make up its own rules and be accountable to no one.”

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