



**EXAMINATION OF SELECTED FINANCIAL
ACTIVITIES OF THE MUHLENBERG
COUNTY RAILS TO TRAILS PROJECT**

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EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

July 18, 2001

The Honorable Rodney Kirtley
Judge Executive, Muhlenberg County
Muhlenberg County Fiscal Court
P.O. Box #137
Greenville, Kentucky 42345

James Codell
Secretary, Kentucky Transportation Cabinet
125 Holmes Street
Frankfort, Kentucky 40622

RE: Muhlenberg County Rails to Trails examination

Gentlemen:

We have performed an examination of selected Rails to Trails project (Project) activities in Muhlenberg County (County). Our examination was initiated in response to information brought to our attention by citizens. The use of Federal Highway Administration (FHWA) funds for transportation enhancement activities is authorized by 23 U.S.C. § 133(b)(8). The FHWA, through the Kentucky Transportation Cabinet (KYTC), approved an application from the County for transportation enhancement funds for Rails to Trails conversions.

The objective of this examination was to determine whether the paving contract awarded by the County for the Project to Road Builders, Inc. (vendor) met all criteria for legality and appropriateness. Our procedures included interviewing KYTC, County, and vendor personnel, as well as examining KYTC, County, and vendor records. During the course of our work, other Project issues came to our attention that were also examined. We identified a County paving contract for more than \$630,000 that did not meet federal requirements. In addition, we found that the County received from KYTC a \$56,000 Project reimbursement for ineligible expenses.

Judge Kirtley
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The scope of our examination was not designed to constitute an audit, and we therefore express no opinion on the County's financial statements. The areas examined, our results, and recommendations, when appropriate, are discussed in the attached detailed report.

We wish to thank Judge Kirtley and his staff, as well as all parties involved, for their cooperation during the course of our examination.

Very truly yours,

A handwritten signature in black ink, appearing to read "Ed Hatchett". The signature is written in a cursive style with a horizontal line extending to the right from the end of the name.

Edward B. Hatchett, Jr.
Auditor of Public Accounts

EBHJr:kct

Findings and Recommendations

Project paving work was properly bid but the County failed to finalize a formal contract.

We received an allegation that the County awarded Project paving work to the vendor without first advertising for bids. The cost of the paving work was \$142,303. This exceeds the \$20,000 threshold that requires competitive bidding. However, we determined that the County fulfilled this requirement, properly observing a competitive bidding process for the County's annual paving work.

\$142,303 in Project paving work violated the Code of Federal Regulations.

Another allegation contended that the County transacted business with the vendor without entering into a contract. We determined that the County relied upon a signed bid proposal, the Fiscal Court's acceptance of this proposal, and an oral contract with the vendor to govern the business transacted with the vendor that included the Project paving work.

The Project paving work was part of a federal subgrant, therefore the Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, contained in 49 CFR § 18, are applicable. A subgrantee's contracts are required to include thirteen different provisions, as listed in 49 CFR § 18.36(i). Neither the oral contract entered into between the County and the vendor, nor the written bid proposal accepted by the County, satisfies these requirements.

County paving work totaling over \$637,000 was managed contrary to prudent business practices.

According to the vendor, over \$637,000 of paving work has been performed for the County during the current fiscal year, including the Project paving work. It is imprudent for the County to rely on an accepted bid proposal and oral representations given the significant dollar amount expended for this work. The bid proposal does contain some general conditions. However, terms covering areas such as remedies in the event of default, termination rights, access to and retention of records, and compliance with various laws and regulations are not included in the bid proposal. In addition to violating federal regulations in this instance, the decision not to enter into a formal, written contract puts the County at undue risk in the event a dispute should arise.

Code of Federal Regulations bonding requirements were not met.

Bonding requirements were triggered because the cost of Project paving work exceeded the simplified acquisition threshold of \$100,000, as stipulated in 41 U.S.C. § 403(11). These requirements, delineated in 49 CFR § 18.36(h), include obtaining a bid guarantee, a performance bond, and a payment bond. According to the vendor, no bonding arrangements whatsoever were made with the County.

Recommendations

We recommend that the County:

- Amend the County Administrative Code to require the use of written contracts whenever the amount paid for materials or services exceeds the small purchase authority limit of \$20,000; and
 - Comply with federal procurement requirements on all projects involving federal funding.
-

KYTC improperly reimbursed the County \$56,000 for land purchased for the Project.

On April 1, 1999, the County purchased land from Paducah & Louisville Railway, Inc. (P&L) for \$70,000. On that date, the County paid P&L a \$20,000 down payment and signed a promissory note due on or before June 1, 1999, for the remaining \$50,000. The County paid off the promissory note on July 26, 1999. The County chose to negotiate a purchase price with P&L without the benefit of an appraisal. KYTC Federal-Aid Transportation Enhancement Program Application Guidelines (Application Guidelines) require an appraisal for land purchases in accordance with KYTC and FHWA guidelines.

Improper acquisition procedures rendered the Project land purchase ineligible for federal reimbursement.

The County entered into an agreement with KYTC to oversee the Project (Agreement). This Agreement, which allows for eighty percent of Project costs to be reimbursed to the County, was signed and adopted by County officials on August 31, 1999. The KYTC Secretary signed the Agreement on November 16, 1999. Section 2 of the Agreement defines the effective date as “the date signed by the Secretary of the Kentucky Transportation Cabinet and filed with the Government Contract Review Committee.” Therefore the Agreement did not take effect until November 16, 1999, well after the County completed the land purchase.

According to 23 U.S.C. § 108, federal reimbursement of costs incurred by states and local governments for the acquisition of real property in advance of federal approval or authorization is permitted only if the property is ultimately used in the approved project and several other listed conditions are met. One such condition, found in 23 U.S.C. § 108(c)(2)(A), requires that “any land acquired, and relocation assistance provided, complied with the Uniform Relocation Assistance and Real Property Acquisition Policies Act [(Uniform Act)] of 1970.”

The Uniform Act, in 42 U.S.C. § 4651(2), requires that “[r]eal property shall be appraised before the initiation of negotiations.” Since this requirement was not met, the County was not eligible for the \$56,000 reimbursement processed by KYTC on February 15, 2001. The FHWA confirmed this ineligibility in a letter dated June 7, 2001 (see Exhibit A).

Additionally, the Application Guidelines require the County, as applicant, to enter into the Agreement, stating that “[a]ny action taken prior to this executed contract agreement will not be eligible for reimbursement.” The Agreement attachment, which outlines the Project budget, also states “costs already incurred are not eligible for reimbursement.” Documentation submitted by the County to KYTC in its request for reimbursement reflects that the land was purchased before the agreement’s effective date. Therefore, the \$56,000 reimbursement was also contrary to Application Guidelines and the Agreement.

The ineligibility of the land purchase creates a reimbursement overpayment for the Project.

The fact that the P&L land purchase is ineligible for reimbursement reduces the Project’s eligible federal funding to \$157,056. Reimbursements by KYTC to the County totaled \$169,842.40 as of March 1, 2001. Therefore, as of that date, the County was reimbursed \$12,786.40 in excess of maximum allowable reimbursements for the Project.

The P&L land purchase could qualify for credit towards matching funding requirements.

The Transportation Equity Act for the 21st Century amended 23 U.S.C. § 323 by expanding the non-federal share credit provisions. These provisions apply to land acquired by local governments used in qualifying projects where project agreements are executed on or after June 9, 1998. The FHWA letter indicates that such credit would be allowable for the County's purchase of the P&L land, stipulating that "[t]he amount of the credit would have to be established by means of a KYTC approved appraisal." (See Exhibit A)

Recommendations

We recommend that KYTC:

- Revise the Project budget to exclude the ineligible land purchased from P&L, which reduces the total federal funding for the Project from \$213,056 to \$157,056 and the total matching funding required from \$53,264 down to \$39,264;
- Require the County to obtain an appraisal for the land purchased from P&L that conforms to KYTC requirements;
- Correct its accounting records to credit the appraised value of the P&L land for the Project towards the County's total matching funding requirement, in accordance with 23 U.S.C. § 323; and
- Correct the \$56,000 improper reimbursement by either obtaining cash repayment from the County, or applying future eligible expenses against the reimbursement and obtaining repayment for the net excess.

EXHIBIT A



Kentucky Division Office
Jose Sepulveda, Division Administrator

330 West Broadway
Frankfort, KY
40601
PH. (502) 223-6720

June 7, 2001

Edward B. Hatchett, Jr.
Auditor of Public Accounts
2501 Georgetown Road, Suite 2
Frankfort, Kentucky 40601-5539

Attn: Brian Lykins, Director
Division of Examination and
Information Technology

Dear Mr. Hatchett:

Subject: Transportation Enhancement Program Inquiry of April 3, 2001

This is in response to your findings involving Transportation Enhancement (TE) Project STPE 3000 (316), Muhlenberg County. The project consisted of acquisition of land and construction of a walking/hiking/biking trail and was authorized by FHWA August 3, 1999.

I have reviewed, along with Kentucky Transportation Cabinet (KYTC) personnel, the subject project and the circumstance that prompted the findings set forth in your letter to the Kentucky Division Office.

The Division Office concurs in your initial findings that the cost to purchase this land appears to be ineligible for Federal reimbursement.

The County was remiss in going ahead with the acquisition with the expectation of Federal reimbursement when there was no contractual arrangement or consultation with the KYTC and no approved appraisal to support the \$70,000 purchase price.

You referenced 23 USC 108(c) and "early acquisitions" in your letter. This subject is expanded upon in FHWA regulations in 23 CFR Part 710.501 and 710.507. (A full copy of 23 CFR Part 710 is enclosed for your information.) Section 710.501 provides for Federal participation as a project credit or as a reimbursable cost, with accompanying conditions for each alternative. It is my conclusion that Federal funds cannot be reimbursed for the property acquisition costs incurred on the subject TE project.

However, the value of the real property may be used as a project credit. The amount of the credit would have to be established by means of a KYTC approved appraisal (not by the amount negotiated by the County and the P&L Railroad).

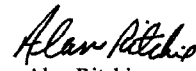
As you mentioned in your letter, KYTC was not without fault in this matter, with the KYTC approving the reimbursement of \$56,000 to the County with no approved appraisal evident and no recognition that the costs were incurred by the County prior to the date of the project agreement.

The KYTC recently submitted to the Division Office a draft "Program Guide" for TE activities in Kentucky. The development of the Guide and its ultimate approval by FHWA was a requirement that was included in a March 1, 2000 Memorandum of Agreement between FHWA, KYTC and the Kentucky State Preservation Office. The Guide is suppose to assist all TE sponsors as well as KYTC personnel in complying with State and Federal law, regulation, directives, standards and practices in the carrying out of TE activities in Kentucky.

The Guide will contain a comprehensive and much needed section on real property acquisition. It is anticipated that the information contained in it will result in TE sponsors and KYTC personnel who are much better informed about real property acquisition matters. This should forestall the development of problems such as the one revealed in this investigation.

Thank you for bringing this situation to our attention. If you have questions, please contact this office at 502-223-6753.

Sincerely yours,



Alan Ritchie
Realty Specialist

Enclosure

MUHLENBERG COUNTY RESPONSE



Rodney Kirtley

Muhlenberg County Judge Executive

P.O. Box 137 • Greenville, Kentucky 42345
(270) 338-2520 • 1-888-251-3364 • Fax (270) 338-6116

July 13, 2001

Mr. Edward B. Hatchett, Jr.
Auditor of Public Accounts
144 Capitol Annex
Frankfort, KY 40601-3448

RE: Muhlenberg County Rails to Trails examination

Dear Mr. Hatchett:

In response to your letter and recommendations concerning Muhlenberg County Rails to Trails, first of all, I would like to say that the "Rails to Trails" project is the nicest project I have ever been involved with. I regret that politics has become involved with this project and that there are some who would rather "tear down" than work to build their community. The public use of the trail has been beyond our expectations. We will be glad to work with you to resolve any questions about this project.

In defense of the purchase of the trail property before the date of the agreement, buying railroad property is different from purchasing other property. If you are purchasing property for most projects and something goes wrong that you are not able to purchase the property, then you just attempt to locate other property to purchase that will also be suitable for the project. This is not true for railroad beds. Very seldom do other railroad beds become available, therefore your project is lost forever. We have experienced this on another rail/trail that we did not act on soon enough and it was sold to others who only wanted it for the gravel. Now it is an eyesore along Highway 62 west of Greenville. We did not want this to happen again so we purchased the property while it was available. There would have been no need for the grant without this property.

I feel there should be exceptions under these circumstances. If we had lost the land because we had to wait on the grant, then the entire project would have been lost and there would have been no need for the grant. If this land could be re-purchased by us and the purchase date fell within the contract agreement, would this be acceptable?

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As far as the appraisal is concerned, the contract agreement we signed did not call for an appraisal. But if the federal regulations do call for it, then we will be more than glad to have an appraisal done. The price of the land was less than the standard price P & L Railroad sells their abandoned land for. I think when the appraisal is complete, you will see the price was very reasonable.

One of the questions brought to your attention concerned the contract for the paving. The paving work was performed by Road Builders, a local contractor that had the lowest bid for all county work (Road Builders was the only bid received and the only bidder for several years). We will be glad to have a contract if the contractor will agree to it. They do work with several other counties and do not have a contract with any of the counties outside of the bid package.

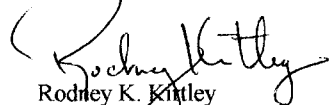
The Ky. Transportation Dept. has asked us to issue them a check for the \$56,000 in question. I feel if it does not qualify for the land purchase, then it should be used on other work for this project and should then be a paper transfer.

I also feel if the Transportation Dept. is going to administer this project, then they should help keep us more informed of the process. In other words - walk us through it like our Area Development District does on grants.

Again, I feel strongly that the purchase of the property should be allowed. If the property had not been purchased when it was, there would not have been a Rails to Trails project and Kentucky would still be last in the nation on trails.

In closing, I ask that you consider an exception to this land purchase because no other property would have been suitable for a rail/trail and P & L Railroad would have sold it to other individuals.

Sincerely,



Rodley K. Kintley
Muhlenberg County Judge Executive

RKK/lm

cc: Phil Bezechertny

TRANSPORTATION CABINET RESPONSE



Commonwealth of Kentucky
Transportation Cabinet
Frankfort, Kentucky 40622

James C. Codell, III
Secretary of Transportation

Paul E. Patton
Governor

Clifford C. Linkes, P.E.
Deputy Secretary

July 5, 2001

Mr. Edward B. Hatchett, Jr.
Auditor of Public Accounts
2501 Georgetown Road, Suite 2
Frankfort, Kentucky 40601-5539

Attn: Brian Lykins, Director
Division of Examination and
Information Technology

Subject: Transportation Enhancement Program Inquiry
Muhlenberg County Rails-to-Trails Project

Dear Mr. Hatchett:

The Cabinet is in receipt of the Federal Highway Administration's response to your office's inquiry of April 3, 2001. This letter is to inform you of the Cabinet activities to correct the inappropriate reimbursement for purchase of land for the subject project. The inquiry has shown and the FHWA has concurred, as do we, that the \$56,000 reimbursement to Muhlenberg County was not an eligible expense. Failure to check for all appropriate documentation before approving reimbursement was an oversight on our part. However, this will be corrected.

The Cabinet has contacted the Muhlenberg County Judge Executive to request the return of the \$56,000 in federal funds reimbursed on the purchase of the railroad right-of-way. The funds will be re-deposited in the project account. Federal funds reimbursed to the Cabinet from the FHWA are also being returned.




KENTUCKY TRANSPORTATION CABINET
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WHICH PROMOTES ECONOMIC GROWTH AND ENHANCES THE QUALITY OF LIFE IN KENTUCKY"
"AN EQUAL OPPORTUNITY EMPLOYER M/F/D"

Mr. Edward B. Hatchett, Jr.
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A meeting between Muhlenberg County and the Cabinet is planned in the near future to discuss the remainder of the project and to identify eligible expenses. The appraisal of the land is also underway by the Cabinet's Right of Way staff so that the value of the land can be used as 20% match credit on future eligible reimbursement requests.

We appreciate your office bringing this matter to our attention so that we may take these corrective actions. Should you have any further questions regarding this matter, please contact Michael Hill in the Cabinet's Division of Multimodal programs (502-564-7686.)

Sincerely,


James C. Codell, III
Secretary

c: J. M. Yowell
J. Carr
M. Hill
R. Divine
A. Ritchie (FHWA)

JMY:JLC:JDR:MLH

