EXAMINATION OF CERTAIN POLICIES, PROCEDURES, AND FINANCIAL ACTIVITY OF THE KENTUCKY HORSE PARK

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The Auditor of Public Accounts (APA) has completed its examination of the Kentucky Horse Park (KHP). This letter summarizes the procedures performed and communicates the results of those procedures.

Examination procedures included interviewing staff concerning KHP's environment and operating activities; reviewing financial transactions associated with KHP for the time period of July 1, 2013 through June 30, 2016, except when otherwise noted; and reviewing additional financial activity of KHP.

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 fiscal management and oversight of the financial activity of KHP 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 in implementing corrective action. Overall, these findings identify a poor fiscal management structure leading to the potential loss of revenue, as well as a serious lack of oversight and transparency, inadequate policies and procedures, circumvention of state procurement rules, and ethics concerns. Due to the issues noted, this report will be referred to the Kentucky Executive Branch Ethics Commission for consideration.

If you have any questions or wish to discuss this report further, contact me or Libby Carlin, Executive Director, Auditor of Public Accounts.

Sincerely,

Mike Harmon
Auditor of Public Accounts

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Examination of the Kentucky Horse Park

Examination Objectives
On May 3, 2016, the Auditor of Public Accounts (APA) notified the Kentucky Horse Park (KHP or Park) that matters had come to our attention which warranted review. After evaluating preliminary information and considering allegations of waste, fraud and abuse, the APA determined that a special examination of KHP would be an appropriate engagement to address the areas of concern and allegations received. The primary focus of this examination was to evaluate certain financial activities and other operations of the Park to determine whether proper policies, procedures, legal and contractual requirements, and appropriate accounting standards were followed.

KHP Background
KHP is a public corporation established by the Commonwealth of Kentucky under KRS 148.260 through 148.320. The Park is under the administration of the Kentucky Horse Park Commission (KHP Commission). The KHP Commission is established under KRS 148.260 as a separate administrative body attached to the Tourism, Arts and Heritage Cabinet. The Commission is comprised of 17 members representing the diverse interests of the Kentucky horse industry to the extent possible, and having the ability to provide management expertise and direction in KHP's operations.

Based on its website, "the Kentucky Horse Park Foundation (KHP Foundation) is a non-profit 501(c)(3) organization dedicated to enhancing, expanding, and improving the Kentucky Horse Park." The KHP Foundation is located on the grounds of the Park, but is a legally separate private entity. The KHP Foundation engages in fundraising events with private donors to provide financial support for activities and acquisitions KHP may not be able to obtain through its annual earnings and state contributions.

Findings and Recommendations

Finding 1: KHP Management Did Not Analyze Fiscal Operations, Which Resulted In Budget Deficits And Required More Than $24.8 Million In General Fund Subsidies Over The Past 10 Fiscal Years
Although it is a highly acclaimed tourist destination in the Commonwealth and billed as hosting some of the world's most prestigious equine sporting events, KHP's revenues are not sufficient to offset its expenditures. KHP management did not adequately analyze the fiscal operations of its largest revenue sources to maximize income and properly manage expenditures. In addition, certain internal controls over KHP's fiscal operations were weak, making its operations subject to waste and abuse. **Recommendations:** KHP management should develop processes to better analyze costs for all of its revenue-generating areas. KHP management should also implement methods for analyzing utilization of all venues and food services, and work with the Department of Parks to improve reporting of campground utilization.

Finding 2: KHP Venue Rental And Food Services Contracts Were Not Managed Properly, Which Led To Undocumented Discounts, Misapplied Rental Rates, Billing Errors, And Sponsor Perks
KHP management had a poor internal control structure over the handling of event and food service contracts. Testing revealed serious weaknesses in both executing contracts and invoicing accurate amounts. No written policies

or procedures existed outlining the proper protocols for handling event and food service contracts, discounts were provided without justification or written approvals, contracts contained elements raising concerns about benefits provided to private entities, and there was a lack of adequate segregation of duties over event and food service invoicing. These weaknesses create an environment in which it appears KHP has lost revenue and in which management and employees have opportunities to provide discounts and favors to certain vendors and clients without oversight or detection. This not only increases opportunities for waste and abuse but also jeopardizes KHP's business reputation.

Recommendations: KHP should ensure all event and food contracts are properly executed, maintain supporting documentation for invoiced amounts, and properly segregate duties between events and food services staff. KHP should also implement policies to ensure contracting procedures are consistently applied to all clients, including the documentation and collection of any booking and damage deposits required in venue contracts. The KHP Commission should establish a policy regarding criteria and permissibility of discounts, deposit waivers, flat rates for multi-day venue rentals, or variable rates, including discounts for multi-year contracts.

Finding 3: KHP's Procurement Practices Led To Improper Vendor Selection That Created Potential Conflicts Of Interest

In March 2015, the Finance and Administration Cabinet (FAC) Office of Policy and Audit, released a report identifying procurement weaknesses noted during its review period of July 1, 2010 thru June 30, 2014. Because of this known risk, our examination procedures included follow up on whether these weaknesses continued after FAC's reported finding. Also, complainants expressed concerns that KHP management was not properly following procurement laws due to potential conflicts of interest or due to favoritism for certain individuals, associations, or businesses. KHP's lack of formalized, written policies and procedures related to procurement continued during the period of our examination. As a result of these procedures, auditors identified eight vendors without contracts that should have been subject to the state's contracting and bid requirements.

Recommendations: KHP management should analyze all payments to vendors in excess of its small purchase authority limit, review procurement files to ensure the vendors were properly procured, and execute and maintain appropriate contracts when required. KHP should review its policies and procedures to ensure they comply with the State procurement laws.

Finding 4: Examination Of KHP Billings Identified Further Potential Conflicts of Interest Or Favoritism Related To Certain Event Organizers

Our examination clearly identified that operating procedures at KHP were not sufficient to detect and prevent potential conflicts or to prevent personal relationships leading to favoritism impacting procurement decisions, including amounts charged for venue rentals and other services. The APA received an allegation that the KHP Food Service Director's in-laws own a horse show production company that frequently hosts shows at KHP. Auditors tested a sample of the company event contracts, and the results identified that these events were handled differently than most other event contracts tested. As a result, the discount for the company totaled $766,970, with discounts ranging from $59,112 to $147,742 per event, which is equivalent to total discounts of 32 to 57 percent. Another relationship of concern was with one high-profile event at KHP. Per review of the contracts for the three years under review, the event organizer was charged a flat rate each year. A conservative recalculation was performed by the auditors, which indicated KHP had a potential loss of revenue of $87,696 over the three years.

Recommendations: The KHP Commission should establish a policy regarding criteria and permissibility of discounts, deposit waivers, flat rates for multi-day venue rentals, or variable rates, including discounts for multi-year contracts. Also KHP management should implement policies and procedures for documenting and approving any venue or food service discount authorized by the KHP Commission.

<u>Finding 5</u>: KHP Did Not Comply With State Requirements Related To Sponsorships, Including One Sponsorship Arrangement That Provided Personal Benefits To KHP Management

KHP has not followed regulations for the advertisement and solicitation of sponsorships and has not maintained appropriate documentation related to the sponsorship acquisitions and agreements in place. In addition to providing signage and other promotional materials, KHP also agreed to provide event tickets to certain sponsors as part of sponsorship agreements. The procedures used by KHP to acquire sponsorships were not sufficient to ensure compliance with state requirements and subjected KHP to the potential for abuse. Documentation related to sponsorships was so poor that no one at KHP could provide auditors a complete list of sponsorship agreements in effect during the examination period. The KHP practice for acquiring sponsorships may violate State requirements by soliciting for goods and services used in general KHP operations rather than only for special events.

Recommendations: KHP should implement internal control procedures to ensure all sponsorship agreements are properly procured, documented, and executed in accordance with 200 KAR 5:080 and other relevant portions of the Model Procurement Code. We further recommend these procedures restrict KHP employees from receiving any personal benefit from these arrangements, and instead only receive benefits that are necessary and reasonable for KHP operations and that provide a benefit to the Commonwealth.

<u>Finding 6</u>: KHP Did Not Properly Procure Food Service Concessionaires And Did Not Execute Written Agreements With On-site Attractions

Inquiry with KHP staff and management identified that procurement procedures in place for obtaining concessionaires do not adhere to requirements of the Finance and Administrative Cabinet's Manual of Policies and Procedures (FAP). There is no documentation to establish that these concessionaires have been properly procured or whether competitive opportunities have been afforded to new concessionaires. KHP's process appears to limit competition and increases the risk of favoritism being used in the selection of concessionaires. KHP has not utilized sound business practices as it relates to on-site concessionaires and entities. This not only increases the risk that KHP may be losing revenue from following poor practices, but it also increases the potential for favoritism and the risk of fraud or abuse because of the lack of established procurement processes and other financial arrangements.

Recommendations: KHP management should implement procedures to ensure compliance with state laws and regulations, and Finance policies as they relate to food service concessionaires. KHP should also analyze concession arrangements to evaluate whether outsourcing permanent on-site food services is more cost effective, and whether in-house operations can be made more efficient. KHP should also ensure that all financial arrangements with entities operating on-site are documented in written agreements that are approved by the KHP Commission and periodically analyzed and reviewed to ensure KHP continues to benefit from the arrangements.

<u>Finding 7</u>: KHP Did Not Maintain An Effective Line Of Separation From The Kentucky Horse Park Foundation

The examination identified circumstances in which the operating relationship between KHP and the KHP Foundation became blurred, leading to KHP staff and property being utilized by the

KHP Foundation without reimbursement. Also, instances were noted in which KHP Foundation staff were involved in KHP operations without a clear business need, which gave the appearance of the KHP Foundation having undue influence in KHP operations. The involvement of KHP Foundation employees in the general operations of the Park gives the appearance of and increases the risk of the fundraising entity having undue influence in agency decisions for the benefit of donors and other individuals and businesses with close ties to the fundraising activities. Although the KHP Foundation exists for the benefit of KHP, it is not appropriate to circumvent requirements that in effect supplant current operating funds and move them to benefit a fundraising objective.

Recommendations: KHP management and employees should maintain an effective separation from the operation of the KHP Foundation. KHP should not allow the KHP Foundation to influence KHP operational decisions, such as procurement and employment decisions, without going through appropriate processes that comply with state laws. KHP should immediately cease providing no cost or discounted benefits to the KHP Foundation and acquiring such benefits for the KHP Foundation from vendors, event organizers, or others. KHP should also renegotiate its agreement with the Foundation regarding the Southern Lights event.

<u>Finding 8</u>: KHP's Poor Control Environment Led To Questionable Hiring Practices Utilizing Temporary Employment Agencies

KHP's poor internal control environment and lack of adequate monitoring and review procedures allowed questionable practices to occur at KHP resulting in potential waste, fraud, and abuse. These practices obscured actual temporary employee hours, and also obscured that KHP paid temporary agencies higher rates than it was contractually required to pay. It is unclear whether KHP management utilized this practice as a way to circumvent hiring requirements, including salary limitations, or if this practice developed out of convenience as a way to avoid the more lengthy state hiring process. Information included in the state's financial reporting system was altered to fit contractual pay rates, and therefore did not agree to supporting documentation. This practice is misleading and unethical. This practice misrepresents the true activity that occurred and fails to meet a basic level of transparency that is incumbent upon all government agencies when spending taxpayer dollars.

Recommendations: We recommend KHP management perform an analysis of temporary employees utilized in positions that are intended to be long-term. Based on the results of this analysis, KHP should establish the needed positions using the appropriate mechanism that complies with state contracting or employment laws. KHP should review contracts periodically and update them as appropriate. Under no circumstance should KHP pay temporary agencies or other vendors amounts in excess of contractual agreements. KHP management should also ensure that staff are appropriately trained on business office operations.

<u>Conclusion</u>

The findings identify a poor fiscal management structure leading to the potential loss of revenue, as well as a serious lack of oversight and transparency, resulting in inadequate policies and procedures, circumventing state procurement, and ethics concerns.

Background

Impetus and Objectives of the Examination

On May 3, 2016, the Auditor of Public Accounts (APA) notified the Kentucky Horse Park (KHP or Park) that matters had come to our attention which warranted review. After evaluating preliminary information and considering allegations of waste, fraud and abuse, the APA determined that a special examination of KHP would be an appropriate engagement to address the areas of concern and allegations received. This notification followed several requests to perform a special examination of KHP, including letters from the Secretary of Tourism, Arts and Heritage Cabinet, Secretary of the Finance and Administration Cabinet, and State Senate Majority Floor Leader.

Scope and Methodology

The primary focus of this examination was to evaluate certain financial activities and other operations of the Park to determine whether proper policies, procedures, legal and contractual requirements, and appropriate accounting standards were followed. These procedures included an examination of procurement policies and procedures, equine and campground rental operations, and other operational activities. The examination covered the time period of July 1, 2013 through June 30, 2016, except when otherwise noted for matters dictating a longer or shorter time period for proper analysis.

KHP Structure and Mission

KHP is a public corporation established by the Commonwealth of Kentucky under KRS 148.260 through 148.320. The Park is under the administration of the Kentucky Horse Park Commission (KHP Commission), and its purpose is to be the world's definitive equestrian educational facility dedicated to all breeds of horses; to provide show facilities capable of hosting national and international equestrian competitions in many disciplines; and to provide a positive impact on both the local and state economies by establishing itself as a nationally recognized tourist attraction, competition facility, and equine office park.

The KHP Commission is established under KRS 148.260 as a separate administrative body attached to the Tourism, Arts and Heritage Cabinet. The Commission is comprised of 17 members representing the diverse interests of the Kentucky horse industry to the extent possible, and having the ability to provide management expertise and direction in KHP's operations. The Commission is to meet quarterly, and its duties include hiring Park staff, including the executive director who is responsible for directing and coordinating staff in discharging the duties of the commission.

KRS 148.280 establishes additional functions of the Commission, including controlling KHP property; building, repairing, and improving buildings on KHP grounds; and promoting the progress of

Background

the Commonwealth and stimulating public interest "by providing the facilities of the State Horse Park for exhibitionary, competitive, and other events relative to various aspects of the horse industry and other functions calculated to advance and enhance the tourist industry, economy, entertainment, cultural, and educational interests of the public."

KHP employs 71 full-time staff, as well as approximately 39 year-round temporary and interim workers and three other interim workers during peak months. According to the FY 2016 Commonwealth of Kentucky's Comprehensive Annual Financial Report (CAFR) the Park had $13,732,000 in operating revenues, $20,977,000 in operating expenditures, and $2,397,000 in General Fund subsidy during the year. KHP derives the majority of its revenue from admission fees charged to the public, rentals of its venues for both equestrian and non-equestrian events, food services provided to event organizers, campground rentals, and sales of general merchandise. KHP reports more than 900,000 visitors to events at the Park and 40,000 visitors to the campground each year.

KHP Foundation

Based on its website, "the Kentucky Horse Park Foundation (KHP Foundation) is a non-profit 501(c)(3) organization dedicated to enhancing, expanding, and improving the Kentucky Horse Park." The KHP Foundation is located on the grounds of the Park, but is a legally separate private entity. The KHP Foundation engages in fundraising events with private donors to provide financial support for activities and acquisitions KHP may not be able to obtain through its annual earnings and state contributions. The KHP Foundation is reported in the Commonwealth's CAFR as a component unit in accordance with requirements of the Governmental Accounting Standards Board since it exists primarily for the benefit of a state agency. However, as a legally separate non-profit entity, it is not required to follow hiring and procurement laws applicable to state agencies.

Findings and Recommendations

Finding 1: KHP Management Did Not Analyze Fiscal Operations, Which Resulted In Budget Deficits And Required More Than $24.8 Million In General Fund Subsidies Over The Past 10 Fiscal Years

The Kentucky Horse Park (KHP or Park) is an enterprise fund of the Commonwealth of Kentucky (Commonwealth), and as such, generates revenue from sales and services to the public. Although it is a highly acclaimed tourist destination in the Commonwealth and billed as hosting some of the world's most prestigious equine sporting events, KHP's revenues are not sufficient to offset its expenditures. Profitability alone does not measure KHP's value to the Commonwealth, but in an environment of scarce governmental resources, it is an important measure in analyzing the Park's long-term viability. During the period under examination, KHP management did not adequately analyze the fiscal operations of its largest revenue sources to maximize income and properly manage expenditures. In addition, certain internal controls over KHP's fiscal operations were weak, making its operations subject to waste and abuse.

KHP generates revenue by charging admission to its grounds and buildings for general and special events, as well as from rentals of equine and non-equine venues, campground rental fees, and sales of food, drink, merchandise, and other concessions. KRS 148.320 requires that all revenues derived from the use of KHP properties and facilities be used to defray the expenses of KHP operations, including costs of the KHP Commission, general operations, maintenance, improvements, and additions. As identified in Table 1, KHP received subsidies from the Commonwealth's General Fund totaling more than $24.8 million in the past ten years.

Table 1 - Kentucky Horse Park General Fund Subsidies FY 2007 - FY 2016

Fiscal Year	General Fund Transfers
2007	$ 1,706,000
2008	1,646,000
2009	1,327,000
2010	1,378,000
2011	3,335,000
2012	5,852,000
2013	2,374,000
2014	2,395,000
2015	2,472,000
2016	2,397,000
Total	**$ 24,882,000**

Source: FY 2007-2016 Commonwealth of Kentucky CAFR

Also, during difficult economic times and in the face of pressing needs, such as large unfunded pension liabilities, agencies across state government have faced a series of budget reductions over the past several years. Because of the relative scarcity of General Fund dollars, it is more important than ever for KHP to become self-sustaining or at a minimum reduce its reliance on a state budget subsidy to continue operations. Our examination revealed numerous barriers to meeting this objective.

Venue and Equipment Rentals

KHP utilizes a standard rental rate sheet to charge for the use of its venues and equipment. These rates are determined by management and approved by the KHP Commission (Commission). Until May 2016, there was a contract committee within the Commission that met periodically to discuss rates, and this committee would then present a rate proposal to the full Commission for approval. However, auditors were told the Park's Executive Director had the authority to unilaterally modify and negotiate rates without consulting the Commission. Auditors found that rental rates were set without any consideration of KHP's actual cost incurred for the events. Auditors were informed the rates had been most recently adjusted in September 2015, with the adjustments based on a comparison of similar horse show facilities identified by KHP management. Auditors reviewed rates for the 2014 through the 2016 season and noted the addition of various charges over these years designed to increase revenue potential. However, missing from consideration was any analysis to determine the costs incurred by KHP for an event, including personnel costs, arena utilities, maintenance and repairs, or historical information on the costs of previously held events. Although it is obviously relevant to consider the cost of comparable venues to maintain competitive prices, it is also important to evaluate the actual cost to KHP of the various rentals and services it offers.

KHP staff indicated that for each event, profit-loss statements were maintained. Auditors reviewed these statements to determine the information on hand for analysis, and how the information was utilized by KHP management for analysis and rate setting. The reviewed statements showed the revenues generated by an event, but did not identify all related expenses of the event. Therefore, these statements did not accurately reflect the true profit or loss generated by the events. KHP personnel indicated that these statements were a work in progress and were in draft format. In 2014, KHP began using QuickBooks for invoicing purposes and have experimented with the program to try to utilize its functionality. However, this has not led to a fully functional and useful analysis.

Also, KHP does not have a process to analyze its venue utilization. Information was requested to determine how KHP employees managed and tracked venue utilization. The only information provided was printed pages from an electronic calendar that listed all events. There was no documentation or process for identifying the availability of a specific venue, so there was no way to readily determine which venues were in use versus those that were available. Using this methodology, event planners could only search venue availability when a request was made, but this is a poor methodology for maximizing rentals. Utilization analysis is necessary for management to understand its event management. This analysis could further be used in identifying non-peak periods for discount offerings, for targeted marketing, and other revenue maximization activities. KHP staff indicated one reason utilization analysis has not been seen as an important tool is because generally the same shows and the same equine organizations utilize the facilities every year. However, in order to move toward self-sustaining operations, KHP should seek opportunities to expand both its equine and non-equine customer base rather than relying on the same, recurring annual rentals. To do so, KHP management needs an effective method to determine the venues available for rental at any given time.

With rate setting based solely on comparison to other show facilities, with no way to properly analyze actual costs, and with weak event management and venue utilization tools, KHP management cannot make informed decisions regarding venue pricing. Failing to analyze costs and utilization also causes KHP management to miss opportunities to create efficiencies, such as different ways to manage staffing or reducing costs by eliminating underutilized services. Although KHP should continue to compare its rates with other show facilities in order to stay competitive, that process should be one part of a thorough analysis, and not the only tool utilized. Additional concerns related to invoicing for venue rentals are discussed in Finding 2.

Food Services

KHP currently manages two restaurants housed in permanent structures on its grounds, including the “Bit and Bridle” and the “Farmhouse.” KHP also manages the “Tack Room,” which is a temporary structure open only during peak event season. Inquiry with KHP Food Services staff indicated management is aware that food services costs more to operate than it generates in revenue, although a formal analysis was not performed by KHP. In attempting to determine what information KHP has on hand to perform a cost analysis, auditors requested information regarding the food inventory process for tracking on-site inventory, purchases, sales, use, and spoilage of food. The Food Services Director indicated KHP does not have a perpetual inventory system for food, and there is no way for

Food Services to do an inventory of food on hand that reconciles to any invoices or usage records.

Upon further inquiry about how food inventory was handled, the Food Services Director stated that KHP puts a lot of trust in food service managers to control food inventory. However, during the examination, allegations surfaced from several sources of inventory theft by workers taking food from food service locations. Auditors did not witness this activity, but found that KHP does not have adequate controls in place to prevent this from happening given the weaknesses in inventory tracking. Failure to maintain an appropriate inventory system can lead to increased food costs for KHP that are not recovered by sales. Further, it provides an opportunity for anyone with access to food inventory to misappropriate items for personal use without detection by management.

KHP outsourced food services until 2010. Since food services were brought in-house, there have been no food inventory procedures implemented, and KHP management was unaware of any analysis performed to determine whether managing food services in-house or outsourcing was the most cost-effective methodology. Additionally, after food service management was brought in-house at KHP, the operations changed to ensure at least one KHP-managed restaurant is open year-around, even during non-peak periods. Based on discussions with KHP Food Services management, the only reason for this practice was the understanding that if the Park was open there had to be some kind of food service available. Auditors could identify no such requirement.

Currently, it appears KHP food services are operating without regard to the best value for KHP. In order to efficiently manage KHP resources and improve the Park's fiscal operations, improved inventory procedures and cost analysis are necessary.

Campground Rentals

KHP does not have sufficient information to properly account for rental income at its campground. This is an area currently beyond the control of KHP management. KHP utilizes an on-line reservation and payment system contracted by the Kentucky Department of Parks. This system is used for all state parks and allows customers to reserve and pay for campsites online. KHP receives payment for these online reservations from the Department of Parks in the form of a hand-written check that is not accompanied by supporting reservation documentation.

Findings and Recommendations

With no supporting documentation, KHP is unable to reconcile the amount received to the sales records maintained by KHP campground management. This creates an additional accounting problem because the inability to match the revenue to the payee makes it difficult for management to accurately calculate the appropriate revenue amount to recognize as required by generally accepted accounting principles. For example, if a payment is received by KHP prior to a camper's stay, the advance payments for rented campsites should be accounted for as a liability until the actual stay occurs.

Recommendations

We recommend:

- KHP management develop processes to better analyze costs for all of its revenue-generating areas. Cost analysis will improve the information management has available to maximize revenues, reduce or eliminate underutilized services, better manage staffing hours and utilization, improve efficiencies, and make decisions regarding the timing and delivery methods of services, such as food services.
- KHP management should also implement methods for analyzing utilization of all venues. Utilization analysis can assist in marketing efforts and pricing decisions, such as permitting management to make decisions for variable rate pricing to attract new rental opportunities.
- KHP management should further analyze its food services management to determine whether its current operations justify being continued in the current manner based on the benefit to the Park and actual costs of operations. The examination identified several areas that need attention, including food inventory procedures, staffing and periods of operation, and management structure. If KHP continues to manage its food services in-house, appropriate inventory tracking procedures should be implemented to identify excess waste and potential theft.
- KHP management should work with the Department of Parks and its online reservation vendor to determine the types of reports available to provide management with improved supporting documentation and afford the opportunity for better analysis and accounting of campground utilization.

Finding 2: KHP Venue Rental And Food Services Contracts Were Not Managed Properly, Which Led To Undocumented Discounts, Misapplied Rental Rates, Billing Errors, And Sponsor Perks

In its FY 2016 audited financial statements, KHP reported more than $12.9 million in income from admissions and sales. Other than admissions, as noted in Finding 1, a primary source of the Park's revenue is derived from rentals and food service sales for events held at KHP's facilities. KHP utilizes event and food service contracts for any vendor wishing to host events at the Park. Auditors examined 75 event and associated food services contracts, 60 equine and 15 non-equine event contracts, occurring between July 1, 2013 and June 30, 2016. Testing revealed serious weaknesses in both executing contracts and invoicing accurate amounts.

Of the 75 events examined, 18 event contracts, or approximately 24 percent, did not contain some or all of the required signatures. Forty-seven of the events reviewed utilized KHP food services. Of those events utilizing KHP food services, 10 events did not have executed food services contracts on file. With more than 20 percent of event and food services contracts lacking proper execution, KHP has put a significant amount of its revenues at risk of nonperformance or nonpayment.

Even more concerning is that the examination identified weaknesses in invoicing, directly leading to a loss of revenue for KHP. Of the 75 event contracts reviewed, auditors noted the following items:

- Twenty-eight events (over 37 percent of those reviewed) for which amounts invoiced did not agree with the services or unit price listed in the event contract or on the invoice worksheet.
- Fifty-seven event contracts (76 percent of those reviewed) identified itemized charges for venues or services that were not in accordance with established rate sheets.
- Forty-six event contracts required booking and/or damage deposits, but the deposits were not collected.
- Additionally, 38 of the 47 food services contracts (more than 80 percent of those food services contracts reviewed) were not billed in accordance with the contract. Invoiced amounts could be more or less than the contract amount due to modifications; however, no documentation for modifications was maintained.

Event coordinators at KHP are assigned to each event and are responsible for drawing up the event contracts; if any food services are needed, the event coordinators will refer them to KHP Food Services and the food service staff will handle those contracts. The event contracts are intended to spell out the venue rental agreement and other services requested, such as venue set-up on the day prior to the event or equipment needs. Beginning in 2016, event coordinators started using invoice worksheets to track the actual services provided during the event, as well as any incidental charges. These invoice worksheets are used by the events staff to prepare the event invoices. Prior to 2016, the only support for preparing invoices was the event contracts, which were generally prepared well in advance of the events and, therefore, may not have included any modifications or other incidental charges that arose during the event. As listed above, auditors noted 28 instances in which the amounts invoiced did not agree to the requested or provided services listed in the contract or invoice worksheets.

Additionally, 57 instances were identified in which the amounts charged for services did not agree to the established rate sheets. This includes 15 instances in which venue rental rates were not utilized, and the renter was charged a flat rate for show facilities and stabling for the event instead of the daily rental rate. There was no documentation of any analysis to determine the flat rate was adequate to cover costs of using the facilities. Auditors performed a conservative recalculation on 15 events examined, which included 14 of the flat rate invoices, and identified a potential missed revenue opportunity of approximately $600,000 due to the use of flat or discounted rates rather than the approved rates. We recognize that the Park may wish to use a discount methodology for certain events; however, without having adequate cost analysis and approved policies, this practice subjects the Park to abuse and potential loss of revenue. Additional concerns were identified related to fixed-rate contracts, as discussed in Finding 4.

In conjunction with these rate discrepancies, auditors also found that discounts were provided in 20 contracts reviewed by marking down the total contract, discounting various charges such as stabling, or providing credits against the charges. Some discounts were noted as non-profit or state agency discount, without documentation to verify the non-profit status of the entity. Other discounts were provided without any documentation or justification of why the discount was being provided.

Inquiries about these discrepancies identified that the flat rate pricing and discounts were primarily used for revenue generation and for the goal of maintaining established relationships. Former KHP management stated that when determining whether to apply flat rate pricing or discounts, management would analyze how much revenue they could afford to forego in order to maintain the relationship. Inquiries with current KHP staff indicated that the practice of providing discounts, including flat rate pricing, had been occurring as far back as 2006.

Forty-six events were not charged a booking or damage deposit as required by their contracts. The contracts did not contain language that the deposits were to be waived, nor did the contracts contain any explanation as to why the deposits were not collected. If there are instances in which KHP management wants to waive deposits for long-standing clients, there should be a written policy establishing criteria for doing so, and the Commission should approve any such adjustments.

The intent of the damage deposit is to have funds paid up front to cover potential damage caused during events. KHP events staff indicated that when they are aware of damage caused during an event, the cost of repair is added to the event invoice if it is detected prior to the invoice being prepared. However, auditors found multiple instances of damage occurring during an event without KHP recovering the repair cost. Back-to-back events often occur in certain venues, and unless damage is detected before the next event moves in, KHP staff cannot identify with reasonable certainty who to bill for the repairs. Based on inquiry about the event procedures, KHP events staff indicated there is not sufficient staff to perform thorough event check-in and check-out inspections. A certain amount of repair and maintenance is a cost of doing business, especially in equine events. However, KHP should have a consistent mechanism in place to identify damage that occurs during events and recover the cost of repairs.

Auditors further identified instances in which multi-year contracts were signed with some clients, which allowed those clients to secure venues at the current rates for future events. Although it can be good business planning to acquire multi-year venue contracts, the KHP Commission has not established any policy to permit a rate to be locked-in for such contracts. Because this practice could easily be subject to abuse and favoritism, it is important to have an established policy identifying the criteria and limitations of multi-year contracts and available discounts, such as who is authorized to approve the multi-year contracts locking in rates and the specific event dates the locked-in rates apply rather than permitting an open-ended option.

Food Service Contracts

As noted previously, more than 80 percent of food services clients were not billed in accordance with the contracts. Per inquiry with food services staff, the contract modifications are shredded once the event is completed. Thus, the contracts reviewed by auditors were the originals and did not reflect any changes or modifications. As a result, KHP did not have documentation to support the invoiced amounts. This practice appears to violate the record retention policies applicable to KHP as a public agency. Series F00007 of the General Records Retention Schedule for State Agencies, which is promulgated pursuant to KRS 171.530, requires all contracts, leases, and agreements entered into with public or private agencies or individuals to be maintained at least eight years “after completion, termination, expiration, or audit, whichever is longest.”

Another issue related to food services contracts included a verbal agreement with one horse show organizer. The food service staffing for the event was charged as a percentage of cost for meetings and at a flat rate for shows, as opposed to being charged through normal procedures which are based on needs. Inquiries with food service staff identified that this particular national organization was accustomed to these arrangements with other caterers and hotels and that this was a verbal agreement in place prior to their employment at KHP.

In addition to the weaknesses noted above, the contracting process also lacked an adequate segregation of duties. Examination procedures identified the Special Events Manager has the responsibility to negotiate and execute contracts for rentals and other services. This employee is also responsible for preparing and submitting invoices and, in some instances, receives payments from the event organizer. All of these actions are performed without any approval or oversight from management or individuals in the KHP Business Office. Therefore, this individual may add or remove services from event sheets and contracts and modify the amounts charged without the approval or even awareness of other management. While the Business Office maintains a spreadsheet of invoice payments received, it does not obtain a listing of invoices submitted or the supporting documentation used to calculate the invoice. Auditors learned this is the same process in place for KHP Food Services. During an observation of the invoicing procedures, auditors noted instances in which applicable fees were not charged. The omission of these fees was due to an oversight and could have resulted in a loss of approximately $3,251 in revenue for this one instance alone.

The KHP Business Office has no assurance that all invoices submitted or payments received by Special Events and Food Services have been recorded. This process indicates KHP management has not properly assessed the risks associated with having a weak internal control system for its invoicing and accounts receivable. A proper system of internal controls should include ensuring:

- Invoices have been properly calculated and include all services rendered per the contracts and event sheets;
- Invoices have not been modified or discounted without supervisory approval;

- Invoices have appropriate supporting documentation for billed charges; and
- Accounts receivable are appropriately tracked, and past due accounts are managed.

Without an adequate segregation of duties, KHP is open to the potential of misappropriation of assets, misstated financial statements, inaccurate financial information, or improper use of funds. KHP should have controls in place that operate to prevent, detect, and correct errors and irregularities, which may occur anywhere in the chain of events. Poor procedures coupled with a lack of proper segregation of duties also significantly increases the risk that waste, fraud, or abuse can occur without being detected. The event and food services contracting and invoicing procedures are a significant portion of the operations of KHP and are especially susceptible to these risks. Adding to these concerns, Finding 4 discusses potential conflicts of interest and favoritism to individuals or businesses, which resulted from these weaknesses.

Foundation and Sponsor Perks

Auditors also discovered contract terms requiring event organizers to provide perks to three private entities that have relationships with KHP. Twenty-six of the contracts examined had a requirement to provide free event tickets to the KHP Foundation for all events held in the Alltech Arena, as well as access to the event organizers' hospitality room during the events. Twenty-five of those contracts also included a requirement to provide these same benefits for one KHP sponsor. One of the contracts included this requirement for two KHP sponsors. In total, these contracts required 51 to 71 tickets be provided at no cost to the KHP Foundation and sponsors. KRS 11A.020 prohibits any public servant from knowingly using "his official position to secure or create privileges, exemptions, advantages, or treatment for himself or others in derogation of the public interest at large." This type of perk provided to private entities gives the appearance KHP used its influence and business arrangements with event organizers to provide benefits to private entities. Additional concerns were noted with this arrangement because a review of sponsorship agreements identified that the tickets provided by the event organizers, at least in some instances, were used to satisfy a sponsorship exchange with KHP. Additional concerns regarding KHP sponsorships are discussed in Finding 5.

In summary, KHP management had a poor internal control structure over the handling of event and food service contracts. No written policies or procedures existed outlining the proper protocols for handling event and food service contracts, discounts were provided without justification or written approvals, contracts contained elements raising concerns about benefits provided to private entities, and there was a lack of adequate segregation of duties over event and food service invoicing. These weaknesses create an environment in which it appears KHP has lost revenue and in which management and employees have opportunities to provide discounts and favors to certain vendors and clients without oversight or detection. This not only increases opportunities for waste and abuse but also jeopardizes KHP's business reputation.

Recommendations

We recommend:

- KHP ensure all event and food service contracts are properly executed by all required parties;
- Supporting documentation be maintained for invoiced amounts and for any modifications to the contracts;
- KHP management, in addition to recommendations for proper authorization and documentation noted in this finding, implement procedures for segregating duties of events and food services staff;
- KHP management implement procedures to timely identify damage from events and recover the cost of repair, including performance of required event check-in and check-out inspections;
- KHP implement policies to ensure contracting procedures are consistently applied to all clients, including the documentation and collection of any booking and damage deposits required in venue contracts;
- KHP events management staff discontinue the use of any verbal arrangements and include all rentals and services in written contracts;
- KHP remove all conditions requiring free tickets, hospitality room access, or other perks to any private individual or entity;
- The KHP Commission should establish a policy regarding criteria and permissibility of discounts, deposit waivers, flat rates for multi-day venue rentals, or variable rates, including discounts for multi-year contracts; and
- KHP management implement policies and procedures for documenting and approving any venue or food service discount authorized by the KHP Commission.

Findings and Recommendations

<u>Finding 3</u>: KHP's Procurement Practices Led To Improper Vendor Selection That Created Potential Conflicts Of Interest

In March 2015, the Finance and Administration Cabinet (FAC) Office of Policy and Audit, released a report identifying procurement weaknesses noted during its review period of July 1, 2010 thru June 30, 2014. Because of this known risk, our examination procedures included follow up on whether these weaknesses continued after FAC's reported finding. These examination procedures focused on the period of July 1, 2015 through June 30, 2016. As a result of these procedures, auditors identified eight vendors without contracts that should have been subject to the state's contracting and bid requirements.

Failure to Properly Bid or Contract with Vendors

As a state agency, KHP should adhere to the Kentucky Model Procurement Code (MPC), outlined in KRS Chapter 45A. The MPC requires all purchases exceeding the agency's small purchase authority to be made using competitive purchasing processes, unless a competitive process is not feasible. Auditors reviewed KHP financial activity to identify all vendors with non-construction expenditures that exceeded $20,000, which was the agency's small purchase authority limit until February 2016, when it was decreased to $1,000. From this population, auditors selected a sample of 25 vendors for further examination to determine whether the vendors were properly procured and to identify whether appropriate contracts were in place with the vendors. Eight of the 25 vendors reviewed, or 32 percent, did not have a contract in place with either KHP or the Commonwealth, and there was no evidence that a competitive process was utilized. These vendors were paid a total of $868,226 during FY 2016. Additionally, of these eight vendors, four received payments exceeding $20,000 in either one or both of the previous two fiscal years.

Table 2 identifies the types of goods and services each of these eight vendors provided to KHP, as well as the total payments received for fiscal years 2014 through 2016.

Table 2 - Payment to Vendors without Contracts by Fiscal Year

Vendor	Goods or Services	Payments FY 2014	Payments FY 2015	Payments FY 2016
Vendor 1	Items for resale	$ 23,489	$ 4,256	$ 23,364
Vendor 2	Fuel	190,908	169,964	112,772
Vendor 3	Items for resale		15,615	20,795
Vendor 4	Items for resale		52,905	234,619
Vendor 5	Items for resale	11,620	14,527	25,745
Vendor 6	Items for resale	16,146	12,982	31,738
Vendor 7	Feed		44,434	26,579
Vendor 8	Food	465,977	491,726	392,614
		$ 708,140	$ 806,409	$ 868,226

Source: KHP financial records, compiled by APA

KHP's lack of formalized, written policies and procedures related to procurement continued during the period of our examination, just as reported by FAC's report for prior years. Auditors were provided policies and procedures that were created during FY 2016 and dated May 9, 2016. Discussions with KHP personnel indicated that many of the vendor payments had been made without contracts for years. KHP did not have procedures in place to properly monitor expenditures to determine if a vendor met the threshold to require a contract.

Allegations of Conflicts of Interest and Favoritism in Vendor Selection

Allegations surfaced before and during the examination regarding KHP's failure to properly bid and contract with vendors for goods and services. Complainants expressed concerns that KHP management was not properly following procurement laws due to potential conflicts of interest or due to favoritism for certain individuals, associations, or businesses. Therefore, auditors evaluated these risks during the examination by reviewing documentation and interviewing KHP management and staff regarding such occurrences.

One of the vendors included in the exceptions identified above supplied fuel to KHP. Fuel pumps on KHP grounds supply farm vehicles, equipment, and golf carts used by employees and event organizers. The lack of proper bidding and contracting for fuel made little sense given that the Commonwealth had a state price contract in place with a fuel vendor. However, KHP utilized a different vendor to provide fuel. Inquiry into the use of this vendor identified that KHP obtained fuel from this vendor at least as far back as 2010, and also identified that the salesperson listed on this vendor's invoices was a member of the board of directors and former interim executive director of an event organizer that hosts one of KHP's largest equine events.

Another vendor identified as operating without a contract is a graphics vendor that supplies merchandise for resale in the KHP gift shop. Interviews with KHP employees indicated that this vendor is operated by the same individual awarded the contract by KHP to serve as a consultant for its gift shop. This raised concerns about whether purchasing merchandise for resale from the gift shop consultant represented a conflict of interest. Additionally, auditors were informed that KHP management knew of the potential conflict, because initially the merchandise was sold to KHP under the same business name as the gift shop contractor until someone mentioned this would not look appropriate. Auditors were told that instead of stopping the practice, the gift shop contractor began supplying the merchandise under a different business name. Auditors inquired further with KHP management and learned that the individual with the KHP gift shop consultant contract also owned the company used to purchase items for resale. Management further stated that the contract with the consultant included language permitting KHP to purchase items for resale. The contract stated, "The Commonwealth reserves the right to leverage resources the Contractor possesses for the purpose of purchasing items for resale, as well as purchase items for resale from other sources separate from the contractor. Final decisions on all purchases of items for resale will be made by the management of the Kentucky Horse Park and all purchases will be made within the best interest of the Commonwealth." This contract language enables the contractor to provide merchandise for resale that was not properly procured. The risk of fraud and abuse is heightened due to the same individual under contract as the consultant for the gift shop also providing goods for resale to the same shop. This lends credence to allegations that KHP favored certain individuals or vendors by permitting such activities to occur. This vendor is one of the eight identified in Table 2 with expenditures exceeding the KHP's $20,000 small purchase authority that did not have a contract in place or evidence that a competitive bidding process was utilized.

Recommendations

We recommend:

- Based on discussions with current KHP management, we understand that steps are being taken to improve KHP procurement procedures in addition to the new policies and procedures put in place in May 2016. We recommend KHP management first take action to identify and end all improper vendor relationships. In order to do this, KHP management should analyze all payments to vendors in excess of its small purchase authority limit, review procurement files to ensure the vendors were properly procured, and execute and maintain appropriate contracts when required.

- Upon performing this analysis, KHP should review its recently written policies and procedures to ensure they comply with the MPC, and then train staff on procurement to ensure all staff engaging vendors are aware of the proper procedures. Specific information in KHP's policies and procedures should outline individual responsibilities related to procurement, include information to educate and inform staff of measures taken to avoid conflicts of interests and other risks in vendor relationships, and address disciplinary action for failing to follow the procedures.
- Procurement procedures should also include a process for estimating aggregate payments to vendors to determine if expenditure thresholds will be exceeded. Additionally, KHP management should review these policies periodically to ensure all information remains accurate, and clarifications are made as needed to ensure procedures comply with state law.

Finding 4: Examination Of KHP Billings Identified Further Potential Conflicts of Interest Or Favoritism Related To Certain Event Organizers

In Finding 2, billing discrepancies were noted in which certain events were billed flat rates for venue rentals rather than based on the rental rate sheet used by KHP for other events. In two instances, auditors identified circumstances that raised questions regarding potential conflicts of interest and whether favoritism led to discounts for the organizations. In these instances, the APA was limited in fully verifying the existence and extent of these conflicts due to having access only to public records, and not personal records of the individuals involved. However, our examination clearly identified that operating procedures at KHP were not sufficient to detect and prevent potential conflicts or to prevent personal relationships leading to favoritism impacting procurement decisions, including amounts charged for venue rentals and other services.

Horse Show Production Company

The APA received an allegation that the KHP Food Service Director's in-laws own a horse show production company (company) that frequently hosts shows at KHP. Auditors tested a sample of the company event contracts, and the results identified that these events were handled differently than most other event contracts tested. The company was charged flat rates for the facilities utilized, with no documentation as to how the flat rates were determined. The flat rates would not only be for venue rentals, but would also include stabling charges for barns rather than the per-stall rate charged for the included barns' 1,076 stalls. In some instances, the flat rate charged for the entire event would not even cover the amount that would typically have been assessed just for stabling fees. Any additional stabling over what was included in the flat rate, was billed at a 35 percent discount. Current KHP management reviewed all of the events held by the company for calendar year 2016. In this comparison, the fees that would have been charged based on established KHP rates were compared to the flat rate invoice. As a result, the discount for the company totaled $766,970, with discounts ranging from $59,112 to $147,742 per event, which is equivalent to total discounts of 32 to 57 percent. Another unusual element included in the agreements were price lock-ins for future events. The rates for these future events were established at the rates in effect at the time of the agreement.

KHP personnel informed auditors that prior experience with the company showed that fair charging practices were not in place dating back as far as 2006. A member of KHP staff indicated that in the past, the invoices for this company were taken to management for review, and they would “take the red pen to it.” The employee further explained that meetings would be held to negotiate the flat rates that KHP felt comfortable charging. Included in these meetings were the former Executive Director and the former Chair of the KHP Commission. The same employee noted additional examples of unfair charging practices, such as reducing the number of entrees for food service provided and discounts given for other contracted services. Again, it is possible that legitimate considerations drove these decisions, such as the volume and amount of business KHP had with this particular company. However, without appropriate documentation of the negotiations or criteria for decision-making, there is a lack of transparency that makes it impossible to determine whether the discounts were authorized and agreements entered into without undue influence by or directly benefitting a member of KHP management. Also, there is no documented analysis of whether KHP could have earned the full amount of revenues for the event dates booked by this company if the dates were open and available to other event organizers, especially given that the dates utilized by the company were during the peak show season.

In addition to the issues noted above, auditors were also informed that the KHP Food Service Director’s family member had horse show equipment housed in a barn on KHP grounds rent free and without documented approval. Auditors observed the barn and noted equipment inside that did not belong to KHP. An article was provided to auditors in which the KHP barn was described as this individual’s “workshop at the Horse Park.” Show trailers rented by the horse show company were brought to KHP each year and kept on the grounds to serve as the company’s show offices for the duration of the summer, again with no charge to maintain these trailers on-site or use the space. Also, auditors observed campers on-site that belonged to the Food Service Director’s wife and one of her employees, also at no cost and without written agreement.

High-Profile Event

Another relationship of concern was with one high-profile event at KHP. Per review of the contracts for the three years under review, the event organizer was charged a flat rate each year. A conservative recalculation was performed by the auditors, which indicated KHP had a potential loss of revenue of $87,696 over the three years. The FY 14 and FY 15 contracts included provisions that along with the flat rate, KHP would receive a portion of ticket sales, a flat rate for parking, stabling fees, utility fees, and fees for any additional services. However, for FY 16, the contract was revised to a flat fee for everything and included the provision that the contract could be renewed with a flat fee for the FY 17 and FY 18 event. An additional concern is that the event organizer has close ties with various individuals that were employed at KHP or held positions on the KHP Commission. The former head of the KHP Commission, also a KHP Foundation member, was a director of the entity organizing the event. In addition, the former Deputy Executive Director at KHP was the former president of the event's organizing entity prior to working at KHP, although this was an uncompensated position. During FY 16, the former Deputy Executive Director signed the contract on behalf of KHP. In addition, the former Deputy Executive Director lived on KHP grounds paying $250 per month for rent, which included utilities, and he was not required to pay security or damage deposits. This rental agreement was signed and approved by the former KHP Commission chair.

Some of the same individuals and companies frequently utilize KHP venues and services, which creates close business relationships. However, when a state agency engages in business practices with family members and others close to management, it becomes more difficult to make objective decisions that put KHP's interests first. This requires the agency to utilize standard procedures for all patrons and vendors, regardless of their relationships. KHP is not a private business, and therefore, cannot provide unfair discounts and advantages to individuals and companies. Furthermore, the housing of non-KHP equipment and private operations on KHP grounds exposes the Park to liability risks for purposes that do not benefit the agency. Discounts and free, undocumented use of KHP property for family members and others with close relationships to KHP management, are inappropriate uses of state resources. These practices also increase the risk that employees and their family or friends have been permitted to utilize KHP property for personal gain and with little or no benefit to KHP.

Recommendations

We recommend:

- All non-KHP equipment be removed from the KHP grounds, other than temporary equipment permitted during events as part of the event agreement.
- Any non-KHP business operations, such as work occurring in the barn, cease immediately, until such time the businesses have a valid and properly procured lease agreement in place with the Park.
- As recommended in Finding 2, the KHP Commission should establish a policy regarding criteria and permissibility of discounts, deposit waivers, flat rates for multi-day venue rentals, or variable rates, including discounts for multi-year contracts; and
- Also as recommended in Finding 2, KHP management implement policies and procedures for documenting and approving any venue or food service discount authorized by the KHP Commission.

Finding 5: KHP Did Not Comply With State Requirements Related To Sponsorships, Including One Sponsorship Arrangement That Provided Personal Benefits To KHP Management

KHP utilizes sponsorship agreements that involve the exchange of goods or services from the sponsor for signage on the KHP grounds and other promotional materials. The Commonwealth permits state agencies to obtain sponsorships, and the Finance and Administration Cabinet (FAC) has promulgated regulations related to sponsorships in 200 KAR 5:080. This regulation provides requirements for agencies to follow to ensure sponsorships comply with relevant sections of the Model Procurement Code (MPC) as codified in KRS Chapter 45A. Poor policies and procedures over sponsorships led to two KHP employees gaining personal benefit from a sponsorship arrangement, which violates the state regulation, as well as potentially the Executive Branch Ethics Code. Further, KHP has not followed regulations for the advertisement and solicitation of sponsorships and has not maintained appropriate documentation related to the sponsorship acquisitions and agreements in place. In addition to providing signage and other promotional materials, KHP also agreed to provide event tickets to certain sponsors as part of sponsorship agreements, as mentioned in Finding 2.

Executive Management Benefitted Personally From Sponsorship Vehicles

The procedures used by KHP to acquire sponsorships were not sufficient to ensure compliance with state requirements and subjected KHP to the potential for abuse. In one instance, KHP had a sponsorship arrangement with a motor vehicle company that provided two vehicles for the Park to use, including one truck and one sport utility vehicle (SUV). However, these vehicles were used full-time by the former KHP Executive Director and former Deputy Executive Director, including personal use. Although documentation existed for the sponsorship details for the vehicles, an executed agreement did not exist. The requirement in 200 KAR 5:080 Section 3 (3) states, "Agency shall make [award] of sponsorship to the responsible bidder(s) determined in writing to be most advantageous to the [C]ommonwealth, taking into consideration the evaluation factors set forth in the sponsorship opportunity." The provision of assets for personal use by an agency's management, especially in the absence of documentation evidencing the need for such assets in the normal course of business, is not an appropriate use of sponsorship arrangements.

The sponsorship provided for signage to be placed on KHP grounds in exchange for the two vehicles, with the estimated value of the exchange at $35,000. The SUV was delivered by a local dealership and was used by the former Executive Director. Although the former Executive Director used the SUV for work when travel was necessitated as part of his job, the vehicle was also used as a personal take-home vehicle. Records indicate the former Executive Director reported personal commuting mileage to KHP personnel to be included as fringe benefit income on an IRS Form W-2.

The truck provided as part of this sponsorship arrangement was documented as a lease in the name of the KHP Foundation, which also insured the vehicle, but it was titled in the name of the KHP Hospitality Group Inc. The KHP Hospitality Group was a mechanism created by KHP to obtain and hold its license for liquor sales before state agencies were permitted to hold such licenses directly. Inquiry with KHP management indicated that the liquor licensing was the only purpose of the KHP Hospitality Group, raising questions as to why a KHP asset would be titled in this manner. Auditors were told by KHP staff that the truck's lease payment was made by a second local dealership to fulfill the sponsorship arrangement, but there is no agreement in place documenting this transaction.

According to interviews, the truck was used by the former Deputy Executive Director as a full-time take-home vehicle. However, personal mileage was not reported by the employee as income from the fringe benefit on IRS Form W-2, nor could auditors confirm that the employee was approved for a take-home vehicle under the state requirements. One aspect complicating this is that the former Deputy Executive Director also lived in a house on KHP grounds, which is mentioned in Finding 4. Although this would reduce or eliminate commuting miles, there was no process for identifying, tracking, or reporting other personal use.

The promotional obligation to the sponsor as part of this arrangement included signage in the KHP Covered Arena. The signage in the Covered Arena for this sponsor states that the motor company is the

"Official Truck of the Kentucky Horse Park." This signage appears to violate state sponsorship requirements. 200 KAR 5:080 Section 3 (5) states, "A sponsorship shall not constitute an 'official endorsement' of a particular company by the Commonwealth of Kentucky as the sole vendor of choice." Auditors were told that the signs were placed to meet a prior sponsorship agreement under different KHP leadership, and that agreement also included the provision of two vehicles. A KHP Foundation employee indicated the signs had not been replaced for the new sponsorship because a signed sponsorship agreement had not been returned to KHP.

The vehicle sponsorship arrangement highlights the opportunity for abuse in KHP's sponsorship procedures and the need for improvements in the internal controls over this process.

Additional Noncompliance

Documentation related to sponsorships was so poor that no one at KHP could provide auditors a complete list of sponsorship agreements in effect during the examination period. However, auditors were provided a listing of 18 sponsorship agreements in place at the time of the request. Goods and services provided by sponsorships include footing for event areas, medical services, cooling fans, horse trailers, watering units, bedding, grooming supplies, and rubber mats for KHP horses. Of the 18 sponsorship agreements listed, 11 were selected for testing for compliance with 200 KAR 5:080 and relevant sections of the MPC. The examination of these sponsorships identified noncompliance with state regulations, including the failure to properly document sponsorship arrangements and properly fulfill sponsorship arrangements, and instances in which potential sponsors were solicited prior to identifying and advertising KHP needs.

State regulations related to sponsorships contained in 200 KAR 5:080, include the requirement to advertise sponsorship opportunities on the agency's website for a minimum of seven calendar days, as well as the number of potential sponsorships available and the relative importance of price and other evaluation factors used to ensure "best value" as defined in KRS 45A.070(1). 200 KAR 5:080, Section 3 (3) states that, "[a]ll evaluation documentation, scoring, and summary conclusions of the award shall be made a part of the file record." This regulation is in place to ensure state agencies obtain sponsorships beneficial to the Commonwealth while maintaining compliance with the MPC, which helps ensure fair and equitable competition for state business. The examination of the 11 sponsorships selected for testing identified:

- Nine sponsorship agreements had no evidence of the opportunity being posted to the agency's website, nor were proposals on file detailing the sponsorship opportunities.
- According to interviews, KHP never received proposals from website advertisement alone. Auditors were told that after a period of no response, KHP would then contact potential sponsors. However, at least two sponsorship opportunities were posted to the agency's website only after a KHP representative had already contacted potential sponsors directly.
- Two sponsorships did not have a signed sponsorship agreement in place.
- Four sponsorship agreements were signed, but not dated, making it impossible to tell when the agreement began.
- KHP did not fulfill its part of one sponsorship agreement in that the signage agreed upon with the sponsor was not displayed.

In addition to the weaknesses noted above, a review of the sponsorship agreements found three instances of sponsors being designated "official supplier" to KHP, which is contrary to 200 KAR 5:080 Section 3 (5).

Further, auditors identified ten sponsors with no current sponsorships in place that either had signage present on the park or that were thanked in the *Kentucky Horse Park Magazine*. Auditors were able to verify that one of the ten identified as a sponsor did have a past sponsorship but not a current agreement. For the remaining nine instances, auditors were unable to determine whether the sponsors had expired agreements, signage was improperly placed or if the businesses were included in the advertisement as KHP sponsors in error. In these nine instances, auditors were unable to confirm whether the Commonwealth received reciprocal benefits from these promotions.

The KHP practice for acquiring sponsorships may violate the MPC by soliciting for goods and services used in general KHP operations rather than only for special events. Auditors noted instances in which some of the goods and services obtained from sponsors were already under contract for provision by other vendors. Therefore, soliciting sponsorship exchanges may undercut state vendors that acquired contracts through legitimate procurement procedures. As an example, auditors learned of one case in which KHP was discussing a potential sponsorship with a vendor to provide free bedding supplies. A KHP employee indicated this solicitation occurred after KHP had already entered into a contract for bedding with another vendor. The contracted vendor reportedly was not contacted about the sponsorship opportunity. This raised the question as to whether sponsorships are intended to be event-specific arrangements, or may also be arrangements for general operations. Auditors discussed the intent of sponsorship arrangements with the FAC Office of Procurement Services (OPS), who agreed that the original intent was to permit event-specific sponsorships rather than general sponsorships. However, neither the auditors nor OPS were aware of written requirements that clarified this as the intended practice.

The process for acquiring and documenting sponsorships at KHP failed to ensure compliance with state requirements. Sponsorships were handled by KHP executive officers until 2013. KHP management recognized that sponsorships had not been dealt with properly, noting for example, some signage had not been installed according to agreements that were in place. At that time, KHP management asked the KHP Foundation to assist with the management of sponsorship agreements. The KHP Foundation hired an employee to identify sponsorship opportunities and needs around the Park grounds, write requests for proposals (RFPs), post RFPs to the KHP website, and solicit sponsors as needed. Separating KHP management from the sponsorship process and instead relying on a legally separate organization to handle the process created a weak environment over the past several years in which no one took ownership of the task of managing sponsorships. This arrangement led to poor documentation of sponsorship activities, violations of the state sponsorship requirements and related portions of the MPC, and ultimately increased the risk of sponsorship abuse as evidenced above in the discussion regarding the personal use of motor vehicles.

The process utilized at KHP increased the risk that sponsorship activities could be used to favor certain vendors and the KHP Foundation without proper reciprocal benefit to the Commonwealth. This risk is heightened due to the process of soliciting sponsorships for general operating needs and the process of limiting KHP management oversight and instead having sponsorships managed by a legally separate fundraising entity, the KHP Foundation. Finding 7 discusses concerns related to the overlapping operations of KHP and the KHP Foundation, which further illustrates this risk.

Recommendations

We recommend:

- KHP implement internal control procedures to ensure all sponsorship agreements are properly procured, documented, and executed in accordance with 200 KAR 5:080 and other relevant portions of the MPC. We further recommend that these procedures restrict KHP employees from receiving any personal benefit from these arrangements, and instead only receive benefits that are necessary and reasonable for KHP operations and that provide a benefit to the Commonwealth.

- It is our understanding that KHP has taken steps in recent months to hire the individual previously working for the KHP Foundation as a KHP employee to manage sponsorships. KHP should ensure this employee is trained in the new KHP sponsorship policies and procedures, as well as the Executive Branch Ethics Code.
- KHP obtain advice of its General Counsel and OPS regarding whether sponsorships may be obtained for general operating needs, rather than event-specific needs. This guidance should be discussed with the KHP Commission for the creation of an approved policy.

Finding 6: KHP Did Not Properly Procure Food Service Concessionaires And Did Not Execute Written Agreements With On-site Attractions

During the examination, auditors observed operations and transactions between KHP and other entities operating on-site. These included various food services concessionaires and a separate equine museum operating on KHP grounds which shares admissions revenue with KHP. Inquiry and testing into the operations of the concessionaires and on-site museum identified weaknesses in that KHP did not follow proper procurement requirements for concessionaires and did not have a recent revenue sharing agreement with the on-site museum. These weaknesses contributed to an operating environment at KHP where relationships with individuals and vendors appeared to take precedence over appropriate business practices and historical operating practices received little scrutiny.

Concessionaire Agreements

KHP utilizes various food service concessionaires regularly, including three concessionaires with continuous on-site presence, as well as numerous temporary concessionaires hired to be on-site during events. Inquiry with KHP staff and management identified that procurement procedures in place for obtaining concessionaires do not adhere to requirements of Finance and Administrative Cabinet's Manual of Policies and Procedures (FAP). Instead, the KHP Food Services Director indicated most concessionaires are hired based on having a historical relationship with KHP. There is no documentation to establish that these concessionaires have been properly procured or whether competitive opportunities have been afforded to new concessionaires.

KHP Food Services hires concessionaires based upon need and concessions requested for each event. Show organizers inform KHP Food Services managers if they desire a particular concession to be on-site during their show. KHP then contacts concessionaires to hire based upon its past history with them. Inquiry with the KHP Food Services Director about how new concessionaires would have an opportunity to be hired indicated that from a practical perspective, few new concessionaires would be eligible. A vendor wishing to be an on-site concessionaire must contact KHP Food Services and provide evidence of a $1 million liability insurance policy and all required health department documentation. Then, KHP Food Services staff will contact whatever vendor they choose to fill the need of the event and enter into signed agreements effective for the dates of the event.

There are three concessionaires with a long-term presence at KHP. These vendors are on-site at their discretion and are generally open during the peak event season. One of these vendors operates a concession stand located in a permanent structure in the middle of the park. The location is adjacent to or within close proximity to show offices, all stabling, an area used by show vendors, and three frequently used show rings. Auditors were told that the vendor was chosen to operate the stand because prior to the construction of the permanent structure, the vendor ran a small vending cart on that location at the park. KHP employees stated that KHP Food Services did not operate the concession stand because it did not have the manpower to operate the stand and maintain the appropriate quality. However, as noted in Finding 1, KHP Food Services operates two permanent restaurants on the grounds that are open year-round. KHP receives a commission of 30 percent of the sales from the vendor, which amounted to $59,354 in FY 2014, $90,276 in FY 2015, and $111,410 in FY 2016.

The two other vendors with a long-term presence each keep trailers, vehicles, or both parked on KHP’s grounds throughout the show season. One of those vendor’s locations is detailed on the park visitor map. Each of these reported commissions to KHP exceeding $20,000 for at least one of the three years during our examination period. One of the vendors had annual commissions ranging from $15,000-$35,000 during the audit period. The other started operating on the park during March 2015, but for the full fiscal year of 2016, commissions were over $41,000.

Procurement of concession services is subject to competitive sealed bidding under the Model Procurement Code as mandated by KRS 45A.080 and 200 KAR 5:306 when the revenue generated by concession exceeds the small purchase authority set by FAC. The requirements relating to concession services are further outlined by FAP 111-24-00, defining concession services as “vending machines, coin-operated laundry equipment, rental golf carts, ice vending equipment, catered food service and food refreshments sold by others at facilities accommodating civic, social, cultural, sporting or other entertainment or business events." The policy requires the following for procuring concession services:

3. A Requisition for a concession contract shall be submitted through the state's eProcurement system describing the type of service desired and providing sufficient information to solicit the vendor community and secure services.
4. Unless the revenue generated by the concession contract is within the amount designated in the agency's small purchase authority, or if the agency has been given statutory or delegated authority from the FAC [Finance and Administration Cabinet], all contracts permitting the establishment and operation of concession services at state operated facilities shall be awarded through OPS [Office of Procurement Services].

KHP's procurement methodology for both the long-term and temporary concessionaires did not include using the state eProcurement system. In fact, KHP's process appears to limit competition and increases the risk of favoritism being used in the selection of concessionaires. As for the requirement to contract through OPS, KHP had some concession agreements that did not exceed the agency's small purchase authority, which was $20,000 during most of the examination period. The KHP small purchase authority limit was reduced to $1,000 beginning February 26, 2016 by the FAC Secretary, which increased the risk that revenue generated by concessionaires, especially during popular events, would exceed this limit. Although it may be difficult in some instances for KHP to determine in advance which temporary concessionaires will exceed its small purchase authority, historical records should provide sufficient information as to expected revenues during events. All three of the long-term concessionaires discussed above exceeded the agency's small purchase authority in one or more years of the examination period, and therefore these concession services should be competitively bid and contracted through OPS. It should also be noted that KHP did not have delegated authority from FAC to establish concession services outside of OPS.

On-site Attractions

Two on-site attractions, including one tourist activity and one on-site museum, operated on the grounds of KHP. KHP had arrangements in place to pay these two attractions a portion of ticket sales or admission fees without written agreements.

The first of these arrangements included a vendor for which KHP sells tickets for a farm tour activity. KHP then remits 75 percent of ticket sales to this vendor. There is no contract or other type of agreement with the vendor outlining the terms of this arrangement. There is also no documentation of proper procurement of the vendor, although KHP did properly procure other tourist activities operating on KHP grounds. Total amounts paid to the vendor in calendar year 2015 and the first six months of calendar year 2016 were $95,292, and $42,050, respectively, which exceeded the agency's small purchase authority.

The other arrangement was with a separately operated on-site museum which receives a portion of the total of KHP admission fees. However, no documented agreement exists between the entities. Auditors were provided a copy of a land lease between the Park and museum, but the lease does not contain any terms related to sharing admission fees. Visitors to KHP pay admission fees that allow access to both the KHP grounds and facilities, and the separately operated museum. Admission fees are collected by both KHP and the separate museum. The museum remits 100 percent of admission fees collected at the museum to KHP on a monthly basis. KHP calculates all admission revenues regardless of which entity collected the admission fee. The only documentation available for the auditors to review was a written price adjustment proposal from 1999, which indicated that KHP would remit four percent of total admission fees to the museum up to the first million dollars in total admissions, then declining to two percent of the second million dollars in admissions and one percent for admissions exceeding $2 million.

Admission fees paid to the separately operated museum during the examination period were:

Fiscal Year 2014	$41,235
Fiscal Year 2015	$41,537
Fiscal Year 2016	$47,035

KHP employees interviewed were not aware why there was never a written agreement implemented, only that this had been the practice for many years. Financial arrangements should be documented by written agreement signed by both parties, and updated as needed. This provides a clear understanding of terms by which transactions should be conducted. It would also permit KHP to analyze the activity generated by the separately operated museum and negotiate contract terms based on visitor utilization, marketing considerations, or other measures. Additionally, no documentation exists to suggest whether KHP has contemplated the pros and cons of having separate admission fees designated for the separately operated museum.

KHP has not utilized sound business practices as it relates to on-site concessionaires and entities. This not only increases the risk that KHP may be losing revenue from following poor practices, but it also increases the potential for favoritism and the risk of fraud or abuse because of the lack of established procurement processes and other financial arrangements.

Recommendations

We recommend:

- KHP management implement procedures to ensure compliance with KRS 45A.080, 200 KAR 5:306, and FAP 111-24-00 as they relate to the procurement of concession services.
- Management include an analysis of the permanent concession stand located in the center of the park in its analysis of food services recommended in Finding 1. The analysis should evaluate whether outsourcing all permanent on-site food services is more cost-effective to KHP, and whether in-house operations can be made more efficient.
- KHP ensure that all financial arrangements with entities operating on-site are documented in written agreements that are approved by the KHP Commission and periodically analyzed and reviewed to ensure KHP continues to benefit from the arrangements.

Finding 7: KHP Did Not Maintain An Effective Line Of Separation From The Kentucky Horse Park Foundation

During the examination, concerns arose as to whether certain operational activities of KHP and the KHP Foundation overlapped in ways that could lead to violations of state procurement rules, state personnel rules, or the Executive Branch Ethics Code. The examination identified circumstances in which the operating relationship between KHP and the KHP Foundation became blurred, leading to KHP staff and property being utilized by the KHP Foundation without reimbursement. Also, instances were noted in which KHP Foundation staff were involved in KHP operations without a clear business need, which gave the appearance of the KHP Foundation having undue influence in KHP operations.

According to its website, KHP Foundation is a "nonprofit organization dedicated to enhancing, expanding, and improving the Kentucky Horse Park." As a legally separate entity, the KHP Foundation has its own board, management, and staff, and is not required to adhere to the state MPC, state hiring practices, or other requirements of state agencies. The KHP Foundation and similar types of foundations acquire and contribute valuable resources for furthering state programs, improving grounds, and acquiring artifacts and other assets that would be difficult to obtain under the state procurement laws. However, the involvement of KHP Foundation employees in the general operations of the Park gives the appearance of and increases the risk of the fundraising entity having undue influence in agency decisions for the benefit of donors and other individuals and businesses with close ties to the fundraising activities.

During the examination, auditors became aware that the KHP Foundation Executive Director and other Foundation employees were included in email distributions for KHP management and staff. These individuals regularly attended weekly KHP staff meetings. Even more concerning were instances in which KHP events contracts included provisions requiring some event holders to provide tickets and hospitality room access at no cost to the KHP Foundation and two sponsors. This concern is further described in Finding 2. These actions not only appear to illustrate influence by KHP Foundation but also raise questions about the appropriateness of benefits provided to a third party derived from an event holder's contract with a state agency.

Southern Lights

One of the largest benefits provided by KHP to the KHP Foundation relates to the annual winter Southern Lights event held at KHP. The event charges admission on a per vehicle basis to drive through a large display of holiday lights within the Park. Southern Lights started over 20 years ago and was designed to be a revenue-generating activity for KHP during non-peak, winter months. The KHP Foundation purchased the lights for the event, and prior to the 2009 event, revenues generated were shared between KHP and the KHP Foundation. At that time, KHP would receive a flat amount or a set amount per vehicle that paid admission, whichever was greater, but the terms of the agreement changed for the 2009 event. During and after the 2009 event, all revenues went to the KHP Foundation and were not shared with KHP. Southern Lights generated $3,031,993 in revenue for the KHP Foundation between the 2009 and 2015 events. Current KHP management calculated that under the terms of the pre-2009 revenue sharing agreement, KHP's lost share of the admission during this time period would have been as much as $568,529.

Auditors reviewed the agreement between KHP and the KHP Foundation for the 2013 through 2015 events, which occurred during fiscal years 2014 through 2016. The 2013 Southern Lights agreement stated, "No charge per agreement with Park." The 2014 and 2015 Southern Lights agreements stated, "Rental fees/profit share waived per agreement that Foundation pays debt on new barns." Auditors inquired about the arrangement that waived the revenue sharing for the KHP Foundation and were told that KHP's share of the revenue was waived to pay debt service for a barn project handled by the KHP Foundation. Documentation for the barn project was requested, and the documentation included information that the KHP Foundation would fund the barn project from donations and that over $1 million in pledged donations existed for the project at that time. Debt for the barn project was acquired in two loans by the Foundation totaling $3.1 million in principal. Of these loans, $1.5 million was paid off on March 7, 2013 and the remaining $1.6 million was paid in full on July 8, 2015. The barn construction project began in 2009 and was completed in 2011, at which time, the ownership of the barns was transferred to KHP. The KHP Foundation Executive Director indicated that it was her understanding that the arrangement made prior to her tenure was established due to the millions of dollars in debt the KHP Foundation incurred for the construction of a three-barn complex, which had debt service payments of over six figures per year. However, when auditors requested the agreement between KHP and the KHP Foundation related to the barn construction, no written documentation existed, nor was there any documentation indicating the need for KHP to forego an existing revenue source to enable payments for this arrangement.

Of particular concern is that the circumstances appear as though KHP circumvented state procedures for incurring debt by having the project debt financing arranged by a legally separate entity and having debt service payments paid by foregoing an existing KHP revenue source. Under this arrangement, the indebtedness of a state agency is not authorized through appropriate means, and is not properly recorded as a liability by the Commonwealth. This methodology also effectively circumvents state procurement rules, which require a competitive bid process for large construction projects and paying prevailing wage.

Auditors learned that the debt on the barn project was paid off during the KHP Foundation's fiscal year ending May 31, 2016. However, while the final payment was made during FY 16, the 2016 winter Southern Lights event contract waiving the rental fees/profit share in exchange for the KHP Foundation paying debt on new barns. Therefore, KHP does not anticipate receiving a share of the revenue or recouping any of its event-related expenses during FY 2017, even though debt service payments are no longer being made on the barn-related loans.

Another concern related to this agreement is that the majority of labor for Southern Lights is provided by KHP employees working on state time. The agreement with the KHP Foundation does not provide for reimbursement for either the labor provided by state employees or the use of the KHP grounds. Although KHP receives promotional benefits from this event, it incurs significant costs in order to raise funds for the KHP Foundation. While on site, auditors observed KHP employees putting up lights, preparing event worker/volunteer packets, and also learned that KHP Business Office employees were responsible for accounting for the cash received from the event. KHP employees maintained spreadsheets that documented the daily cash receipts and counted the cash from the event, while KHP Foundation employees counted the tickets sold. KHP employees performed these functions during their normal work hours, as evidenced by an example of a KHP employee's timesheet. Thus, state employees were performing work for private fundraising activities on state time and being paid by state funds.

The operating lines between KHP and the KHP Foundation have become blurred. The KHP Foundation was treated more as a part of the operations of the state agency than as a legally separate entity. As a result, KHP provided benefits to the KHP Foundation that it should not have been entitled to, such as writing into event contracts certain perks for the KHP Foundation, and allowing the use of KHP grounds and employees at no cost. These problems were more serious than administrative concerns, as they led to a misuse of public funds by using state employees on state time for private fundraising activities going back as far as 2009. Circumventing state law to incur debt and construct assets illustrates an environment in which KHP management disregarded requirements intended to ensure such transactions are authorized and transparent.

Although the KHP Foundation exists for the benefit of KHP, it is not appropriate to circumvent requirements that in effect supplant current operating funds and move them to benefit a fundraising objective. Furthermore, KRS 148.320 requires that all revenues derived from the use of KHP properties and facilities be used to defray the expenses of KHP operation. As noted in Finding 1, KHP has repeatedly required state subsidies to fund its operations. Activities that reduce KHP's access to financial resources and use its resources for the objectives of a private, legally separate entity take funds away from other priorities of the Commonwealth.

Recommendations

We recommend:

- KHP management and employees maintain an effective separation from the operation of the KHP Foundation. KHP should not allow the KHP Foundation to influence KHP operational decisions, such as procurement and employment decisions, without going through appropriate processes that comply with state laws.
- KHP immediately cease providing no cost or discounted benefits to the KHP Foundation and acquiring such benefits for the KHP Foundation from vendors, event organizers, or others.

- KHP renegotiate its agreement with the KHP Foundation regarding the Southern Lights event, and at a minimum, recoup costs associated with the event.
- The KHP Commission implement policies that appropriately limit the amount of employee time that can be used for activities of the KHP Foundation on state time. The use of employees for events such as Southern Lights should be specifically addressed.

Finding 8: KHP's Poor Control Environment Led To Questionable Hiring Practices Utilizing Temporary Employment Agencies

During the course of the examination, concerns arose regarding KHP's use of temporary employment agencies, including whether KHP was using temporary agencies to circumvent state hiring practices. Additional concerns raised were that KHP paid overtime to one particular temporary agency, although overtime was specifically prohibited in the agency's contract, and also paid rates above the contracted amount. Examination procedures confirmed that KHP hired a significant number of year-round temporary employees, and instances were identified in which KHP paid overtime in violation of the contract and paid rates to temporary agencies higher than those stated in the contract. Additionally, auditors found that KHP processed invoices in the state's accounting system in a way that did not agree to the invoices from the temporary employment agencies, which obscured the actual rates and hours paid.

KHP utilized four temporary employment agencies during the examination period, and as of December 2016, contracts with these agencies covered 39 employees that worked with KHP year-round. There were additional, seasonal employees hired by KHP to work only during peak periods. Expenditures for temporary agencies were $544,919 in FY 2014, $925,539 in FY 2015, and $2,175,993 in FY 2016. This reflects an almost 300 percent increase over the three year period under examination. KHP primarily uses temporary employees in Maintenance and Food Services, with 19 of the 39 employees mentioned above working in those areas. Other areas at KHP using temporary employees include the Mounted Police, Business Office, Campground, Museum, Gift Shop, Equine, and Housekeeping. KHP has 71 full-time employees, excluding seasonal workers. Therefore, a significant amount of the KHP workforce is made up of individuals hired through temporary employment agencies, although they are not being used for temporary needs.

KHP did not maintain any analysis of the use of temporary workers to determine whether certain factors created the need to use temporary workers instead of full time staff, such as the pace of turnover, for example. Although there may be some instances in which using temporary employees provides necessary flexibility, such as for food service servers, having this level of the workforce hired from temporary agencies increases the risks that temporary agencies are being used to circumvent state hiring requirements. Inquiry with KHP management indicated that they used temporary agencies because they have a personnel cap that they must adhere to and are unable to hire the number of additional employees needed to meet the demands of the Park. One example identified a temporary employee working as the KHP executive chef. The executive chef was hired via a temporary agency in March 2016, earning $29,141 in regular pay and $28,749 in overtime pay, for a total of $57,890 between March and December 2016. The position of executive chef appears to warrant a full time employee, which is further supported by the amount of overtime paid during the nine months he worked in 2016. Full-time employees with similar classifications in other parks earned between $23,960 up to $58,904 in regular and overtime pay for the entire calendar year of 2016.

Auditors reviewed language included in the contracts with the four temporary agencies to identify whether prohibitions against overtime existed. The contracts for three of the four temporary agencies stated, “No overtime will be billed or paid unless documentation is provided that appropriate management staff gave prior authorization. Overtime and holiday pay shall be invoiced at a bill rate not to exceed one and one-half times the normal hourly bill rate for that classification. The overtime bill rate shall only apply to hours worked in excess of forty (40) hours in a workweek.” The contract for the fourth temporary agency included language stating, “Unless the KHP identifies/requests a specific staff person is needed to work in excess of 40 hours a week, KHP shall not be responsible for paying overtime charges.” The language as noted does not specifically prohibit overtime, but that documentation must be provided by appropriate management giving prior authorization.

The vendor files containing invoices for each temporary agency were also reviewed. Auditors examined 10 to 15 invoices for each of the four temporary agencies for FY 2015 and FY 2016. The examination of these invoices resulted in significant weaknesses, such as:

- Discrepancies between invoices and the state’s accounting system for actual hours and rates paid;
- Discrepancies between payment rates charged on invoices and rates included in the executed contracts; and
- Overtime paid for temporary workers without required documentation of management’s approval.

Hours worked, pay rates, and job descriptions as noted on the invoices were not properly reported in the state’s accounting system (eMARS). For example, one invoice documented that a temporary employee working as a KHP Food Service Worker worked 39.75 hours at a rate of $22.98, for a total invoice of $913.46. The associated eMARS payment document reported hours worked as 86.01 hours, at a rate of $10.62. Although the total payment amount was the same, the hours and rate were misrepresented in eMARS, which obscured that the pay rate did not comply with the pay rate listed in the contract for this employee. This invoice and eMARS payment document are presented in Appendix A for illustrative purposes.

In another example of an invoice not agreeing to eMARS, KHP was invoiced for security officers, carpenters, and horse workers. In this instance, the description in eMARS identified these temporary employees under the classification of “Executive Assistant I.” The rates on the invoice ranged from $13.33 to $18.48, but were listed as $15.36 on the eMARS payment document. The actual hours invoiced totaled 177.75, but were reported as 173.87 hours in eMARS to force the invoice total to agree.

Auditors also noted instances in which invoiced rates paid to temporary agencies did not agree with rates in the executed contracts. Of the four temporary agency contracts reviewed, only one contract listed the specific rates for each work category. The remaining three contracts outlined the markup to be applied to the base pay rate. One invoice showed job descriptions for food handlers, event level workers, and catering, in which KHP was invoiced $14.14 per hour. However, the contracted rates for these positions ranged from $12 per hour to $13.30 per hour. In this instance, the eMARS payment identified the rate as listed in the contract; however, the actual hours were adjusted in eMARS to disguise the payment of a higher rate.

Overtime was paid for employees in all four temporary agencies. However, no documentation of management approval was obtained. Auditors inquired about this with KHP personnel, who identified no record of authorization for overtime worked by temporary employees.

KHP’s poor internal control environment and lack of adequate monitoring and review procedures allowed questionable practices to occur at KHP resulting in potential waste, fraud, and abuse. These practices obscured actual temporary employee hours, and also obscured that KHP paid temporary agencies higher rates than it was contractually required to pay. It is unclear whether KHP management utilized this practice as a way to circumvent hiring requirements, including salary limitations, or if this practice developed out of convenience as a way to avoid the more lengthy state hiring process. Information included in the state’s financial reporting system was altered to fit contractual pay rates, and therefore did not agree to supporting documentation. This practice is misleading and unethical.

This practice misrepresents the true activity that occurred and fails to meet a basic level of transparency that is incumbent upon all government agencies when spending taxpayer dollars. It also greatly impairs the ability for analysis, oversight, and accountability.

Recommendations

We recommend:

- KHP management perform an analysis of temporary employees utilized in positions that are intended to be long-term. Based on the results of this analysis, KHP should establish the needed positions using the appropriate mechanism that complies with state contracting or employment laws.
- KHP review contracts periodically and update them as appropriate. Under no circumstance should KHP pay temporary agencies or other vendors amounts in excess of contractual agreements. As such, KHP management should ensure that future payments for contractual services are made in accordance with the written contract, which documents the responsibilities of each party, the nature of the services, and the associated compensation for services.
- KHP management should also ensure that staff are appropriately trained on processing invoices and other business office operations. This should include ensuring invoices processed in eMARS agree to invoiced information to the extent practicable. KHP staff should not falsely modify payment details such as rates, hours, and positions.

APPENDICES

Appendices

Appendix A – Discrepancy Between eMARS and Temporary Agency Invoice

eMARS Payment Request

Kentucky UNBRIDLED SPIRIT

Commonwealth of Kentucky
PAYMENT REQUEST

Page: 1 of 1

Doc ID No: [redacted] version 1 | Total
Doc Description: TEMP LABOR FOR FOOD SERVICE | 913.46
Budget Fiscal Year: Fiscal Year: Period:

Release Date: 2016-06-02 | Received Date: 2016-06-02
Cited Authority: FAP111-35-00-G | Scheduled Payment Date: 06/02/2016
Competitive Sealed Bidding-Goods

5-9

VENDOR [redacted]

Referenced Agreement No: MA [redacted]

Vendor Invoice No: 68075112

Vendor Invoice Date: 2016-05-09

Line	Vendor Invoice No	Quantity	UOM	Unit Price	Contract Amt	Fund	Dept	Unit	Func	SFunc	Obj	Mjr Pg	Program	PPC	Total Price
1	[redacted]	86.01	HR	10.62	$0.00	2900	665	1530	NA00		E191				913.46

CL Description: Food Service Worker HIGH RATE

[redacted]

Source: Kentucky Horse Park

Appendices

Appendix A - Discrepancy Between eMARS and Temporary Agency Invoice (Continued)

Temporary Agency Invoice

[redacted]

PAGE 1 of 1

ORIGINAL INVOICE

INVOICE #:	68075112
INVOICE DATE:	05/09/2016
AMOUNT DUE:	$913.46
CUSTOMER #:	[redacted]
BILL TO ID:	
OFFICE ID:	
PO #:	
TAX ID #:	[redacted]

RETURN SERVICE REQUESTED

COMMONWEALTH OF KENTUCKY
[redacted] KY HORSE PARK
KENTUCKY HORSE PARK
4089 IRON WORKS PKWY
LEXINGTON KY 40511

[redacted]

NAME	WEEK END DATE	DESCRIPTION	LABOR TYPE	HOURS	RATE	TAX	TOTAL W/ TAX	TRANSACTION NUMBER
[redacted] Approved on 05/09/2016 [redacted]	05/08/2016	KHP FOOD SERVC WRKR	REG	39.75	$22.98	$0.00	$913.46	[redacted]
				39.75		$0.00	$913.46	
SUBTOTAL FOR: [redacted]				39.75		$0.00	$913.46	

[redacted]

Open Invoice Status for Bill To ID [redacted] of 05/08/2016. This invoice is not included in the summary below.

1-30 Days	31-60 Days	61-90 Days	91-120 Days	121-150 Days	Over 151 Days
$110,365.45	$38,896.13	$0.00	$6,424.51	$8,204.17	$17,366.32

This represents the outstanding balance for this bill to only. There may be additional balances for other bill to's associated with this customer
If copies of outstanding invoices are required, please contact [redacted]

Except as otherwise provided in a current written agreement between the parties, Invoice payments are due in full upon receipt. Please pay invoices promptly to avoid late fees and/or interest charges. After payments are made, any disputes must be communicated within 60 days from the invoice date. In the event that you do not dispute the invoiced amounts within (60) days of invoice date the billed amounts will be deemed accurate.

---------------- Detach Here ---------------- Detach Here ----------------

[redacted]

TAX ID #: [redacted]

CUSTOMER SERVICE : [redacted]

COMMONWEALTH OF KENTUCKY
[redacted] KY HORSE PARK
KENTUCKY HORSE PARK
4089 IRON WORKS PKWY
LEXINGTON KY 40511

Please Include This Portion With Your Payment

PAYMENT ADVICE

Amount Due:	**$913.46**
Customer Number:	[redacted]
Invoice Date:	05/09/2016
Invoice Number:	**68075112**
Payment Terms:	PAYABLE UPON RECEIPT

Please check this box if change of address is required and fill in the appropriate information in space provided

☐ Company Name
Bill To Name
Bill To Address
City,State,Zip

To receive Invoices via email or to update an existing email address check the box and enter the new email address

☐ Email Address

[redacted]

Source: Kentucky Horse Park Files

KENTUCKY HORSE PARK'S MANAGEMENT RESPONSE

KENTUCKY HORSE PARK

Matthew G. Bevin
GOVERNOR

Don Parkinson
CABINET SECRETARY

Regina Stivers
DEPUTY SECRETARY

Laura Prewitt
EXECUTIVE DIRECTOR

February 17, 2017

Mike Harmon, Auditor of Public Accounts
209 St. Clair Street.
Frankfort, KY 40601

Dear Mr. Harmon,

Please find attached the Kentucky Horse Park's Audit Response for your review. We sincerely appreciate the support and cooperativeness of your team during this process. While we have addressed many of these findings, we look forward to working towards a resolution to the remaining items to ensure the Kentucky Horse Park is compliant with all state laws and procedures.

Sincerely,

Laura Prewitt

Laura Prewitt
Executive Director
Kentucky Horse Park

KENTUCKY HORSE PARK

Matthew G. Bevin
GOVERNOR

Don Parkinson
CABINET SECRETARY

Regina Stivers
DEPUTY SECRETARY

Laura Prewitt
EXECUTIVE DIRECTOR

KENTUCKY HORSE PARK AUDIT RESPONSE

FEBRUARY 17, 2017

Finding 1: Kentucky Horse Park Management Did Not Analyze Fiscal Operations, Which Resulted In Budget Deficits and Required More Than $24.8 Million In General Fund Subsidies Over The Past 10 Fiscal Years

KHP Response:

Analysis of Fiscal Operations: KHP management continues to analyze costs for all revenue-generating departments. Management is in process of determining utility costs associated with each venue during every event and an analysis of food and beverage service operations are currently underway; these studies include but are not limited to profit/loss statements, inventory management protocols, and staffing issues. Policies and procedures are being reviewed and updated for all departments, including food and beverage, to ensure proper oversight is in place. Online reservations and reporting for the KHP campground currently resides with The Department of Parks. Moving forward management will request this documentation for retention and review.

Finding 2: KHP Venue Rental And Food Services Contracts Were Not Managed Properly, Which Led To Undocumented Discounts, Misapplied Rental Rates, Billing Errors, And Sponsor Perks

KHP Response:

Rental and Food Services Contracts: Management is currently reviewing all contracts and rates for 2017. Management has worked diligently to get all contracts to published rack rates (for facility and equipment rental), which were approved by the Kentucky Horse Park Commission in fall of 2015. Policies and procedures are/will be in place going forward relating to contracts, including: deposits, discounts, inspections, and invoicing. Food service procedures are currently being updated to ensure proper rates and reporting are in compliance. KHP will continue to implement and update internal controls related to billings and accounts receivables to manage food service contracts going forward. Management is working on a policy for discounts applicable to all events that are both competitive, consistent, and in the best interests of the park. These discounts will be presented to the Kentucky Horse Park Commission for review.

Finding 3: KHP's Procurement Practices Led To Improper Vendor Selection That Created Potential Conflicts Of Interest

KHP Response:

Procurement practices with potential conflicts of interest: KHP management has reviewed and updated procurement policies and procedures, which have been distributed to all employees that are involved in the purchase of goods or services. Management continues to identify all improper vendor relationships and has discontinued use of vendors accordingly. Management will continue to review all vendors and contracts to ensure that procurement procedures are being followed to avoid conflicts of interest going forward. Contractual duties of negotiation and execution of contracts have been divided amongst employees to add an additional check on

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procedures and conflicts of interest. Furthermore, Management is working with the Office of Procurement Services to ensure all polices are up to date and proper training is provided to employees to comply with state law.

Finding 4: Examination Of KHP Billings Identified Further Potential Conflicts of Interest Or Favoritism Related To Certain Event Organizers

KHP Response:

Favoritism related to event organizers: Management is currently working on short-term agreements for temporary storage on KHP grounds. Some of these items have been removed and going forward, all personal items unrelated to events or KHP operations will be removed from the park. As noted in finding #2, management is working on policy discounts for event contracts that will be reviewed by the Kentucky Horse Park Commission, allowing for temporary storage for events as part of the contract.

Finding 5: KHP Did Not Comply With State Requirements Related To Sponsorships, Including One Sponsorship Arrangement That Provided Personal Benefits To KHP Management

KHP Response:

Compliance with state requirements regarding sponsorships: Current management identified that personal benefits with sponsorships are not allowed by the state and immediately discontinued use of vehicles that were being driven for personal use. Sponsorship solicitation and fulfillment for the Kentucky Horse Park is being managed by a dedicated, full-time staff member employed by the park/Commonwealth of Kentucky. Management has reached out to support agencies in state government for continued guidance and compliance as it pertains to procuring sponsorships and have updated KHP's procedures accordingly. Management will continue to work with Office of Procurement Services (OPS) regarding updates and amendments in all sponsorship and procurement policies.

Finding 6: KHP Did Not Properly Procure Food Service Concessionaires And Did Not Execute Written Agreements With On-site Attractions

KHP Response:

Food Service Concessionaires and Written Agreements: Current management identified that the full-time concessionaires on the park were not properly procured by state law. KHP is currently working to submit bids through OPS to comply with all statutory and regulatory requirements. The park is currently reviewing all food service concessionaires to determine the most effective options that benefit the park. KHP will review all agreements between entities leasing property on the park to determine if the agreement is in the best interests of the park and what amendments are necessary.

KENTUCKY HORSE PARK

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<u>Finding 7</u>: KHP Did Not Maintain An Effective Line Of Separation From The Kentucky Horse Park Foundation

KHP Response:

Effective Separation from the KHP Foundation: Current management is working with the foundation to ensure all employees follow state law and eliminate any influence by the foundation as it pertains to procurement and employment decisions. Management agrees that beginning immediately, the park will no longer provide no-cost or discounted benefits to the foundation through vendors, event organizers, or others affiliates. KHP has already begun negotiating the 2017 agreement with the foundation regarding the Southern Lights event to include reimbursement to the park for all costs associated with the event. Management will work with the Office of Legal Affairs on a memorandum of understanding between the park and the foundation to ensure proper segregation between the two entities.

<u>Finding 8</u>: KHP's Poor Control Environment Led to Questionable Hiring Practices Utilizing Temporary Employment Agencies

KHP Response:

Poor control over utilizing temporary employment agencies: KHP encompasses over 1200 acres and operates as an active horse farm, in addition to being a tourist attraction and event center. The park has full-time mounted police for security and over 80 stabled horses. Management is currently budgeted for 77 full time and 62 interim employees from the state. This allows us to cover several areas throughout the park but leaves several gaps, particularly in food and beverage and maintenance.

Due to several law changes over the years at the federal and state level, it has been determined that using temporary labor agencies is the most cost-effective way to cover the labor shortage. Using state interim positions for food service or maintenance is not effective due to the limits set on these employees, such as term of employment and hours worked. KHP is currently working with the temporary agencies to update agreements that benefit the park going forward. Management is aware of the overtime that some temporary employees worked during the audit period; going forward management has updated policy and procedures to ensure this practice does not continue. Should some temporary employees get overtime, management will require documented approval.