



ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

December 16, 2015

Mayor Les Stapleton
200 North Lake Drive
Prestonsburg, KY 41653

The Auditor of Public Accounts (APA) has completed its examination of the City of Prestonsburg (City). This letter summarizes the procedures performed and communicates the results of those procedures.

The purpose of this examination was not to provide an opinion on the City's financial statements, but to examine serious allegations communicated to this office. The examination procedures primarily covered periods pertinent to specific events identified in this letter, which primarily occurred between July 1, 2010 and June 30, 2015, unless otherwise noted.

Examination procedures included examining ledgers, expenditure transactions and available supporting documentation; reviewing minutes and recordings of City council meetings; and examining additional financial activity related to the City. Auditors also interviewed certain City employees and other individuals as deemed necessary to confirm or corroborate information gathered during the examination.

Detailed findings and recommendations based on our examination are attached to this letter to assist all parties involved in improving policies and procedures, corrective action, and further examination. The City's response is also attached to this letter. Overall, these findings identify serious concerns with regards to conflicts of interest involving a former official, lack of appropriate policies and procedures leading to questionable expenditures or donations some of which are personal in nature that were not reimbursed by employees, and failures to follow bid requirements. Due to the seriousness of these matters, these findings will be referred to the Kentucky State Police, the Kentucky Office of the Attorney General, and the local Ethics Board.

We appreciate the cooperation provided during the examination from the City. If you have any questions or wish to discuss this report further, contact me or Libby Carlin, Assistant Auditor of Public Accounts.

Sincerely,

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

Adam H. Edelen
Auditor of Public Accounts

c: Prestonsburg City Council Members

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FINDINGS AND RECOMMENDATIONS

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS**

FINDING 2015-001: The Former Mayor's Personal Involvement In Property Transactions He Had Influence Over In His Professional Capacity Created A Conflict Of Interest

On December 13, 2001, the City entered into an agreement to transfer 100 acres of property at Cliff to the Prestonsburg Industrial Corporation (PIC). The agreement states that PIC will design and develop the Cliff property not to exceed 19 acres, and the remaining property would be sold. The agreement stated the City would receive \$5,000 for each acre of land sold.

The auditors were unable to determine if PIC paid the City any money for land sales. Beginning on January 12, 2005 through August 25, 2009, the former mayor personally purchased several tracts of land from the PIC by three separate deeds for a total of \$3,000. The total size of the land was approximately two acres. This purchase price was \$7,000 less than the amount \$5,000 per acre stated in the agreement, which raises questions as to whether the former mayor received financial benefit as a result of his relationship with the PIC.

Several years later, the property was discussed by the City council again because the Floyd County Emergency and Rescue Squad (Rescue Squad) began looking for property to build a larger facility. Citing the Rescue Squad's inability to receive state or federal grant funds directly, the City agreed to enter into a \$200,000 grant agreement with the Kentucky Department for Local Government (DLG) on behalf of the Rescue Squad. Of these funds, \$100,000 was for the purchase of property for a building site, and the remaining \$100,000 was for the Rescue Squad Building Fund.

The City received \$100,000 of the grant proceeds from DLG and passed these funds to the Rescue Squad to pay for the property. On December 28, 2012, the former mayor sold the three tracts of land he purchased at Cliff to the Rescue Squad for \$100,000, which is \$97,000 more than the former mayor paid for the tracts between 2005 and 2009. The Rescue Squad paid the former mayor \$35,000 on January 23, 2013, and the balance of \$65,000 on August 2, 2013. The Rescue Squad captain who oversaw the project is also a City councilman. The councilman stated he did not know how much the former mayor paid for the property at Cliff. He also stated that he considered several other properties before purchasing the property from the former mayor.

It should also be noted that during this same time frame, the former mayor signed a deed dated December 19, 2012, on behalf of the City to donate to the Rescue Squad the City-owned building it was already using. Nine days later, on December 28, 2012, the former mayor, as a private individual, signed a contract for purchase of real estate with the Rescue Squad Captain/City Councilman, which contained language for an option on the building that the City had just donated to the Rescue Squad. In the event the Rescue Squad could not sell the donated building within six months to obtain the additional \$65,000 as noted above, this formerly owned City property would transfer to the former mayor as the balance due for the Cliff property transaction. This being said, the former mayor had two avenues to remedy himself of the Cliff property by either (1) the Rescue Squad selling the property itself and/or transferring the property to the former mayor, or (2) through the acquisition of DLG grant funding to pay for it.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-001: The Former Mayor's Personal Involvement In Property Transactions He Had Influence Over In His Professional Capacity Created A Conflict Of Interest (Continued)

Based on the circumstances of the Cliff property transactions, the former mayor was involved in both personally and in his official capacity in the transactions. This created a conflict of interest given that the mayor appears to have personally benefitted from his official position, both in having the opportunity to purchase property at a lower cost than it was intended to be sold to the public and by having knowledge of and influence over the Rescue Squad's purchase of his personal property, including providing City assistance in acquiring grant funding that he personally received, in part.

According to the Kentucky League of Cities City Officials Legal Handbook "No elected or nonelected officer of employee shall act in his or her official capacity in any matter where the officer or employee, a family member, or any business organization in which the officer or employee has a direct or indirect financial or personal involvement that might reasonably be expected to impair his or her objectivity, independence, or judgment.

Recommendations

In the future, we recommend that City officials avoid circumstances in which they may personally benefit from City transactions. The City may develop policies to make exceptions in certain circumstances, but the policy should ensure that any exceptions are clear that the official should not have an ability to receive any benefit that is not available to the public, such as rights to buy/sell property before public announcement or discounts or other favorable terms not offered to the public.

Additionally, we recommend that in all such cases involving an official, the official recuse himself of decision making related to the activity or property, and the City attorney review the matters and advise the official and the City council on the propriety of the potential transaction. Additionally, we recommend that the local Ethics Board review this matter to determine whether the former mayor violated the City's Code of Ethics.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-002: The Former Mayor Directed The Fire Department To Perform A Controlled Burn Without Submitting Appropriate Applications And There Is A Risk The Former Mayor May Have Accepted A Gift Valued More Than \$100

According to dispatch records of the Prestonsburg Fire Department, firefighters were on detail to an abandoned farm supply building that sits adjacent to an ambulance service on June 8, 2013. According to firefighters on the scene, they were instructed by the former mayor to report to the location for a controlled burn of a standing structure. However, the process for conducting a legally controlled burn for a standing structure is to file an application with the Kentucky Division for Air Quality for fire training, and an application for live fire training with the Kentucky Fire Commission. A copy of these applications should be maintained by the fire department. However, auditors were informed that there was no evidence in the fire department that these applications were completed.

During the examination, allegations were made that the former mayor may have received personal compensation in the form of a Chevrolet Tahoe for his efforts in assisting with the building demolition.

According to the Floyd County Property Valuation records and Floyd County Clerk's office, the property where this structure was burned is currently owned by an individual but the property's tax bill is being mailed to an adjacent ambulance service owner. In assessing the validity of this allegation, the following information was found:

- Information obtained from the Kentucky Transportation Cabinet identified that the Tahoe belonged to an unrelated third party (former Tahoe owner).
- The former Tahoe owner stated the lien on the Tahoe for more than \$10,000 was paid by an individual associated with the ambulance service located adjacent to the former farm supply building.
- The Tahoe was not transferred to the individual that paid the lien, but instead was transferred to the former mayor on May 8, 2014.

Although auditors did not find detailed evidence that the Tahoe was specifically related to the controlled burn, the fact pattern does establish a potential risk that it was given to the former mayor as a gift since a third party paid for the lien on the Tahoe, even though it was directly transferred to the former mayor.

The City's Code of Ethics Ordinance 13-94 Section 7 states that "no officer or employee of the city or any city agency shall directly, or indirectly through any other person or business, solicit or accept any gift having a fair market value of more than (\$100), whether in the form of money, thing or promise, or any other form, under circumstances in which it could reasonably be expected to influence the officer or employee in the performance of his or her public duties."

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-002: The Former Mayor Directed The Fire Department To Perform A Controlled Burn Without Submitting Appropriate Applications And There Is A Risk The Former Mayor May Have Accepted A Gift Valued More Than \$100 (Continued)

Recommendations

We recommend that this finding be reviewed by the local Ethics Board. Also, we recommend periodic training should be provided to officials and employees to ensure they have a good understanding of the City's Ethics Code. Additionally, the Prestonsburg Fire Department should ensure that appropriate applications are made and maintained on file for fire training.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-003: The Former Mayor Accepted A Gift Prohibited By The City's Code of Ethics

During the June 30, 2010 City council meeting, the council voted to submit a bid of \$300,000 to purchase a vacant elementary school and lot from the Floyd County Board of Education. However, the City was unsuccessful in its bid due to being outbid by the current property owner for \$500,000. Evidence indicated the successful bidder was an individual that had been a partner of the former mayor's in another land transaction.

Subsequently, during the February 10, 2014 meeting, there was discussion that the City was trying to purchase the now-vacant lot for \$1,000,000. A City councilman brought it to the attention of the attendees that the mayor had interest in the property since he had received money from the scrapping of metal from the school building that was once on this lot, and that they were paying twice as much for the property now than when it was purchased in 2010. During this discussion, the former mayor acknowledged that he received scrap metal from a vacant elementary school as a gift.

The City's Code of Ethics Ordinance 13-94 Section 7 states, "no officer or employee of the City or any City agency shall directly, or indirectly through any other person or business, solicit or accept any gift having a fair market value of more than (\$100), whether in the form of money, thing or promise, or any other form, under circumstances in which it could reasonably be expected to influence the officer or employee in the performance of his or her public duties."

According to the Kentucky League of Cities City Officials Legal Handbook "No elected or nonelected officer or employee shall act in his or her official capacity in any matter where the officer or employee, a family member, or any business organization in which the officer or employee has a direct or indirect financial or personal involvement that might reasonably be expected to impair his or her objectivity, independence, or judgment.

Recommendations

We recommend this finding be reviewed by the local Ethics Board. All City officials and employees should adhere to gift limitations outlined in the City's Code of Ethics. Also, we recommend periodic training should be provided officials and employees to ensure they have a good understanding of the City's Ethics Code.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-004: The Former Mayor Contributed City Resources To A Private Professional Arena Football Team Of Which He Was A Member, And Questions Over This And Other Spending Led To A Loss Of Grant Funds For The Prestonsburg Senior Citizen Center

The former mayor authorized expenditures of City funds totaling \$7,835 for a professional indoor football team based in Pikeville, Kentucky, of which he was a member. The payments made were in the form of checks paid directly to the team, in lodging costs paid on behalf of the team, or in gas costs charged to the City's gas card for transporting the team to games.

Ten checks totaling \$4,750 were written from bank accounts of the City to the team. Below is a detail of checks written to the team from the City's bank accounts:

<u>Date</u>	<u>Check No.</u>	<u>Amount</u>	<u>Account Written From</u>
5/24/2012	9435	\$ 300.00	Mountain Arts Center
1/7/2013	10318	400.00	Mountain Arts Center
2/2/2012	8270	200.00	General Fund
1/23/2013	9319	1,350.00	General Fund
1/28/2013	1261	500.00	911 Wireline
1/29/2013	1094	500.00	Fire Department Support
1/28/2013	1010	500.00	Parking Fund
1/28/2013	4140	500.00	Stonecrest
3/12/2013	5893	250.00	Tourism
1/28/2013	5870	250.00	Tourism
	Total	\$ 4,750.00	

In addition to the checks above written directly to the team, other expenses were also paid on behalf of the team using City accounts. The rental of two cabins for 35 days, from March 25th, 2013 through April 28th, 2013, was paid from the City's Senior Fund in the amount of \$2,500. Auditors were able to confirm these cabins were used by the team during their season.

Additionally, during the examination auditors found that the United Way of Eastern Kentucky, a nonprofit charitable organization that provides funding to the City's Senior Fund to be used for the Meals on Wheels program, expressed concerns regarding the \$2,500 check written to a local theater organization. The former mayor acknowledged the payment from the Senior Fund, and indicated it was a donation. Auditors confirmed this was the same payment made for the cabin rentals. During the examination, auditors learned that due to this and other concerns regarding the use of grant funds, the United Way ultimately voided its 2014 Grant Allocation to the Prestonsburg Senior Citizens Center and revoked the 2015 Grant.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-004: The Former Mayor Contributed City Resources To A Private Professional Arena Football Team Of Which He Was A Member, And Questions Over This And Other Spending Led To A Loss Of Grant Funds For The Prestonsburg Senior Citizen Center (Continued)

Also, according to a taped City council meeting, the former mayor said that during the team's football season, the City's Senior Citizens Center vans were used to transport the team to at least one of their games. Records indicate two of the vans were utilized during the season by the team, and two City Senior Citizens Center employees were paid to drive the team to a game in Port Huron, Michigan on Saturday, April 21, 2013. Auditors interviewed one of the drivers who transported the team to the Port Huron game and confirmed that the Senior Citizens Center vans were used and that they were paid to do so.

It also appears that during four away games the City's gas card was used by the team since during the days of the away games there was gas charged to the card in a city near the destination of the games. Although auditors could not determine the amount paid to drivers for the use of the senior citizen vans for the Port Huron game, below is a detail of gas charges found on the City's card for the four away games:

<u>Date</u>	<u>Opponent</u>	<u>Amount Charged</u>
2/8/2013	Owensboro Rage	\$ 68.66
3/1/2013	Kentucky Xtreme	51.43
3/17/2013	Dayton Sharks	265.37
4/21/2013	Port Huron Patriots	199.60
	Total	\$ 585.06

Any donations made to a private entity must meet three factors according to the Kentucky League of Cities Handbook.

- 1.) The city must receive benefit from the appropriation, and the activity must be one in which the city could independently engage.
- 2.) The city must have control over either the organization itself or how the money is being spent.
- 3.) The expenditure must primarily benefit the public at-large rather than just a private entity.

Auditors were unable to determine how the City met any of these criteria. Additionally, it appears that the former mayor benefitted from these payments as a member of the team, which indicates a conflict of interest.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-004: The Former Mayor Contributed City Resources To A Private Professional Arena Football Team Of Which He Was A Member, And Questions Over This And Other Spending Led To A Loss Of Grant Funds For The Prestonsburg Senior Citizen Center (Continued)

Recommendations

The City should refrain from making appropriations to private entities unless it can document that the City receives a benefit and can independently engage in the activity, that the City has control over the entity or how the money is spent by entering into a written agreement with the private entity addressing how any funds will be spent, and how it will benefit the City in return.

Also, the appropriation must primarily benefit the public at-large, not solely specific individuals or the private entity. Additionally, to avoid potential conflicts of interest, the City should request guidance from the City attorney prior to making appropriations to an entity and ensure that the relationship between the entity and the employee is properly disclosed.

Also, the City should implement procedures to ensure all grant funds and contributions from charitable organizations are used solely for the purposes for which they are intended.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-005: The City Failed To Competitively Bid Construction Work Performed By A Single Contractor On At Least Two Occasions

The examination identified two construction projects performed by the same contractor that were not bid by the City. Both projects exceeded the \$20,000 expenditure amount, which triggers bid requirements.

The first construction project was for the construction of two 80' by 324' awnings at the Stone Crest Golf Course. The City expended \$137,240 for this project, with \$105,620 of this amount being paid directly to the contractor. The additional \$31,620 was expended for materials. Auditors were unable to find an advertisement for bids, or other documentation verifying this work went through a competitive process.

The second construction project related to sidewalk work. The contractor was paid \$112,225 in labor charges alone for the work completed in 2012. Based on an examination of the invoices, it appears the City attempted to split the sidewalk work into separate projects to avoid bidding requirements.

According to the City Official's Legal Handbook, because the Prestonsburg City Council had not adopted the provisions of the Local Model Procurement Code, "it must advertise pursuant to KRS 424.260 for bids for any contract, lease, or other agreement for materials, supplies, equipment, or nonprofessional services that involve expenditures in excess of \$20,000."

Also, the handbook states, "Where the purchaser can reasonably anticipate the aggregated costs of materials, supplies, and/or services relating to one project will exceed \$20,000 limit, the purchaser must advertise for bids. The purchaser must act in good faith and not attempt to "split" contracts to avoid bidding requirements."

Recommendations

We recommend the City implement procedures to ensure all expenditures expected to exceed \$20,000 are properly bid, as required by KRS and local ordinance.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-006: Appropriate Supporting Documentation Was Not Maintained For Travel And Other Expenditures Which Appear To Be Personal In Nature

An examination of expenditures identified travel reimbursements, including meal and hotel expenditures, did not have sufficient supporting documentation, including documentation supporting that the expenditures were for training events or other legitimate business purposes. Also, payments were identified that appeared to be personal in nature for the former mayor. The following weaknesses were noted:

- Two City checks written to two hotels (1) October 10, 2013 for \$918.45 and (2) February 25, 2014 for \$914.85 didn't have a receipt or invoice from the hotels to support the expenditure.
- Of the 20 expense checks tested reportedly related to training events, 19 of the payments totaling approximately \$3,744 did not have any documentation to support the expenditures. Purchase orders were available, but these documents did not provide any details about training locations or dates. Based on the City's policy, meal per diems should be at the state rate of \$25 per day. However, the policy also requires an overnight stay in order to receive a per diem, and no documentation existed to show whether the event involved an overnight stay to qualify.
- Records indicate that the former mayor paid 3 years worth of HVAC and Journeyman license renewals using City funds. The HVAC and Master/Journeyman licenses were unrelated to his professional capacity as mayor, and therefore, it is not clear how this is a legitimate business expense for the City to incur. Detail of the payments are:

<u>Check Date</u>	<u>Description</u>	<u>Amount</u>
2/20/2012	2012 License Renewal	\$ 300
2/20/2012	2012 Master & Journeyman Renewal	300
2/19/2013	2013 License Renewal	300
2/19/2013	2013 Master & Journeyman Renewal	300
2/20/2014	2014 License Renewal	300
2/20/2014	2013 Master & Journeyman Renewal	300
	Total	\$ 1,800

The City's Employee Personnel Handbook provides guidelines for expense reimbursements for travel, follows:

- Room / Lodging costs: reimbursements shall be made for actual room cost if lodging is not otherwise provided.
- Meal Costs: reimbursements shall be made at a per-day rate equal to that paid by state.
- These reimbursements shall only be made for travel requiring an employee to be away from home overnight and further than 50 miles from work address (City Hall).

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-006: Appropriate Supporting Documentation Was Not Maintained For Travel And Other Expenditures Which Appear To Be Personal In Nature (Continued)

- Automobile expense: When official travel by personal vehicle is required, reimbursements shall be made a per-mile rate as equal to that paid by state government.
- Other related expenses: Reimbursement for actual amount of receipt

No documentation was located authorizing the former mayor's personal expenses related to the renewal of his HVAC and Master/Journeyman licenses. The Kentucky League of Cities states that public funds may only be spent for public purposes. Since this expenditure was solely for the purpose of the former mayor, it does not meet this requirement.

Recommendations

The City should implement procedures to obtain and maintain detailed documentation for all travel related expenditures. This should include maintaining evidence that the employee attended the training event or other event that has a legitimate business purpose for the City, such as a training agenda, attendance record, and/or registration form. Except in the case of per diems, appropriate receipts should be maintained showing locations, dates, and details of the travel expense.

Personal expenses without a legitimate business purpose for the City should not be paid. The City should follow the Kentucky League of Cities guidance in paying only for public purpose expenditures with public funds.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-007: Employee Payroll Advances Were Not Fully Reimbursed By A Former Employee And Payroll Advances Were Authorized After The City Council Voted To Cease The Practice

During the period under review, all City employees were given an opportunity to receive payroll advances until the City council voted to stop all payroll advances in its March 24, 2014 meeting. The council's decision was because the City's annual financial audit at the time commented on the practice. During the examination, weaknesses were identified related to the payroll advances, both before and after the council's vote to cease the practice.

First, records indicate the former City comptroller received payroll advances, but did not repay all amounts owed. City policy did not limit the amount of payroll advances and did not require the employee to repay a previous advance prior to obtaining another one. During the examination, auditors reviewed a list of checks made payable to the former City comptroller. There were no invoices or other supporting documentation for these payments, although the payment description identified the payments to be payroll advances. Since 2004, the former City comptroller received \$15,250 in payroll advances. However, reimbursements paid by the former City comptroller, through both payroll deductions and payments posted to a separate bank account, identified only \$13,325 was paid back, leaving \$1,925 still outstanding and due to the City.

Second, several months after the council voted to cease the practice of payroll advances, a check was written to a City employee for \$1,000 as a payroll advance. The human resources manager signed a statement that the former mayor authorized the payroll advance so that the employee could purchase a vehicle from the former mayor. The former mayor requested the advance be paid even after the human resources manager reminded him that it was not allowed since the auditors recommended and City council voted to cease the practice. During the examination, the employee confirmed that the \$1,000 advance was used to purchase a vehicle from the former mayor. Therefore, it appears the former mayor circumvented the City policies by authorizing the transaction. Also, this created an apparent conflict of interest since the decision of the former mayor benefitted him personally.

Recommendations

The City should take action to recoup all salary advance reimbursements still owed by current and former City employees.

Also, the City officials should adhere to the vote of the City council to cease the practice of providing employee salary advances. In the situation noted above, the human resources manager acted properly and is to be commended for documenting the former mayor's directive to override the City policy and reminding the mayor that the practice is not allowed. The City should implement procedures for employees to report egregious concerns regarding potential wrongdoing, noncompliances, and/or acts of potential waste, fraud or abuse to a responsible party, such as the City attorney. Officials should abide by issues voted by the governing body when the matters are within that body's purview.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-008: The City Failed To Obtain Proper Reimbursement From Employees For City Paid Cell Phone Plans Obtained For Their Family Members

Between July 1, 2010 and June 30, 2015, there were 7 cell phones included on the MAC's Appalachian Wireless account. These phones included the former City comptroller and her spouse and child, the MAC executive director and his wife, and the MAC general manager and child. The cost of the cell phones for the employees' spouses and children were to be withheld from the employees' payroll each pay period. During the examination, records indicated that the full amounts owed by the employees were not withheld. The discrepancies are noted below:

<u>Cell Phone Account</u>	<u>Total Cost</u>	<u>Amount Withheld from Employees' Payroll</u>	<u>Amount Under Paid by Employee</u>
Former Comptroller's Spouse and Child	\$ 4,198.45	\$ 3,064.15	\$ 1,134.30
MAC Executive Director's Spouse	4,409.18	2,499.87	1,909.31
MAC General Manager's Child	3,608.47	3,310.13	298.34
	<u>\$12,216.10</u>	<u>\$ 8,874.15</u>	<u>\$ 3,341.95</u>

Recommendations

The City should take caution to ensure it is providing employee benefits consistently, such as family cell phone plans. A cell phone policy clarifying whether family cell phone plans may be added to the City's accounts, the reimbursement requirements, etc. should be prepared and provided to all employees.

Additionally, procedures should be implemented to ensure that any costs to be reimbursed by employees are properly reconciled and accounted for to ensure the City obtains all reimbursable expenses.

Finally, we recommend that the City seek reimbursement of these costs from the employees and former employees that under paid for these services.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-009: The Former City Comptroller Purchased Income Tax Software With City Funds, Installed The Software On City Resources, And Used City Time For Preparing Tax Returns For Individuals And Businesses

Records indicate the former City comptroller purchased income tax software six times between December 12, 2008 and June 3, 2014 totaling \$7,504. These expenses were paid from the City's Mountain Arts Center (MAC) account using the City's credit card. The examination found additional evidence indicating the former City comptroller installed the income tax software on two of the City's computers, one at the MAC and one at City Hall, and that tax returns were prepared for individuals and external businesses on City time.

The examination of one of the computers identified numerous tax return files, including at least 8 City employees, a business owned by a City employee, a business owned by the former Comptroller's family member, and several other individuals. Based on interviews with two City employees, the former City comptroller charged fees for the tax preparation services, with one of them paying the former City comptroller \$100 for the tax preparation service. Additionally, the two employees admitted their tax returns were completed on City time.

Documentation or other evidence was not found to justify how these expenditures were proper business purposes of the City, and appears to be personal in nature. According to OAG 99-5, expenditures must confer "a direct benefit of reasonably general character." The City did not implement proper internal controls over financial activities, including credit card expenditures. The former City comptroller appeared to have sole control over all accounting functions, including purchasing, preparing checks, signing checks and reconciling bank accounts. As a result, one employee was able to expend \$7,504 of City funds for income tax software without any official or employee questioning the validity of the expenditure.

Additionally, it appears the former City comptroller operated a tax preparation business utilizing City resources and City time. Although auditors could not determine the amount of time spent on these activities, records indicate it could be significant.

Recommendations

We recommend the City adopt a credit card policy that includes specific identification of unallowable expenditures, including a prohibition against all personal expenditures. Also, the policy should require:

- Appropriate supervisory approval prior to use;
- The credit card receipt be signed and reviewed by the employee's supervisor, and maintained as supporting documentation for the purchase;
- Finance staff to reconcile credit card receipts to the statements; and
- Employees are responsible for reimbursing the City for any unsupported expenditures.

Internal controls should be implemented to avoid the lack of segregated duties with the comptroller position to help reduce the risk of future undetected misuse of credit cards.

Additionally, the City should ensure all employees understand that City resources or time may not be used for personal gain. This policy should also be clear in the City's Code of Ethics.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-010: There Is Inadequate Supporting Documentation For \$8,300 Paid To The Former Comptroller's Spouse

The examination identified 10 checks written from the City's public accounts to the spouse of the former City comptroller, or his media consulting business. The checks were signed by two individuals; however, one of those signatures was the former City comptroller's. Between May 28, 2013 and March 14, 2014, the total paid to the former Comptroller's spouse was \$10,180. Only two of the 10 payments had invoices to support the payments. The following table provides additional details of the checks written:

<u>Check Date</u>	<u>Written To</u>	<u>Check From</u>	<u>Check Amount</u>
2/7/2014	Business of Former Comptroller's Spouse	Mountain Arts Center	\$ 950.00
2/14/2014	Business of Former Comptroller's Spouse	Mountain Arts Center	1,430.00 *
3/14/2014	Business of Former Comptroller's Spouse	Mountain Arts Center	450.00 *
11/15/2013	Former Comptroller's Spouse	Mountain Arts Center	1,025.00
5/28/2013	Former Comptroller's Spouse	Mountain Arts Center	250.00
10/23/2013	Business of Former Comptroller's Spouse	City of Prestonsburg	1,750.00
11/4/2013	Former Comptroller's Spouse	City of Prestonsburg	1,125.00
12/3/2013	Former Comptroller's Spouse	City of Prestonsburg	1,250.00
12/16/2013	Former Comptroller's Spouse	City of Prestonsburg	1,000.00
12/30/2013	Former Comptroller's Spouse	City of Prestonsburg	950.00
		Grand Total	<u>\$ 10,180.00</u>

*An Invoice was available for this payment.

Recommendations

Related party relationships may present a greater opportunity for collusion, concealment and fraud, which includes transactions with family members. Although implementing dual signatures is a good compensating control, the second signor in a dual system process should not sign checks without verifying and reviewing proper supporting documentation for the payment, including invoices, contracts, etc. All disbursements should have invoices to support the payments.

The City should implement a process for review of all transactions that ensures proper supporting documentation exists. Furthermore, the City should implement a policy on handling transactions with related parties to ensure that these types of transactions receive additional scrutiny and authorization. As a reminder to the City, all significant related party transactions should be disclosed in the City's financial statements.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-011: Checks For Prize Money Related To A City Sponsored Healthcare Initiative Were Written To Petty Cash And Were Written For More Than The Total Prizes

In 2013 and 2014, the City held a weight loss competition between employees, offering monetary prizes to the employees in each category that lost the most weight. For each of the two years, different prize amounts were awarded, as shown in the table below.

Healthcare Initiative Weight Loss Prize Offerings

2013	Categories			
	Women	Men	Teams	Total Available
1st Place	\$550	\$550	\$2,000	\$3,100
2nd Place	350	350	1,000	1,700
3rd Place	250	250	600	1,100
	\$ 1,150	\$ 1,150	\$ 3,600	\$5,900

2014	Categories			
	Women	Men	Teams	Total Available
1st Place	\$500	\$500	\$500	\$1,500
2nd Place	300	300		600
3rd Place	150	150		300
	\$ 950	\$ 950	\$ 500	\$2,400

The examination identified at the end of the 2013 competition, the former City comptroller wrote a check to herself as petty cash for \$6,000 in order to distribute the prize money in cash. However, this amount is \$100 more than the total prizes listed on the flyer for the 2013 competition. Also, at the conclusion of the 2014 competition, the former City comptroller wrote a check for \$3,000 for the prize money. However, the total prizes for the competition was advertised to be \$2,400, or a difference of \$600.

In both 2013 and 2014, there was no documentation to confirm that the stated winners received their cash payments, or in what amounts. Additionally, flyers could not be located for all other years that checks were written for the healthcare initiative, and therefore auditors were unable to confirm the amount of prize money advertised for the contest. Checks were written in the amount of \$2,500 in both June and December 2012.

Recommendations

If the City offers cash incentives for a healthcare competition in the future, it should write checks directly to the individual winners rather than provide cash payments. This not only decreases the risk of fraud or misappropriation related to cash disbursements, but also improves the documentation of the individuals receiving payments.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-012: The City Did Not Properly Withhold Supplemental Insurance Premiums From Employees, Resulting In Thousands Of Dollars Of Under Payments

The City pays health insurance premiums, life insurance, medical bridge and critical care for employees, their dependents and spouse if the spouse is not covered under their employer. Any other insurance benefit the employee obtains is voluntary, with premiums to be deducted through the payroll system.

Inquiry with City employees identified that City employees at the MAC also received dental and vision insurance, but that it was not being properly withheld from their checks. Evidence examined confirmed that the former City comptroller had not withheld premiums for dental and vision insurances, and also identified that premiums for other voluntary supplemental insurances were not being withheld correctly. Testing identified numerous withholding discrepancies of employees working at the MAC, as well as in City Hall, as identified in the tables below. It should be noted that this test was based on a sample selected for the period July 1, 2010 to June 30, 2015, and does not represent the entire population of City employees during that time. Therefore, it is likely that additional errors exist.

Employee	Insurance Agency A: Offering Dental, Vision, Term Life, and Critical Care Policies			Insurance Agency B: Offering Other Supplemental Insurance Policies			Net Total Under (Over) Paid Per Employee
	Total Supplemental Insurance	Amount Withheld From Employee	Difference Employee Under (Over) Paid	Total Supplemental Insurance	Amount Withheld From Employee	Difference Employee Under (Over) Paid	
Employee 1 - MAC	\$ 5,720.15	\$ (770.17)	\$ 4,949.98	\$ 1,820.96	\$ (1,619.52)	\$ 201.44	\$ 5,151.42
Employee 2 - MAC	1,877.18	(378.85)	1,498.33	4,007.80	(3,920.10)	87.70	1,586.03
Employee 3 - MAC	9,453.18	(5,834.16)	3,619.02	-	-	-	3,619.02
Employee 4 - MAC	949.48	(85.60)	863.88	1,664.32	(1,674.08)	(9.76)	854.12
Employee 5 - MAC	8,550.58	(910.42)	7,640.16	6,624.01	(3,742.80)	2,881.21	10,521.37
Employee 6 - MAC	6,694.44	(1,353.40)	5,341.04	4,356.92	(3,486.62)	870.30	6,211.34
Employee 7 - MAC	1,035.08	(85.60)	949.48	1,067.93	(1,034.56)	33.37	982.85
Employee 1 - City Hall	6,685.43	(5,814.47)	870.96	-	-	-	870.96
Employee 2 - City Hall	9,615.01	(12,980.28)	(3,365.27)	597.27	(500.04)	97.23	(3,268.04)
Employee 3 - City Hall	3,810.30	(2,297.01)	1,513.29	2,293.56	(2,139.28)	154.28	1,667.57
Employee 4 - City Hall	4,582.14	(3,618.48)	963.66	3,734.44	(3,734.10)	0.34	964.00
Employee 5 - City Hall	698.40	(657.00)	41.40	1,036.80	(1,097.60)	(60.80)	(19.40)
Employee 6 - City Hall	240.00	-	240.00	-	-	-	240.00
Employee 7 - City Hall	-	-	-	1,416.15	(1,416.12)	0.03	0.03
NET Amounts	\$ 59,911.37	\$ (34,785.44)	\$ 25,125.93	\$ 28,620.16	\$ (24,364.82)	\$ 4,255.34	\$ 29,381.27
			Total Overpaid by Employees			\$ (70.56)	\$ (3,287.44)
			Total Underpaid by Employees			\$ 4,325.90	\$ 32,668.71

Recommendations

Supplemental insurance premiums and withholdings should be closely monitored for changes. The City should immediately implement procedures to ensure employee withholdings are properly reconciled to ensure proper deductions. Additionally, the errors noted could be deemed unfair since some employees receive more employer-paid benefits than others. Finally, the City should work with the City Attorney to determine the most appropriate way to address amounts due to or from employees.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-013: The City's Records Indicate Donations To The MAC For \$25,000 For Show Sponsorships, When The Funds Were Actually Used To Pay Bonuses And/Or Salary Advances To City Employees

City records indicate that it donated \$25,000 from the Coal and Mineral Severance Fund to the Kentucky Opry, an entertainment organization that frequently performs at the MAC. The Opry sent the City two invoices, one in the amount of \$15,000, which stated the money was to be used to sponsor a show, and a second invoice for \$10,000, which also stated it was for a show sponsorship for the Kentucky Opry Junior Pros. According to the executive director of the MAC, who is also an emcee/performer of the Opry, the money the Opry received was actually a donation, which was used to pay him \$20,000. Auditors reviewed bank records, which listed a net payment of \$15,670 associated with this transaction.

Auditors also examined the Opry's records to determine how the additional \$5,000 of donated funds were used. Based on the Opry's records, the Opry gave a City employee a \$5,000 payroll advance in addition to paying the executive director of the MAC \$20,000. Auditors were unable to determine exactly how much of this payroll advance was repaid to the City. Additionally, at the time of this advance, City policy permitted salary advances, so it is unclear why the funds were transmitted to the Opry to pay this salary advance. The effect of this methodology was that it clouded transparency, and makes it difficult for the City to reconcile payroll advances authorized and amounts due from employees.

According to KRS 65.1575 (5), "If a nonprofit organization receives a gift from a local government, it shall maintain the financial records so as to be able to ascertain the use of the donated funds." Although the Opry's records were sufficient in identifying the use of City funds, it appears City funds were paid to the Opry to pay a bonus and a payroll advance to City employees. Although the MAC executive director also worked for the Opry, as a City employee, it is not permissible for him to receive a bonus from the City.

The Kentucky Constitution, Section 3, has been interpreted to mean that public employees may not receive bonuses. If the Opry would have liked to provide compensation to the executive director for his work with the Opry, those funds should come from private sources and not City funds.

Also, as noted in a previous finding, the Kentucky League of Cities – City Officials Legal Handbook identifies three factors to consider when donating funds:

- 1) The city must receive benefit from the appropriation, and the activity must be one in which the city could independently engage. If the city will not receive benefit or may not itself engage in the activity in question, then it is likely that the city could not donate funds to another organization to perform that activity.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-013: The City's Records Indicate Donations To The MAC For \$25,000 For Show Sponsorships, When The Funds Were Actually Used To Pay Bonuses And/Or Salary Advances To City Employees (Continued)

- 2) The city must have control over either the organization itself or how the money is being spent. If the city has no control over how the money is to be spent, then the appropriation will likely be held invalid. It would greatly increase the chances that an expenditure would be held valid if the city entered into a written agreement with the private entity addressing how any funds will be spent and what benefit the city will get in return for the donation. It is also advisable for the city to continue to monitor the results of the donation after it has occurred, to ensure the expenditure is truly serving the public purpose for which it was earmarked.
- 3) The expenditure must primarily benefit the public at large rather than just a private entity.

Recommendations

The City should implement the donation guidelines set forth in the Kentucky League of Cities - City Officials Legal Handbook. The City's donation to the Opry did not meet any of the three guidelines listed above. We recommend the City enter into a written agreement with all private entities when donating money, especially donations of this magnitude.

Also, the City should implement procedures to ensure that invoices are accurate before payment is made. The supporting documentation for the payments to the Opry was deceptive since the intent of the payments did not agree with the documented purposes of the payment.

Additional concerns regarding payroll advances are discussed in a separate finding.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-014: The Process Used For Paying Performers At The MAC Has Weak Controls And Creates A High Risk Of Waste, Fraud Or Abuse

During the examination, records indicated checks totaling \$28,500 were written to “cash” at the MAC. These checks were not written on standard MAC operating checks, but instead were counter checks containing only one signature instead of the standard dual signatures.

Auditors inquired with the current City mayor, who discussed the concerns with the MAC executive director. The MAC executive director then provided copies of cashier’s checks purchased with the cash that were written to artists for performing at the MAC.

Although performers may require payment in the form of cashier’s checks, the process used by the MAC of writing checks to cash first for the purchase of the cashier’s checks create a high risk of error, waste, or abuse. These risk factors are further increased because counter checks are used that require only one signature to authorize the payment.

Recommendations

The City should establish policies prohibiting employees from writing checks to cash. Additionally, any payment that does not fall within the standard operation procedures of the City should be carefully scrutinized to reduce the risk of waste, fraud, and abuse. This includes requiring dual signatures on all checks, and both signors reviewing the appropriate supporting documentation.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-015: The City Purchased A Structure Without Adequate Supporting Documentation And Without Knowing The Feasibility Of Its Intended Use

An old cabin was purchased from a local construction company in 2010 by the City's Tourism Commission for \$9,000. Upon inquiry, it was noted that the City had purchased the structure for possible use at the Middle Creek Battlefield site. However, it was later determined that the cabin could not be relocated to that site due to the location's flooding problems. As a result, the cabin was dismantled and the pieces currently sit in a shed on a trailer covered with a tarp. The City's Tourism Commission is still trying to decide where it can put the cabin.

The Tourism Commission voted to purchase the cabin at the February 23, 2010 meeting for \$9,000. The Tourism Commission paid a deposit of \$500 to the construction company on the same date. However, the supporting documentation for this deposit is an invoice dated December 17, 2010, nearly 10 months later. Additionally, the remaining \$8,500 purchase price for the cabin was paid by check on July 13, 2010. Again, the invoice for this payment is dated December 17, 2010.

The current mayor and a few council members indicated they believed that the purchase price was a little extravagant. However, auditors did not inspect the cabin, and were unable to determine its value. The most significant concerns relate to the unusual nature of the invoices dated after the payment dates, and that it appears approval was granted to purchase the cabin prior to the Tourism Commission confirming the feasibility of its planned use.

Recommendations

The City should implement procedures to ensure all departments follow proper internal controls in purchases. Proper supporting documentation should be obtained, reviewed, and approved prior to making payments. Additionally, the City should ensure that purchases are for appropriate business uses and are feasible prior to making purchases.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-016: The Mountain Arts Center Did Not Receive \$45,000 In Grant Funds Paid To The Kentucky Opry On Its Behalf

The MAC applied for and received three grants totaling \$75,000 from a private foundation. The foundation grants in the amount of \$25,000 per year were intended to be used for the Mountain Arts Center School Matinee Series for fiscal years 2010, 2012 and 2013. The Kentucky Opry, a non-profit 501(c)(3) organization acted as the fiduciary agent between the MAC and the private foundation, intended to receive the funds from the foundation and pay the funds directly to the MAC. However, the MAC's records do not indicate that the entire \$75,000 was received.

Below is a schedule of the grant funds awarded and paid:

Fiscal Year End	Foundation Grant Funds Awarded to MAC, Paid to Kentucky Opry	Amount of Grant Funds Paid to the MAC from the Kentucky Opry	Difference
June 30, 2010	\$ 25,000	\$ 15,000	\$ 10,000
June 30, 2012	25,000	-	25,000
June 30, 2013	25,000	15,000	10,000
	\$ 75,000	\$ 30,000	\$ 45,000

The Kentucky Opry did not turn over \$45,000 of the foundation grant funds to the MAC. Auditors considered whether the funds were not remitted to the MAC due to legitimate reasons, such as if the Kentucky Opry provided services to the school matinee series to meet the grant requirements. However, interviews with MAC employees and the executive director indicated the Kentucky Opry did not provide such services. Therefore, it appears the MAC did not properly monitor the grant to ensure the Kentucky Opry fulfilled its responsibility as the fiduciary agent for the private foundation grant and ensuring all of the grant funds were paid to the MAC.

Recommendations

We recommend the City implement policies and procedures to ensure all grant agreements are properly monitored and the terms of the agreement are carried out. Additionally, the City should take steps to recoup the remaining grant funds from the Kentucky Opry.

**CITY OF PRESTONSBURG
FINDINGS AND RECOMMENDATIONS
(CONTINUED)**

FINDING 2015-017: Money Was Transferred From The City's General Fund To An Account Not Owned by The City Without Supporting Documentation

Records indicate that on September 5, 2014, \$2,500 was transferred from the City's general fund to a bank account number that does not match any of the City's accounts. The transfer was initiated over the phone, and no supporting documentation exists to identify the purpose of the transaction or to provide evidence that it is a legitimate expenditure of the City. Auditors were able to perform procedures to confirm that the bank account was in the name of the Kentucky Opry, but no records existed regarding the purpose of this payment.

Although it is not clear who initiated the transaction, auditors noted a significant lack of segregation of duties in the functions performed by the former City comptroller. The former City comptroller had the ability to initiate, record, and reconcile transactions with little or no oversight. The lack of appropriate policies and procedures over expenditures coupled with this significant lack of segregation of duties creates a significant risk of error, waste, fraud or abuse that could go undetected.

Recommendations

We recommend that the City improve its internal controls over expenditures to reduce the risk that funds are not misappropriated and to reduce the risk of error.

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CITY OF PRESTONSBURG'S MANAGEMENT RESPONSE

CITY OF PRESTONSBURG MANAGEMENT'S RESPONSE

MAYOR
LES STAPLETON

CITY COUNCIL
HARRY ADAMS
TIMOTHY C. COOLEY
DAVID GEARHEART
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December 11, 2015

State Auditor Adam Edelen
209 St. Clair Street
Frankfort, Ky 40601

State Auditor Edelen:

I am writing in response to the findings from an investigative audit that was performed by your office concerning issues and procedures of the previous Administration. Understanding that this was initiated by two separate complaints filed by the City Council, and that this is a little outside of the normal course of business, I appreciate your time even more so. The first complaint was signed by six of eight councilmen and submitted in 2013, and the second complaint dated June 17, 2015 was signed by all eight councilmen and submitted to your office, which initiated your investigation. I would like to thank you and your staff for conducting this investigation/audit, and further would like to commend your entire office as they conducted themselves with decorum and demeanor that was nothing less than exemplar. The professionalism from all of your staff was refreshing.

I will begin my response by noting our latest audit, which was completed in the Spring of 2015 and covered the 2014/2015 Fiscal Year. When returning the audit, most, if not all of the recommendations that are listed by your staff was addressed. Furthermore, when discussing the findings of the audit it was noted that most of the deficiencies were either corrected, or in the process of being corrected, by the current administration. For the purposes of this audit/investigation I will respond with an item by item response.

FINDING 2015-001: Personal Involvement in Property Transfers

FINDING 2015-002, 003: Receiving gifts over \$100.00

FINDING 2015-004: Contributing of funds to a private organization

FINDING 2015-005: Failing to follow procurement/bidding process

FINDING 2015-006: Lack of supporting document for travel and training

FINDING 2015-007: Employee advances

FINDING 2015-008: Failure to receive reimbursement from cell phones

FINDING 2015-009: Purchasing of private use software at city's expense

FINDING 2015-010: Inadequate documentation for compensation



Home of
The Kentucky Opry - Mountain Arts Center • Thunder Ridge Racetrack • Jenny Wiley
Summer Music Theatre and State Park • Jenny Wiley Pioneer Festival • StoneCrest Golf Course



**CITY OF PRESTONSBURG
MANAGEMENT'S RESPONSE
(CONTINUED)**

FINDING 2015-011: Checks written for cash in excess

FINDING 2015-012: Controls in supplemental insurance premiums

FINDING 2015-013: City funds being donated for bonuses and cash advances

FINDING 2015-014: Process of paying performers at MAC (check signatures)

FINDING 2015-015: Supporting document/intelligent spending

FINDING 2015-016: Controls-accountability for funding sources

FINDING 2015-017: Money transfer with no documentation

As this administration was aware of some issues and became even more aware after beginning our term in January of 2015, it was determined that accountability and transparency would be a remedy to the majority of issues. We implemented the following procedures which would address most, if not all, of the listed findings:

1. Segregation of duties: any person who generates a check is required to have a Purchase Order and invoice attached. Also, any personnel who generates a check cannot sign the check and two (2) signatures are required for any check. All personnel have been made aware of the code of ethics, and all transactions are generated with oversight procedures in place. Also, administrative employees and department heads are made aware of laws/guidelines/policies for handling/transferring/spending of any City funds.
2. The procurement/bidding process has been utilized in accordance with the laws and procedures as listed in the Kentucky Revised Statutes.
3. In an effort to eliminate the appearance of any inappropriate transactions, when an employee at any level is concerned in an action with the City they are eliminated from any conversations or discussions concerning said action and further are asked to abstain from any vote. It should also be noted that I have no business interested that could be considered a conflict with my duties as Mayor of Prestonsburg.

In conclusion, this administration has implemented many oversight and accounting procedures to align our finances and procedure with the State mandated approved and usual practices. We welcome any recommendation that will help us to better serve the citizens of Prestonsburg.

As was noted in the original complaint filed by the City Council, we asked for an investigation. We understand that your duties are to audit/investigate and report your findings to me along with the City Council, and Law Enforcement as needed. I personally am of the opinion that these findings should be investigated by law Enforcement and would request your assistance in initiating the investigation.

Thank you,



Les Stapleton, City of Prestonsburg Mayor
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