

**Examination of Certain Policies, Procedures, Controls,
and Financial Activity of the Bluegrass Regional
Mental Health - Mental Retardation Board, Inc.**



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ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

December 20, 2012

Audrey Haynes, Secretary
Cabinet for Health and Family Services
275 East Main Street, 5W-A
Frankfort, Kentucky 40621

Scott Gould, Chair
Board of Directors
Bluegrass Regional Mental Health - Mental Retardation Board, Inc.
1351 Newtown Pike, Building 1
Lexington, Kentucky 40511-1277

RE: Examination Report Findings and Recommendations

Dear Secretary Haynes and Mr. Gould:

We have completed our Examination of Certain Policies, Procedures, Controls, and Financial Activity of the Bluegrass Regional Mental Health – Mental Retardation Board, Inc. (Bluegrass). The enclosed report identifies eight findings and offers over 70 recommendations to strengthen the management and oversight of Bluegrass.

Examination procedures included interviews of current and former Bluegrass Board members, Bluegrass management and staff, Cabinet for Health and Family Services (Cabinet) management and staff, financial information, and other documents. An examination was performed of applicable Bluegrass policies and procedures, credit card expenses, employee reimbursements, and direct payments to determine whether expenditures were appropriate. In performing this examination, we requested and examined records and information for the period January 1, 2011 through June 30, 2012, unless otherwise specified.

This examination also included a review of certain financial aspects regarding Cabinet contracts with Bluegrass to operate Oakwood and Eastern State Hospital. However, it is not the intent of this examination to address facility care operations and client services provided by Bluegrass, as the Cabinet and other regulatory agencies have this oversight and authority.

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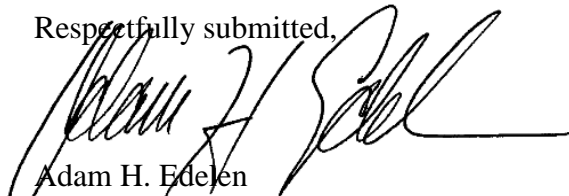
Secretary Haynes and Mr. Gould

December 20, 2012

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The Auditor of Public Accounts requests a report from Bluegrass and the Cabinet on the implementation of audit recommendations within (60) days of the completion of the final report. If you wish to discuss this report further, please contact Brian Lykins, Executive Director of the Office of Technology and Special Audits, or me.

Respectfully submitted,



Adam H. Edelen
Auditor of Public Accounts



Examination of Certain Policies, Procedures, Controls, and Financial Activity of the Bluegrass Regional Mental Health – Mental Retardation Board, Inc.

Examination Objectives

On June 7, 2012, the Auditor of Public Accounts (APA) informed the Bluegrass Regional Mental Health – Mental Retardation Board, Inc., (Bluegrass) that an independent examination would be conducted on certain policies, financial transactions, and other activities of Bluegrass and its subsidiary organizations, including the for-profit Bluegrass New Directions, Inc. (New Directions). This examination was in response to news media reports and anonymous concerns presented to the APA regarding certain financial transactions and policies of Bluegrass. The objectives developed by the APA for this examination included:

- Evaluate certain Bluegrass policies, internal controls, and other aspects of Bluegrass operations;
- Examine all credit card expenses, employee and board member reimbursements, and other expenses paid directly by Bluegrass and its various subsidiaries;
- Determine whether expenditures were excessive or unusual;
- Ensure the transparent, efficient use of financial resources;
- Determine the appropriateness of cash reserves;
- Determine whether conflicts of interest exist; and,
- Report findings and recommendations related to these and other matters identified during the examination.

The scope of the examination encompasses records and information for the period January 1, 2011 through June 30, 2012, unless otherwise specified. It is not the intent of this examination to report on facility care operations and client services provided by Bluegrass, as the Kentucky Cabinet for Health and Family Services (Cabinet) and other regulatory agencies have this oversight and authority.

Background

Bluegrass was created in 1971, as a Community Mental Health Center (CMHC), after the Central Kentucky Regional MH/MR Board merged with the Southern Bluegrass Regional MH/MR Board. Bluegrass was created under Kentucky Revised Statute (KRS) Chapter 273 as a non-profit corporation and is approved to operate a mental health services program under KRS 210.370 to 210.460. As a CMHC, Bluegrass provides mental health, intellectual and developmental disability, and substance abuse services in 17 counties across Kentucky. Currently, the CMHC operated by Bluegrass provides primarily outpatient services to approximately 30,000 individuals, adults and children, in their 17-county region.

In addition to the CMHC services that Bluegrass provides and operates in their 17-county region, Bluegrass also operates Eastern State Hospital and Oakwood under contracts with the Cabinet. Bluegrass created a for-profit entity, New Directions, to earn unrelated business income and account for it separately.

As of this year, Bluegrass, which includes its subsidiaries, has over 2,100 employees on staff with approximately 30,000 clients being treated for mental health, substance abuse, and intellectual and developmental disability issues in its service region. In addition, Bluegrass had more than 2,000 client admissions at Eastern State Hospital and has 121 clients residing at Oakwood. Bluegrass' total operating expenses for 2012 were \$156 million.

The Bluegrass Board is a volunteer board comprised of 20 individuals who live in the Bluegrass service area. The Board membership has been established in a manner so that each county within its 17-county service area shall have at least one member residing in the county which they represent. Bluegrass Board members' backgrounds are varied and include health care professionals, educators, bankers, lawyers, and other business people.

While Bluegrass is a private non-profit organization formed under KRS Chapter 273, it is approved by the Cabinet to operate as a mental health services program, as described in KRS 210.370. Executive Order 66-378 allowed regular full-time employees of community mental health boards to participate in the Kentucky Retirement Systems. Executive Order 69-667 specifically named mental health boards as participants, including Bluegrass predecessors Southern Bluegrass Regional MH/MR Board and Central Kentucky Regional MH/MR Board who elected to participate in Kentucky Retirement Systems. These Executive Orders were ratified by the General Assembly in KRS 61.520(3) effective March 26, 1974. Once these two organizations merged, Bluegrass continued to participate in Kentucky Retirement Systems with no break in service. Retirement costs have increased from \$7,421,000 in FY 2008 to over \$14 million in FY 2012.

Findings and Recommendations

Finding 1: Bluegrass adopted an Executive Benefit Plan to make contributions to employees selected solely at the discretion of the President/CEO with no scrutiny by Board members.

Adequate reviews of those receiving employer-paid supplemental retirement plans were not performed by the Board to ensure this benefit met the original intent of the Plan and supported the organization's mission. While these types of supplemental executive retirement plans are being used by tax-exempt healthcare organizations to retain top executives, they are not typically provided to any employee selected by the President/CEO without the Board's knowledge of the actual benefits being provided to the organization. Since 1997, the Board provided contributions totaling over \$2.8 million to various employees. These contributions were awarded largely to a core group of central office administrative staff with healthcare employees receiving either no contributions or less significant amounts. In addition, without the Board's involvement, the President/CEO determined the amount contributed to retain the President/CEO and other employees for a specified period of time.

Recommendations: We recommend that the Board evaluate the effectiveness of the Plan and whether it should continue. Additionally, we recommend the Board, prior to determining the annual amount of contributions, evaluate the frequency of the contributions to each employee's account, review and request status information as to the amount of contributions paid into an employee's account, the account's balance, and the terms of the agreement with the employee. This information allows the Board to make inquiries regarding the effective use of funds to retain valuable staff and determine whether this benefit

should be provided to other employees whose positions are susceptible to turnover. The Board should consider establishing a maximum amount for contributions made to each participant's account. We recommend that the Board also consider other rewards, such as the amount of bonuses already being provided, when determining the Plan contribution amount. This consideration should also take into account the amount of time remaining until the employee will be able to retire with full benefits through the Kentucky Retirement System. We further recommend that this review process include the President/CEO and that the contribution amount rewarded is not automatic but determined specifically by the Board.

Finding 2: The Cabinet was unaware that funds paid to Bluegrass to transition the management of Oakwood were used to purchase a house in Somerset.

Cabinet funds paid to Bluegrass to transition the management of Oakwood were used to purchase a house in Somerset, Kentucky on September 12, 2006, for \$296,000. This was done with no contract terms to stipulate how this purchase should be reported, what documentation should be maintained to support any savings realized from the purchase, and how the proceeds from the sale of the house should be accounted for and settled. The invoices submitted by Bluegrass to request reimbursement for the house and furniture did not indicate what items were purchased with the requested funds. Cabinet staff questioned the invoices internally but paid the amount without requesting detailed invoices that would have provided evidence that a house was purchased by Bluegrass. The Cabinet was aware of the house but thought that it was purchased with Bluegrass' cash reserves.

Recommendations: We recommend that the Board discuss the purchase of the house and furniture with the Cabinet in order to negotiate how the proceeds from the sale of the house and furniture should be resolved. Considering that the house did reduce the amount of lodging and travel costs that would have been reimbursed by the Cabinet, this cost should be reasonably estimated by Bluegrass. This cost estimate should be reviewed for reasonableness by the Cabinet since no documentation to support these costs was maintained by Bluegrass. Further, the Cabinet and Bluegrass should review the annual budgets for Oakwood to determine if these costs included expenses related to the house. Finally, we recommend that these discussions consider the proceeds from the sale, along with any related expenses paid by the Cabinet through Bluegrass' annual budget for Oakwood, be reduced by the amount Bluegrass estimates would have been spent for travel had the house not been purchased.

Finding 3: The Board did not take actions to address inherent conflicts of interests created by personal relationships that existed between Bluegrass employees.

Inherent conflicts of interests due to personal relationships were found in three instances among Bluegrass employees. In two instances, the relationships began after the individuals were already employed at Bluegrass, while another spousal relationship was clearly known by Bluegrass prior to the individuals being employed. This relationship did not initially create a conflict because there was not a direct line of supervision between the spouses until one was promoted into a supervisory role responsible for oversight of the other. Despite the knowledge of these personal relationships, the Board did not take immediate action to address the potential conflicts. In at least one instance, the Board's actions perpetuated the inherent conflicts of interests.

Recommendations: We recommend the Board revise its nepotism policy to require employees to report to the HR Department when a personal relationship develops between an employee and their immediate supervisor. Bluegrass should consider not only personal relationships through marriage but also situations where a supervisor and employee are dating. This disclosure should be evaluated by the HR Director and presented immediately to the Board's HR Committee for consideration as to how the situation should be addressed in a reasonable and effective manner. The recommended action by the HR Committee should then be reported to the full Board during its regularly scheduled monthly meeting. This policy should include a statement that, by reporting a relationship, the employees will not be adversely affected but that the lack of reporting could have an impact on their employment with Bluegrass. We recommend the Board develop and implement a process by which it may receive and investigate anonymous concerns without a formal grievance having to be filed. The lack of a formal grievance should not preclude the Board from investigating significant information brought to the Board by a reliable source, especially one of Bluegrass' executives. This process could include the provision that the Board may appoint a committee from its body to evaluate and investigate the reported issue or a Board attorney could evaluate the situation. Upon conclusion, this committee should report its findings to the Board and any recommendations deemed necessary to resolve the issue.

Finding 4: Cash reserves for Eastern State Hospital and Oakwood have been maintained or increased during our examination period; though each has a stable funding source.

Due to the stability and reliability of the contract revenue Bluegrass receives from the Cabinet to operate Eastern State Hospital and Oakwood, the need for cash reserves for these organizations is reduced. Based on a negotiated annual budget, the Cabinet provides monthly payments to Bluegrass for each facility. While the benchmark of 90 days of cash on hand is a recommended reserve amount for nonprofit organizations, a single standard does not apply to all nonprofits. The variables involved in this determination should be the stability of cash receipts and the effect that reserving cash has on the services provided or the potential to expand services. Maintaining a high amount of cash reserves for organizations that have stable income could prevent a beneficial expansion of services and compensation benefits. Efforts must continually be taken to ensure that funds are used to effectively carry out the mission of each organization, while also considering the amount of cash reserves required for the business to remain financially secure.

Recommendations: We recommend that the Board request and review an analysis of any cash reserves related to Eastern State Hospital and Oakwood separately so that any funding and stability concerns can be evaluated individually. The Board should evaluate the amount of cash on hand for each organization to determine whether there is excess revenue. We further recommend that this analysis include a review of any long term certificates of deposit to ensure that complete information is considered by the Board. In addition, the Board should have an understanding of the purpose of any cash reserves to make informed decisions when approving the negotiated budgets for each organization. We also recommend the Cabinet perform an analysis of the cash reserves and long term certificates of deposit for Eastern State Hospital and Oakwood to ensure the reserves were accumulated appropriately. Excess revenue related to Eastern State Hospital should be spent on additional community support services as required by the contract. Cash reserves and excess revenue related to Oakwood should be questioned by the Cabinet to determine whether there are issues with Bluegrass' reimbursement requests.

Finding 5: Consolidation of board governance, management, and infrequent reporting of New Directions creates the appearance that the Bluegrass entities are not truly separate.

During this examination, auditors reviewed the relationship between the non-profit organizations of Bluegrass and the for-profit entity, New Directions. During the examination, we found that Bluegrass New Directions was created as a separate legal entity wholly

owned by Bluegrass, but the operations and governance of these entities were often the same. By operating with the use of the same personnel, resources, and board governance, it becomes difficult to make a distinction between the organizations. Auditors believe these commonalities, coupled with conflicts of interests, infrequent reporting or discussions of its for-profit subsidiary operations, leads to confusion among board members and the general public regarding whether these organizations are truly separate and distinct entities. Given the public nature of the services Bluegrass organizations provide through the CMHC and contracts with the Cabinet to operate two state facilities, the organizations must clearly distinguish their actions to provide greater transparency and accountability.

Recommendations: We recommend the Board of Bluegrass, along with the boards of its subsidiaries, ensure these organizations are clearly operated as distinct organizations and specifically identify the governing body taking formal actions while in meetings of the boards. To assist the boards in their efforts to provide greater transparency and to guide the boards while conducting business of the non-profits and for-profit collectively, we recommend the boards engage the services of a legal counsel for the purpose of providing advice during board meetings. We recommend the boards of each Bluegrass organization, along with management, review the bylaws of each organization to ensure that the boards are operating in agreement with their bylaws. We recommend executive management provide to the Board of New Directions, monthly financial reports using the same format currently used in reporting financial activities of the non-profit organizations to the other boards. This should include a combined balance sheet and statement of operations to date and in comparison to the prior year.

Finding 6: Approximately \$38,000 of credit card purchases during an 18-month period was not supported by detailed receipts.

Credit card expenditures totaling almost \$38,000 initiated by the current President/CEO and the former Consultant for New Directions, also the former President/CEO, were not supported by detailed receipts. While explanations for the purposes of the charges were provided during the examination, certain charges were questioned as excessive or inappropriate due to a lack of a documented business purpose. In addition to credit card purchases, our review of expenditures included employee reimbursements and payments to vendors for the period January 2011 through June 2012. Detailed receipts and a documented business purpose

are needed to minimize the risk that Bluegrass is paying for unnecessary, excessive, or personal expenses.

Recommendations: We recommend that the Board broaden their credit card policy to include use and review procedures for all of Bluegrass' credit cards. We recommend the adopted policy require the card user to provide itemized receipts to support all expenses. We also recommend the policy require a purchase to have a documented need or purpose to ensure that expenditures are completely supported prior to payment. This policy should apply to all Bluegrass employees, including contract consultants or employees, without exception. If an adopted policy determines a minimum dollar amount for which a receipt is not required, this policy should be consistent and apply to all staff and not just the President/CEO. To limit the organization's risk of abuse or fraud, we further recommend that the Board review the number and type of assigned credit cards to ensure that each card is necessary. In addition, the Board should take actions to ensure that the credit card assigned to the former Consultant with New Directions is canceled. We recommend that the Board Chair or designated committee of the Board determine whether all required documentation for a credit card charge has been submitted. If required documentation has not been provided, the policy should state a reasonable time period for the documentation to be provided and a time period requiring reimbursement.

Finding 7: Bluegrass spent \$172,025 in lobbying expenses from January 2011 through September 2012 without adequate documentation of lobbying activities.

Bluegrass maintained contracts with three entities for lobbying services instead of employing someone within the organization to perform this responsibility. The total amount paid for these services could possibly be less than the cost to employ a fulltime staff member, but Bluegrass Board members and management would be more informed of the lobbying activities performed. These contracts did not require the lobbyists to provide information or details of any lobbying activities conducted. Contracts were written so that invoices were only required if the entities requested reimbursement from Bluegrass for incurred out-of-pocket expenses. In our review of the lobbying expenses, we found that the contracted monthly payment amount was made regardless of whether an invoice was submitted. For the period of January 2011 through September 2012, Bluegrass paid \$172,025 for lobbying services, yet there is no documentation of what actual services were provided.

Recommendations: We recommend that Bluegrass amend all of its lobbying contracts to include additional language regarding the lobbying activities desired for Bluegrass to succeed in their mission. Further, we recommend the contract require that all lobbying activities conducted by any lobbyist should be reflected in every invoice. We recommend any additional expenses beyond the agreed upon lobbying activities be documented by the actual receipt, the business purpose of the activity or expense, and a description of the lobbying activity associated with the expense. In addition, we recommend that Bluegrass determine whether there is a continued need for three separate contracts and if these are necessary expenses. Also, the Board should ensure that public funds derived through state contracts are not used to pay for lobbying expenses. The requirement of additional documentation of lobbying activities conducted each month will facilitate this review and ensure transparency regarding the benefits Bluegrass is receiving for these payments.

Finding 8: Bluegrass policies should be strengthened to achieve greater accountability. Through our evaluation of Bluegrass policies related to a number of administrative issues, opportunities were identified for Bluegrass to strengthen its policies and achieve greater accountability. In addition to the recommendations related to specific audit findings, there were additional policy weaknesses that should be addressed by the Board.

Recommendations: We recommend the Board establish a comprehensive organizational structure and process by which they may receive, analyze, investigate, and resolve anonymous concerns from employees, business associates, customers, and the general public. The policy developed should ensure that the process is sufficiently independent to offset any risk of internal influence over the process. Once the policy is developed, it should be formally documented in writing and disseminated to its employees and made available to the public. The information should be easily accessible through the Bluegrass internet website.

We recommend the Board consider the creation of an internal audit function. We recommend the Board hire the person for this position and structure reporting of the internal auditor so that information is provided by the internal auditor directly to the Audit and Finance Committee of the Board.

We recommend the Board revise its current ethics policy to include a statement specifying the ability of an employee to accept gifts and honoraria.

We recommend the Board revise its policy to require a Corporate Compliance Acknowledgement form to be completed by its President/CEO and executive staff to disclose any conflicts of interest that may exist.

We recommend the Board require Bluegrass management to provide annual reporting to the Board, or a committee of the Board, of all executive level salaries, along with their complete compensation packages. This information should also include each executive employee's compensation for at least a three-year period to give the Board a historical perspective to compare when considering future compensation for these individuals.

We recommend the Board, or the HR Committee of the Board, be advised by the HR Director when a recommendation by management has been made to create a new management classification/position. The request should be reviewed by the Board or a designated committee, to allow for Board discussion and inquiry.

We recommend the Board consider requiring contractors participating in a bid process to submit a disclosure or certification of any financial interests that may exist between the vendor, its employees, and Bluegrass. If the Board implements this requirement, the procurement policies should be revised to include this new requirement. The policy should include a specific party or designated Board committee responsible for obtaining the disclosure information from bidders. The disclosures should then be shared with the Board when a recommendation as to the winning bidder is made to allow for greater transparency and accountability. Once the policy is revised, Bluegrass management should disseminate the policy to its staff responsible for the procurement process to ensure their understanding of the new disclosure requirement. When bids are sought, Bluegrass staff should ensure contractors are advised of this requirement. If a bidder does not submit the required disclosure or certification, as with other bid disclosure requirements, this should be considered grounds for disqualifying the bid.

We recommend the Board develop and implement a written travel policy for all staff, including the President/CEO. At a minimum, the policy should include allowable costs relating to lodging, meals, acceptable entertainment, personal mileage reimbursement, rental cars, and airfare. This policy should also define allowable costs and acceptable reimbursement of the employee's expenditures. The policy should require the President/CEO and executive

staff to submit their travel itinerary and estimated expenses to the Board or a Board committee for review prior to traveling out-of-state. Subsequent to the travel, actual out-of-state travel amounts should be reported to the Board.

We recommend the Board develop and formalize in writing a gift and entertainment policy to provide specific guidance and procedures for all staff to follow. The policy should determine what is to be considered an acceptable gift amount and the policy should provide guidance for what Bluegrass deems reasonable entertainment expenses.

We recommend the Board develop a formal written policy to ensure that personal expenses are paid back to the organization timely. This policy should specify the period of time employees are allowed to make reimbursement to Bluegrass and the subsequent actions that will be taken if reimbursement is not made. Once the policy is approved by the Board, Bluegrass management should disseminate the policy to its employees.

We recommend the Board develop a formal written policy to address the procurement process to be followed when purchasing or disposing of fleet vehicles. The use and assignment of vehicles owned by the organization should be addressed within this policy. In addition, the practice of providing a vehicle should be reviewed and monthly vehicle allowances considered. The policy should include following the IRS guidelines for personal use of a vehicle.

Chapter 1

Introduction and Background

Scope

On June 7, 2012, the Auditor of Public Accounts (APA) informed the Bluegrass Regional Mental Health – Mental Retardation Board, Inc. (Bluegrass) that an independent examination would be conducted on certain policies, financial transactions, and other activities of Bluegrass and its subsidiary organizations, including the for-profit Bluegrass New Directions, Inc. (New Directions). This examination was in response to news media reports and anonymous concerns presented to the APA regarding certain financial transactions and policies of Bluegrass. The objectives developed by the APA for this examination included:

- Evaluate certain Bluegrass policies, internal controls, and other aspects of Bluegrass operations;
- Examine all credit card expenses, employee and board member reimbursements, and other expenses paid directly by Bluegrass and its various subsidiaries;
- Determine whether expenditures were excessive or unusual;
- Ensure the transparent, efficient use of financial resources;
- Determine the appropriateness of cash reserves;
- Determine whether conflicts of interest exist; and,
- Report findings and recommendations related to these and other matters identified during the examination.

The scope of the examination encompasses records and information for the period January 1, 2011 through June 30, 2012, unless otherwise specified. It is not the intent of this examination to report on facility care operations and client services provided by Bluegrass, as the Kentucky Cabinet for Health and Family Services (Cabinet) and other regulatory agencies have this oversight and authority.

Background and Current Structure

History of Community Mental Health Centers

A Community Mental Health Center (CMHC) can be seen as a one-stop center for mental health treatment. A CMHC is usually locally based and generally provides services for children with severe emotional disabilities, persons with intellectual and developmental disabilities, residential treatment and detoxification for adults with substance abuse related problems, and residential treatment for severely and persistent mentally ill adults. While these are the typical types of resources CMHCs offer their communities, a CMHC can also offer medications and psychotherapy for the mentally ill.

A CMHC helps fill the care gap for those clients with little or no health insurance. Some CMHC can offer more than just medications and psychotherapy treatments. Better-funded centers offer a lifeline for the chronically mentally ill with day programs that help teach important social and work skills. Such programs offer a chance to socialize and find support with others who are coping with similar issues. The centers offer a home for community support groups and a refuge for those who otherwise find it difficult to function well within today's society.

Chapter 1

Introduction and Background

The passage of the Federal Community Mental Health Centers Act of 1963 required CMHCs to provide core services such as inpatient, outpatient, partial hospitalization, emergency care, and consultation/education. Due to the passage of the act, Kentucky's General Assembly enabled the creation of Community Mental Health – Mental Retardation Boards in 1964. The first Central Kentucky Regional Mental Health Board began operation in 1965.

History of Bluegrass

Bluegrass was created in 1971, as a CMHC, after the Central Kentucky Regional MH/MR Board merged with the Southern Bluegrass Regional MH/MR Board. Bluegrass was created under Kentucky Revised Statute (KRS) Chapter 273 as a non-profit corporation and is approved to operate a mental health services program under KRS 210.370 to 210.460. As a CMHC, Bluegrass provides mental health, intellectual and developmental disability, and substance abuse services in 17 counties across Kentucky. Bluegrass has provided these services for over 40 years. Currently, the CMHC operated by Bluegrass provides primarily outpatient services to approximately 30,000 individuals, adults and children, in their 17-county region.

Per Bluegrass' website, "[a] key component of the Bluegrass mission is to plan with our communities to develop innovative programs to respond rapidly to individual and community needs." Bluegrass has done this by expanding their service diversification, most significantly through its management contracts with the Cabinet to manage and operate Eastern State Hospital and the Oakwood facility. As Bluegrass has expanded its services, it has created several non-profit subsidiary corporations, along with one for-profit operation, all under the Bluegrass corporate umbrella.

Currently, the Board for Bluegrass serves as the board of its different non-profit corporations and one for-profit corporation. While there are several corporations under the Bluegrass corporate umbrella, including Housing and Urban Development (HUD) homes, the Bluegrass Board has four primary corporate entities it oversees: the CMHC, Bluegrass Regional Psychiatric Services, Bluegrass Oakwood, and New Directions. The following is a timeline of the creation of these four primary corporations considered subsidiaries of Bluegrass:

- 1971: Bluegrass Regional MH/MR Board, Inc. – Serves as a CMHC.
- 1996: Bluegrass Regional Psychiatric Services, Inc. – Bluegrass created this non-profit subsidiary organization after it first began operating the Eastern State Hospital in 1995 through a contract with the Cabinet.
- 1999: Bluegrass New Directions, Inc. – For-profit subsidiary organization initially created by Bluegrass to initiate managed care; however, after managed care did not materialize, this organization was used to provide crisis line and call center services, along with financial software and a proprietary electronic health record program to other CMHCs in Kentucky.

Chapter 1

Introduction and Background

2006: Bluegrass Oakwood, Inc. – Bluegrass created this non-profit subsidiary organization as Bluegrass began operating the Oakwood facility in Somerset, Kentucky through a contract with the Cabinet.

As of this year, Bluegrass, which includes its subsidiaries, has over 2,100 employees on staff with approximately 30,000 clients being treated for mental health, substance abuse, and intellectual and developmental disability issues in its service region. In addition, Bluegrass had more than 2,000 client admissions at Eastern State Hospital and has 121 clients residing at Oakwood. Bluegrass' total operating expenses for 2012 were \$156 million.

Subsidiary Organizations

In addition to the CMHC services that Bluegrass provides and operates in their 17-county region, Bluegrass also operates Eastern State Hospital and Oakwood under contracts with the Cabinet. Bluegrass created a for-profit entity, New Directions, to earn unrelated business income and account for it separately. Below is a brief overview of these three primary organizations:

1. Eastern State Hospital is funded by the Kentucky Department for Behavioral Health, Developmental and Intellectual Disabilities, which funds mental health and mental retardation services. Eastern State Hospital provides psychiatric, rehabilitative, and nursing care services to its clients. These programs provide acute, inpatient psychiatric care for adults who are mentally ill.
2. Oakwood, an Intermediate Care Facility that Bluegrass took over management of in 2006, provides support for individuals with intellectual and developmental disabilities. Bluegrass was awarded a contract by the Cabinet for operation and management of Oakwood at a point in time when the facility had received over 20 Type A citations related to resident care. This contract is funded by Kentucky Department for Behavioral Health, Developmental and Intellectual Disabilities. The Cabinet divided Oakwood into four distinct and separate units to better manage the facility's population of mentally challenged and developmentally disabled clients.

On September 12, 2006, the Cabinet entered into a six-week, \$2.5 million transition contract with Bluegrass to “build the foundation for Bluegrass Regional MH/MR Board to become the single entity to manage and operate the Oakwood Community Center providing a full range of residential services.” Once this contract expired, the Cabinet contracted with Bluegrass on a year-to-year basis to continue to operate Oakwood.

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In May 2008, the Centers for Medicare and Medicaid Services terminated federal funding paid to the Cabinet for this facility, leaving the facility costs entirely the responsibility of the state. In March 2009, state officials announced that federal funding for three of the four units at Oakwood were restored after the federal government found the facility corrected deficiencies during an earlier survey. Later in 2009, it was announced that the remaining unit at Oakwood had passed the certification survey and federal funding would be restored.

3. New Directions, formed in 1999, is the for-profit arm of Bluegrass which provides, at a charge to other CMHCs around Kentucky, crisis line and call center services, financial software, as well as electronic health record software developed by New Directions.

Board Structure

The Bluegrass Board is a volunteer board comprised of 20 individuals who live in the Bluegrass service area. The Board membership has been established in a manner so that each county within its 17-county service area shall have at least one member residing in the county which they represent. Bluegrass Board members' backgrounds are varied and include health care professionals, educators, bankers, lawyers, and other business people.

Members of the Board serve four-year terms and can serve no more than two terms consecutively, except when appointed to fill an unexpired term. In addition to regular members of the Board, the Board may elect up to nine associate members who are to advise the Board but do not have the right to vote. The associate board members can be regular members whose terms have ended. For this reason, Bluegrass Board members may have more than eight years of experience.

Board officers include:

- Chair – presides at all meetings of the Board and Executive Committee;
- Vice Chair – serves as ex-officio to all functions and duties assigned to the Board Chair;
- Secretary – responsible for minutes and records of Board meetings; and,
- Treasurer – serves as the Chair of the Audit/Finance Committee.

Election of Board officers takes place in August each year, with new Board officers officially taking office at the conclusion of the annual Board meeting the following October. Officers serve for a period of one year and are eligible for reelection to the same position for an additional one-year term.

Committees of the Board

According to the Bluegrass by-laws, there are six standing committees of the Board.

Chapter 1

Introduction and Background

- Executive Committee – composed of at least 25 percent of the membership of the Board, including all officers, chairmen, and vice-chairs of the standing committees.
- Audit/Finance Committee – composed of at least the Board Treasurer and three other members.
- Human Resource Committee – composed of at least 20 percent of the membership of the Board.
- Nominating Committee – composed of not less than six Board members, representing at least five counties.
- Program Planning and Evaluation Committee – composed of at least seven Board members.
- Intellectual/Developmental Disabilities Committee – composed of at least five Board members.

The members of this Board serve as the members of the boards of all the organizations created under its corporate umbrella. Though each is a separate legal organization, including the for-profit New Directions. As such, according to the Bluegrass President/Chief Executive Officer (President/CEO), the organizations utilize the existing committee structure(s) rather than create new or separate ones.

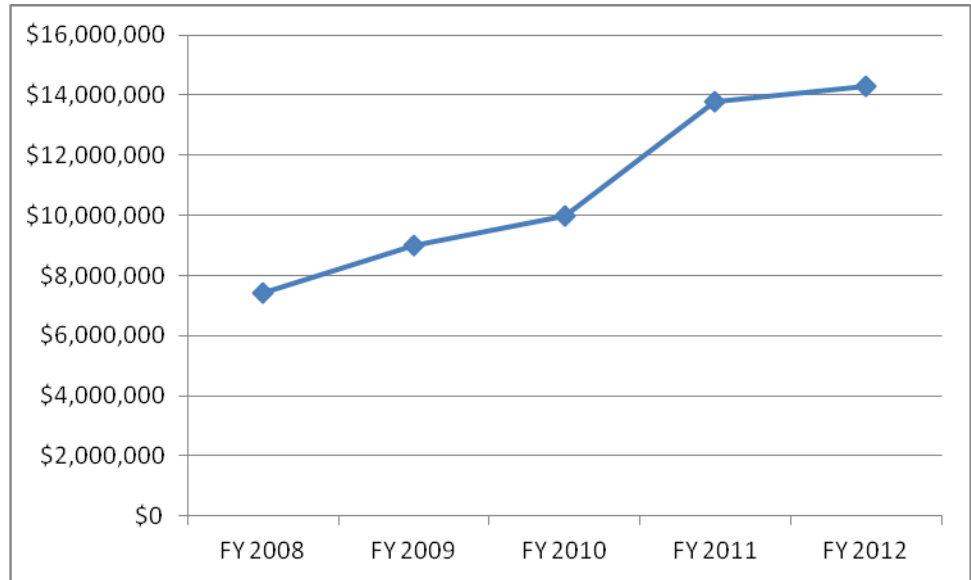
Bluegrass’ Participation in Kentucky Retirement Systems

While Bluegrass is a private non-profit organization formed under KRS Chapter 273, it is approved by the Cabinet to operate as a mental health services program, as described in KRS 210.370. Executive Order 66-378 allowed regular full-time employees of community mental health boards to participate in the Kentucky Retirement Systems. Executive Order 69-667 specifically named mental health boards as participants, including Bluegrass predecessors Southern Bluegrass Regional MH/MR Board and Central Kentucky Regional MH/MR Board who elected to participate in Kentucky Retirement Systems. These Executive Orders were ratified by the General Assembly in KRS 61.520(3) effective March 26, 1974. Once these two organizations merged, Bluegrass continued to participate in Kentucky Retirement Systems with no break in service.

According to the Notes to Bluegrass’ Consolidated Financial Statements, the retirement contributions paid by Bluegrass for all of its employees have increased significantly since FY 2008. Retirement costs paid to the Kentucky Retirement Systems are based on a percentage of the employees’ gross salaries. The following graph illustrates how retirement costs have increased from \$7,421,000 in FY 2008 to over \$14 million in FY 2012.

Chapter 1
Introduction and Background

Chart 1: Bluegrass' Retirement Cost Increases from FY 2008 through FY 2012



Source: Auditor of Public Accounts based on the audited financial statements provided by Bluegrass.

Financial Information

Through its organizations and state contracts, Bluegrass has considerable financial activity. The following table illustrates the annual amount of revenues that Bluegrass receives and the corresponding expenditures. In FY 2012, the decrease in revenue and expenditures was the result of cuts to Oakwood due to a Cabinet evaluation of activity at Oakwood and a determination that expenditures could be decreased at the facility.

Table 1: Annual Revenue and Expenditures for Bluegrass

Category	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Total Revenue	\$169,364,785	\$171,012,974	\$175,282,364	\$175,944,827	\$156,914,915
Total Expenses	165,103,253	168,058,127	171,375,685	171,053,270	156,308,068
Excess Revenue Over Expenses	\$4,261,532	\$2,954,847	\$3,906,679	\$4,891,557	\$606,847

Source: Auditor of Public Accounts based on the audited financial statements provided by Bluegrass.

Findings and Recommendations

Introduction to Bluegrass' Executive Benefit Plan

Coinciding with Bluegrass' contract to operate Eastern State Hospital, an Executive Benefit Plan (Plan) was signed by the President/CEO on June 30, 1995. The Plan's stated purpose was "to protect Participants against contingencies that interrupt or impair their earning power and to assure that funds will be available for such Participants to depend upon while seeking other employment." According to interviews with staff and Board members, this plan was the idea of a former Board member to address the difficulties Bluegrass faced in retaining staff. The former President/CEO agreed with the idea and an attorney was engaged to develop and present the Plan to the Board. After the attorney's presentation, Bluegrass' external auditing firm was asked to review the Plan prior to the Board approving its implementation.

Plan adopted to provide severance benefits to retain key employees

According to the Plan adopted by Bluegrass, employee eligibility is to be designated by the Board as long as the employee is a member of a select group of employees as defined by the Employee Retirement Income Security Act (ERISA). The Plan also includes a statement that "the Employer has determined that the implementation of a plan to provide severance benefits will best serve its interest in retaining key employees, and best serve the interest of its key employees in providing funds to depend upon in the event of their termination of employment with the Employer." This was intended to be a severance pay plan within the meaning of section 457(e)(11) of the Internal Revenue Code and section 3(2)(B)(i) of ERISA.

According to Article VII of the Plan, the Board, or such other person designated by the Board, will be the Plan Administrator. The Administrator may adopt rules of procedure as it deems desirable as long as the rules do not conflict with the Plan. The decisions of the Administrator are final and binding upon the employer and employee. The Administrator has the authority to interpret the Plan and make decisions concerning any questions that may arise related to the Plan. Complete records of all decisions and data pertaining to the Participant's account are to be maintained by the Administrator, who is required to periodically report the status of the Plan to the Board.

The Plan is a non-qualified retirement plan that allows the employee to delay receiving additional income until a later date determined by the Board. The employer has the responsibility of maintaining the deferred Plan income contributed by Bluegrass in a special account until the employee has completed an agreed upon length of service. While not subject to taxes during the calendar year in which it is received, the income is subject to taxes when paid out of the Plan. With a non-qualified retirement plan, the fund is not secure, which means the creditors of the organization could initiate a legal process to seize these funds if there are outstanding debts. There are very few government regulations or guidelines for governing non-qualified retirement plans.

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Findings and Recommendations

Executive Benefit Plan is structured as a supplemental executive retirement plan for select employees

Bluegrass has structured this Plan to be a supplemental executive retirement plan because it is provided in addition to the organization's primary retirement plan established within the Kentucky Retirement System. Because this Plan is not offered to all employees and is reserved for a select group of management or highly compensated employees as described under sections 201(2), 301(a)(3) and 401(a)(1) of ERISA, it is known as a "top hat" plan. Being in this Plan is not automatic for all employees or even for employees with similar positions or responsibilities. For example, being in an executive level position may not be sufficient to receive an invitation to participate.

Executive Benefit Plan language amended to allow benefit payouts without severing employment with Bluegrass

On November 7, 2002, meeting minutes document that revisions to the Plan were approved. According to the new language in the Plan, "the phrase "as of the date the employee's employment terminates" means the date the employee satisfies the length of service requirement stipulated for that particular employee." The amended section further states that there "is no need that an employee must sever employment to be eligible for payment of benefits under this plan, only that an employee must satisfy the length of service requirements" established by the agreement with the Participant. According to the current President/CEO, the Board changed the Plan in 2002 after it was pointed out that an employee would have to sever employment to receive a payout, yet the intent was to incentivize the employees to stay with Bluegrass. She stated that the attorney engaged to develop the Plan reviewed the changes and thought them to be acceptable.

These amended changes do not agree with the stated purpose and other statements within the originally adopted Plan that were not changed. According to the President/CEO, even though there may be contradictions, it is the actual agreements between the employer and employee that are used to implement the Plan.

The agreement is provided to the participant by the President/CEO and establishes the amount contributed that year into the employee's account and the years of service required to be completed in order to receive the balance of the employee's account. However, it would appear reasonable that the agreements would reflect the objective established in the Plan.

The employee's account is managed by an outside trustee under contract with Bluegrass to administer the individual accounts and track the value of its investments. The trustee is responsible for investing the contributions as specified in the employee's agreement with Bluegrass and for recording any earnings or losses from the investment activity related to the contributions.

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Findings and Recommendations

All contributions are from Bluegrass' funds and not the employee's earnings

One of the distinguishing characteristics of this Plan is that the employer makes the contributions and the employee cannot defer any personal earnings. Therefore, the funds are entirely the property of the employer until the employee satisfies the requirements of the agreement. Currently, an employee is required to work until the specified date of the Plan or all of the money in the employee's account will revert back to the employer. The Plan also limits the amount of the payout to 200 percent of the employee's compensation during the year immediately preceding the required date. For example, if an employee had total wages of \$100,000 for the year prior to specified date, the most the employee could receive is \$200,000 and any remaining money in the employee's account would revert back to the employer.

According to a survey published in 2010 entitled, Mercer's Executive Benefit and Perquisite Practices Survey for Tax-Exempt Organizations, "about half (49%) of participating organizations offer their top executive an employer-paid nonqualified retirement plan." These plans "are most prevalent among healthcare organizations (60%)." Of that 60 percent, supplemental executive retirement plans are provided by 38 percent of the healthcare organizations for the top officer. Related to executives that report to the top officer, 58 percent of healthcare organizations provide this type of retirement plan, with 36 percent of those entities using supplemental executive retirement plans. Going down a tier to employees that report directly to executives, only 36 percent of healthcare organizations provide an employer-paid plan, with 18 percent of those entities providing supplemental executive retirement plans similar to the Plan implemented by Bluegrass. While this survey states that supplemental executive retirement plans help tax-exempt organizations compete with publicly traded companies, it also cautions that organizations must consider the financial impact of these benefits to be responsible and competitive.

New Directions implemented Executive Deferred Compensation Plan

Bluegrass created New Directions as a for-profit entity on February 17, 1999. On February 18, 1999, the Board signed a new employment contract with the Bluegrass President/CEO who was retiring from Bluegrass on March 31, 1999 to become the President/CEO of New Directions. On August 6, 1999, the Board adopted a separate Executive Deferred Compensation Plan, retroactively effective to April 1, 1999, for the former Bluegrass President/CEO.

New Directions' Executive Deferred Compensation Plan allowed the President/CEO to defer a portion of his earned compensation

This plan was designed to allow for contributions similar to the Bluegrass Plan, as well as allowing the New Directions' President/CEO to defer portions of his earned compensation. As the only participant in the Executive Deferred Compensation Plan, the former President/CEO was allowed to deposit the balance of his account with the Bluegrass Plan into a new account that allowed for three different types of contributions: 1) Retirement Contributions; 2) Participant Contributions; and 3) Executive Benefit Contributions. The first two types of contributions were the actual earnings of the employee, but the Executive Benefit Contributions are provided by the employer in the same manner as the Plan.

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The Board directed New Directions to make contributions in an amount determined at the sole and absolute discretion of the Board. Unlike the Plan, these contributions vested immediately but could not be paid out until the Participant ceases to be an employee of New Directions.

*New Directions’
 President/CEO
 received almost
 \$1.6 million from
 the Executive
 Deferred
 Compensation Plan*

When the former President/CEO resigned from this position in October 2008, the Executive Deferred Compensation Plan was no longer used by the Board. However, he remained an employee of New Directions and was not able to receive his payout at this time. In October 2010, the former President/CEO resigned as an employee of New Directions and received the balance of his account, which was almost \$1.6 million. At this point, the former President/CEO continued to contract with New Directions as an independent contractor on a part-time basis with no benefits until June 2012.

Since 1997, the Board has provided contributions totaling over \$2.8 million to various employees under both of the plans. Though contributions were made to the Plan in 1995 and 1996, Bluegrass could not locate this documentation so the auditors were not able to include the total contributions provided in those years. Table 2 illustrates the amounts contributed to both plans from 1997 through 2011.

Table 2: Bluegrass Board Contributions to Select Employees

Benefit Period	Executive Benefit Plan		Executive Deferred Compensation Plan		Total Contributed by Board
	Number of Participants	Amounts Contributed	Number of Participants	Amounts Contributed	
CY 1997	17	\$120,000	N/A	N/A	\$120,000
CY 1998	17	120,000	N/A	N/A	120,000
CY 1999	17	136,000	1	\$14,000	150,000
CY 2000	15	180,000	1	20,000	200,000
CY 2001	16	188,500	1	21,500	210,000
CY 2002	17	200,000	1	20,000	220,000
CY 2003	17	200,000	1	20,000	220,000
CY 2004	16	200,000	1	22,000	222,000
CY 2005	14	180,000	1	22,000	202,000
FY 2006	13	180,000	1	23,000	203,000
FY 2007	13	180,000	1	26,500	206,500
FY 2008	11	151,500	1	21,000	172,500
FY 2009	15	175,000	1	0	175,000
FY 2010	15	220,000	1	0	220,000
FY 2011	16	200,000	N/A	N/A	200,000
Totals		\$2,631,000		\$210,000	\$2,841,000

Source: Auditor of Public Accounts based on data provided by Bluegrass.

Chapter 2

Findings and Recommendations

**Finding 1:
Bluegrass adopted
an Executive
Benefit Plan to
make
contributions to
employees selected
solely at the
discretion of the
President/CEO
with no scrutiny
by Board
members.**

Adequate reviews of those receiving employer-paid supplemental retirement plans were not performed by the Board to ensure this benefit met the original intent of the Plan and supported the organization's mission. While these types of supplemental executive retirement plans are being used by tax-exempt healthcare organizations to retain top executives, they are not typically provided to any employee selected by the President/CEO without the Board's knowledge of the actual benefits being provided to the organization. Since 1997, the Board provided contributions totaling over \$2.8 million to various employees. These contributions were awarded largely to a core group of central office administrative staff with healthcare employees receiving either no contributions or less significant amounts. In addition, without the Board's involvement, the President/CEO determined the amount contributed to retain the President/CEO and other employees for a specified period of time.

The Board's reliance on the President/CEO's judgment and the Board's lack of review of information resulted in limited knowledge of the extent of this lucrative benefit. This supplemental retirement plan is a significant benefit that should be monitored at least annually by the Board to ensure that it is not used as a reward program by the President/CEO. If the supplemental retirement benefit is continued, these funds should be used conservatively to retain employees that are at risk of leaving the organization and are beneficial to Bluegrass' mission of providing health care services to its clients.

At the adoption of the Plan in 1995, the Board designated the former President/CEO as the Plan Administrator, but no criteria were established regarding which employees would receive the contributions or the period of time required per the agreement that an employee should be expected to work to receive a payout. Therefore, the employees invited to participate were selected at the sole discretion of the President/CEO with very limited Board involvement or review, other than approving the total annual amount available for the program.

Only the total amount of contributions is approved by the Board

According to the former President/CEO, he always discussed the individuals who would receive contributions in an executive session with the Board's Human Resource (HR) Committee and received Board approval for the total amount to be contributed to the Plan. He stated that these contributions were discussed after the HR Committee presented him with his performance evaluation after the end of the fiscal year when it was known whether Bluegrass would have excess revenues to contribute to the Plan. Once the total amount to be contributed to the Plan was approved by the Board, it was left to the President/CEO to determine the Plan participants, the amount contributed to each participant's account, and the years of service required to receive this benefit. The former President/CEO stated that if the Board members had requested anyone to be in the Plan, that the person would have been included, but this never occurred.

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From the Plan's inception, regardless of who held the position, the President/CEO was the only member of the staff that communicated with the selected Plan participants and maintained any documentation to support these contributions in order to prevent the Plan and its participants from being publicized to the staff. Therefore, no documentation of any Plan contributions was in the employee's personnel file, including the President/CEO's file.

To determine which employees were selected to participate in the Plan and the amounts allocated to an employee account each year, auditors requested the individual agreements for the employees that were in the Plan beginning in FY 2005. After an analysis of this documentation, it was found that there were no employee agreements related to the 2006 contributions. In order to provide the amount of contributions for 2006, Bluegrass provided the letter that was sent to the trustee in 2006 with the check for the total contribution and a listing of the amounts to be deposited in the individual employee accounts. To ensure complete information was obtained, the letters were requested for each year since the Plan started in 1995. While the letters provide some form of documentation to assist auditors in examining the Plan, the letters do not provide the number of additional years the employee agreed to work in order to receive the balance of their account.

No documentation to support the contributions provided to the former President/CEO from 1999 to 2008

Our review of the letters to the trustees found that documentation for the years 1995 and 1996 could not be located. Further, the former President/CEO was not included in contribution totals from 1999 to 2008 when he was an employee of New Directions. When asked for documentation of his contributions, Bluegrass stated that there was no documentation of these contributions. According to the current President/CEO, it was an established practice that the President/CEO would receive the highest amount provided to the other participants in the Plan and could not exceed that amount. Therefore, based on the amounts contributed to others, Bluegrass provided a list of the contributions assumed to have been awarded to the former President/CEO.

Based on these letters and the annual signed Plan agreements, several concerns were evident. One was that the Board was providing a lucrative benefit to employees without knowing the individual amounts being provided to them as determined by the President/CEO. A Board member's signature was not on any of the Plan documents or letters until FY 2011, when the Board Chair initialed the listing of the employee contributions determined by the current President/CEO.

Another concern auditors noted was that the largest contributions were consistently provided to the central office administrative staff and not the employees providing health services to the clients. In addition, the logic of the process to fund the Plan was not reasonable to achieve the objective of retaining employees. By Bluegrass making a contribution every year to an employee's account, without also making a meaningful increase in the number of years an employee must work, Bluegrass is ultimately contributing a significant amount of money to retain the employee for less and less time required to continue employment. Some employees received a Plan payout of over \$250,000 after they had reached the goal date of their Plan agreement and then received an entirely new Plan agreement with additional contributions. This benefit also does not take into account the incentive employees already have to continue employment due to their participation in the Kentucky Retirement System and the increased retirement benefit that accrues with additional years of employment.

*No Board signature
on original 1995
Executive Benefit
Plan document*

Regarding the Board's involvement, no Board members signed the original Plan document that was developed in 1995. The original Plan was signed by the former President/CEO on June 30, 1995. The person witnessing this signature was another Bluegrass employee that reported to the President/CEO and benefitted substantially from the Plan receiving a payout of \$264,602 in 2010. All of the agreements with the individual employees that actually documented the terms of the Plan were only signed by the employee and the President/CEO. The agreements that existed for the former President/CEO from 1995 to 1999 were only signed by the former President/CEO, and his 1999 agreement was also signed by the same employee that had witnessed his signature of the original Plan document.

The agreements that the Board had with the current President/CEO were signed by the Board Chair for the three years she has been in this position and received contributions. In a move to promote transparency, the President/CEO sent a letter to the Board Chair in FY 2011 listing the employee names and amounts contributed. The letter had the initials of the Board Chair to represent approval of the contributions.

According to our interviews with seven former and current Board members, they all agreed the Board only approved the total amount of the Plan's annual contributions. The majority of those interviewed stated that there was no formula to determine the total contribution amount, but there needed to be excess revenue before funds would be allotted for the Plan. When interviewing Board members regarding the criteria to be invited to participate in the Plan, the members either stated that there were no criteria or that they were not aware of any criteria. Most of the Board members stated that the funds were given to the President/CEO to decide how to allocate among employees because the President/CEO worked directly with the employees and would know which were the most valuable to reward and retain. Three Board members stated that a listing of participants was provided to the Chair of the Board's HR Committee to ensure that it was a reasonable allocation, but that other Board members probably were not aware of the details.

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Findings and Recommendations

Board members lacked understanding of the Executive Benefit Plan

The Board members' comments about the Plan indicated a lack of understanding regarding how the Plan worked. One former Board member was certain that the employees could not receive the money unless employment was terminated because it was strictly a retirement incentive. According to this former Board member, the total annual amount of funds available for the Plan was only approximately \$60,000 and the employees only received \$3,000 to \$6,000 each. Another Board member was not sure if this Plan was a method for Bluegrass to match a contribution made by a participating employee. One Board member thought the supervisors selected the employees and another thought the HR Department determined which employees were rewarded.

Two Board members stated that only executives that reported to the President/CEO could participate. One Board member stated that if the time period of the employee's agreement was adjusted, the Board would have to approve this change. Another Board member commented that there was nothing wrong with the Plan and wished that this money could be expanded since it is not a lot of money.

In addition, the current Board Chair thought that it was a requirement of the Plan that the President/CEO could not get more of a benefit contribution than the highest awarded participant received. While the current President/CEO also stated this practice, the Plan did not contain this requirement and the Board's approval of this requirement was not documented in the minutes or any other document.

Another issue identified is that the criteria for who should participate in the Plan was not determined by the Board. Everyone interviewed stated that employees participating in the Plan were supposed to be those who could not be easily replaced, are valuable to the organization, and have a great work ethic, but none of these criteria were formalized or documented. Considering the mission of the organization is to assist individuals and families by providing mental health, developmental disabilities, and substance abuse services, it was surprising that the largest contributions were provided to central office staff in administrative positions and not the employees providing direct services to clients.

Board did not question whether Executive Benefit Plan contributions were made to employees providing health care services

While hard-working, long-tenured administrative staff are beneficial, employees in the healthcare professions are considered the hardest to retain. These are also the employees that are crucial to Bluegrass' efforts to maintain the continuity of care that is important to their clients. Since no Board efforts appear to have been made to review the amount of contributions made to individual employees, decisions involving limiting or establishing a maximum amount of contributions that can be awarded to individual employees apparently was not determined or discussed. A review of this type of information could help to ensure that these contributions incentivize other employees in healthcare positions, instead of being repeatedly provided to the same group of central administrative employees.

Chapter 2

Findings and Recommendations

Current President/CEO has had three plans with total contributions of \$301,875

From our review of agreements, we found several noteworthy issues related to how the Plan was administered. In 1997, the current President/CEO's agreement reduced the number of years required to be worked from 15 years to 10 years. After reaching that goal date, the employee took the payout and another Plan was provided to that same employee requiring only five years of work to receive another payout. When this goal was reached and a second payout received, the employee had been promoted to President/CEO and operating as the Plan Administrator. In August 2009, a third Plan agreement was given to the President/CEO requiring an additional five years to receive a third payout. Since 1995, this employee's account has received contributions totaling \$301,875. However, the actual payouts could be lower or higher than the amounts contributed depending on any investment losses or earnings associated with the employee's account. The employee receives the payout on the agreed-upon Plan benefit date regardless of the value of the account at that time.

At least six employees were provided a new Plan after receiving a payout from their first Plan

Since 1995, based on the information provided by Bluegrass, there have been six employees that received new plans after reaching the years required to receive a Plan payout. In total, at least 12 employees received an amount every year until they were eligible for a payout. There are 11 current employees that have received a contribution every year and are continuing to work towards the specified completion date established in their Plan agreements, with seven of these being employees that had not been awarded contributions by the former President/CEO.

Most participants received a contribution every year until the specified payout date

The current President/CEO has continued to make contributions to two employees that are working on their second Plan agreement. Since 1995, these employees have received total contributions of \$280,000, and \$117,500. Regardless of what the payouts will be for the second plan, Bluegrass has already paid this money to retain these employees. While some employees left employment prior to meeting the goal date, only two employees who continued employment did not receive a contribution every year from Bluegrass until the specified date of employment was reached. These two employees were not part of the administrative staff but provided psychiatric services.

One employee interviewed stated that they were not able to negotiate the amount of contributions but remembers being given an option as to the number of years to establish as the goal date. The positive side of selecting 10 years is that you will get a payout in 10 years but, if you select 15 years, you will receive more contributions. The employee stated that the trick is to pick a date that will maximize contributions but not go past the date you want to retire. However, certain employees, including the current President/CEO, have fulfilled Plan dates and then received new Plan agreements allowing payouts to be received multiple times through their employment at Bluegrass.

Findings and Recommendations

For the most recent contributions in FY 2011, the contributions ranged from \$3,500 to \$20,000, with an average contribution of \$12,500. The employees that received Plan contributions in FY 2011 also received a total of approximately \$90,600 in bonuses.

According to Bluegrass' HR Director, the employees of the CMHC and Eastern State Hospital were eligible to receive bonuses in recent years even though annual increments were discontinued starting in January 2009. Oakwood employees have not received bonuses due to budget cuts and efforts to prevent any employee layoffs. For those eligible, bonuses are based on productivity and quality of work. An employee that meets expectations will receive a bonus of three percent of base pay, four percent if the employee exceeds expectations, and five percent if the employee is evaluated as outstanding.

Due to the lack of formal criteria and the Board's reliance on the President/CEO to distribute Plan contributions, it could appear that the Plan has resulted in contributions that are not based as much on retaining employees, but on rewarding selected employees that work closely with the President/CEO. Because the majority of the staff receiving these contributions was retained, the Board members apparently considered that they had no reason to question the Plan's design or effectiveness. Due to the confidentiality of the Plan, there were no employee complaints that would cause the Board to review the Plan further or create formal criteria as to who could participate in the Plan and at what dollar amount.

The Boards review cannot be based on the review of one year of data

In practice, the Plan has allowed the President/CEO to provide large contributions to central office staff, with minimal efforts to ensure that staff providing healthcare services are also retained. While the Board was informed of the amounts being contributed in FY 2011, they were not aware of the total amounts that have been contributed, the frequency of the contributions to each employee's account, the balance of the employee's account, the employees that are receiving new plans, the number of additional years required to work, or how close the employee is to the agreed upon date for the payout. The Board's review of the contributions for one year will not provide the Board with complete information as to the historical and current status of the employees participating. The Board did not ask questions to determine if the contributions were being used in a manner to retain various employees that were critical to Bluegrass' mission.

Findings and Recommendations

Considering that most employees have the opportunity to receive bonuses and Bluegrass is already paying significant amounts into the Kentucky Retirement System for all of these employees, it is important that this program be evaluated by the Board and, if continued, that additional money be used effectively to retain employees that are at risk of terminating their employment. Without an adequate review by the Board, a significant amount of money can be provided to employees who may continue working at Bluegrass because their account balance is already large or they plan on staying for the substantial retirement benefits provided by the Kentucky Retirement System. If this money is not ensuring that a valuable employee is being retained, the Board is risking that this money is being repeatedly awarded to the same employees favored by the President/CEO, and is not being provided to a broader number of employees whose retention is also beneficial to Bluegrass. Excess revenues should be used, wisely and effectively to the best benefit of the organization to achieve Bluegrass mission.

Recommendations We recommend that the Board evaluate the effectiveness of the Plan and whether it should continue. Additionally, we recommend the Board, prior to determining the annual amount of contributions, evaluate the frequency of the contributions to each employee's account, review and request status information as to the amount of contributions paid into an employee's account, the account's balance, and the terms of the agreement with the employee. This information allows the Board to make inquiries regarding the effective use of funds to retain valuable staff and determine whether this benefit should be provided to other employees whose positions are susceptible to turnover. The Board should consider establishing a maximum amount for contributions made to each participant's account.

We recommend that the Board also consider other rewards, such as the amount of bonuses already being provided, when determining the Plan contribution amount. This consideration should also take into account the amount of time remaining until the employee will be able to retire with full benefits through the Kentucky Retirement System. We further recommend that this review process include the President/CEO and that the contribution amount rewarded is not automatic but determined specifically by the Board.

Finding 2: The Cabinet was unaware that funds paid to Bluegrass to transition the management of Oakwood were used to purchase a house in Somerset.

Cabinet funds paid to Bluegrass to transition the management of Oakwood were used to purchase a house in Somerset, Kentucky on September 12, 2006, for \$296,000. This was done with no contract terms to stipulate how this purchase should be reported, what documentation should be maintained to support any savings realized from the purchase, and how the proceeds from the sale of the house should be accounted for and settled. The invoices submitted by Bluegrass to request reimbursement for the house and furniture did not indicate what items were purchased with the requested funds. Cabinet staff questioned the invoices internally but paid the amount without requesting detailed invoices that would have provided evidence that a house was purchased by Bluegrass. The Cabinet was aware of the house in Somerset but thought that it was purchased with Bluegrass' cash reserves.

After recent news media attention, Bluegrass put the home up for sale and it sold on September 7, 2012, for \$292,000. Now that the Cabinet is aware of the source of funds used to purchase the house, Cabinet staff stated that the house was the Cabinet's asset and the entire purchase amount should be remitted back to the Cabinet. Though Bluegrass and the Cabinet have not discussed this issue, Bluegrass considers the proceeds of the sale to be its revenue and is determining internally how to account for these proceeds in its financial statements.

The contract between the Cabinet and Bluegrass to transition the operations of Oakwood did not contain language regarding the purchase of an asset. The contract did contain the requirement that Bluegrass comply with the Office of Management and Budget Circular A-122, which requires that the purchase of an asset must receive prior approval. The contract's payment terms require that, "[u]pon receipt of appropriate invoices, the Cabinet will reimburse actual costs plus an eight percent (8%) administrative fee" for a variety of expenses incurred related to this transition. The contract gives specific examples of expenses that will be reimbursed. These examples were travel, training, necessary supplies and administrative support, staff costs prior to November 1, 2006, technology infrastructure, telephone systems, and any information system upgrades.

On September 12, 2006, a former Cabinet Secretary and the former President/CEO of Bluegrass signed a transition contract negotiated to reimburse Bluegrass up to \$2.5 million for expenses incurred by Bluegrass to prepare to take over Oakwood's operating contract. While this document makes no mention of purchasing assets, a house was purchased in Somerset on September 26, 2006, for approximately \$296,000. Bluegrass also made furniture purchases during this same time that totaled \$32,463.

According to the former President/CEO, the house was discussed with the former Cabinet Secretary as a means to provide lodging for the executive staff that needed to stay at Oakwood to facilitate the transition by November 1, 2006. He also stated that it was a goodwill effort to show the community that Bluegrass would have a long term community presence and was not just a temporary management company.

Findings and Recommendations

Former Cabinet Secretary does not recall the house being part of the agreement for Bluegrass to operate Oakwood

In an interview with auditors, the former Cabinet Secretary stated that the house was not part of the deal to his memory and thinks that the house would have raised some “bureaucratic bristles.” However, the former Secretary also felt like Bluegrass took over a horrific problem for the Cabinet and the house purchase would not have been an issue for him at the time because he was more concerned about what Bluegrass was going to do for the programmatic aspect of Oakwood. At the time, the former Secretary was concerned with Bluegrass’ plans to address personnel issues and retirement costs, correct federal compliance issues, and basically protect clients’ lives. If a house was purchased, the former Secretary feels that the former President/CEO would have considered this purchase justified because Bluegrass was putting their reputation at risk by assuming the responsibility of operating and improving Oakwood.

While there was no documentation to support that the Board approved the purchase, there was documentation that the Board was informed of the purchase. A memo to the Board from the former President/CEO regarding Oakwood dated November 1, 2006, documents the information provided to the Board in regards to this purchase.

As earlier reported, a residence has been purchased and furnished for the use of the many staff who are in Somerset on a daily basis. This has proven to be a great asset, as it allows a place of respite and retreat away from the stresses of the campus while providing for a sense of community that cannot be accomplished in a hotel. The house is set up as an office with full wireless integration to Bluegrass (and Oakwood) and has teleconferencing capability. Staff can sign on to computers in remote desktop mode and emulate their office computers. There is a large room where we conduct staff meetings in the evenings and on weekends.

The purchase price was \$295,000 and my estimate would be that a comparable house in Lexington would be marketed at \$550,000 - \$600,000. Furnishings for the house came in well under my target at under \$30,000. I have charged all of this expense to the transition allocation from the Cabinet for Health Services.

Board members state purchase of house and furnishings handled directly by President/CEO

According to the interviews conducted during this examination, some of the Board members recalled approving this purchase and others remembered discussing the purchase. While the purchase may have been approved or discussed in a Board meeting, though not recorded in meeting minutes, the Board members interviewed were comfortable in stating that the house selected and the amount spent was determined by the former President/CEO. In fact, the purchase of the house and its furniture was handled directly by the former President/CEO.

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Bluegrass did not document savings realized from the purchase of the house

According to the majority of Bluegrass staff and Board members involved in the transition with Oakwood, this house was crucial to the transition and assisted them in preparation and travel costs. This house was used by the Bluegrass employee that was assigned to be the facility director at Oakwood who lived there almost permanently for a year. In addition, the other members of the management team also used the house so that there was no need for lodging costs, and meetings and interviews could be held privately. However, no prior analysis of savings was performed and no records were maintained as to the number of nights the house was used or by which Bluegrass staff.

On October 6, 2006, Bluegrass submitted an invoice to the Cabinet for \$661,818. The invoice was a summary of the amount of costs per category types. The house purchase was included in the \$320,622 amount submitted for administrative support. No details or invoices were provided regarding what was purchased for this amount. According to Bluegrass, this was the typical method of requesting reimbursement, though it appears that the purchase of a house would not be a typical expense. The actual invoices to support the purchases were maintained at Bluegrass in case of any questions or audits.

The auditors interviewed Cabinet personnel responsible for making contract payments to Bluegrass and found that this staff was unaware that a house was purchased with Cabinet funds. Cabinet management that worked with Bluegrass staff on-site at Oakwood was aware that Bluegrass had a house near Oakwood, but thought it was purchased with Bluegrass' cash reserves.

Invoices provided by Bluegrass did not indicate a house was purchased

After the Cabinet staff reviewed their information related to these payments in 2006, a second meeting between the auditors and Cabinet personnel was held. Cabinet personnel stated that the invoices submitted did not indicate that a house was purchased and, from reviewing the transition contract with Bluegrass, does not think that a reasonable person would think that a house would be an allowable purchase. When asked if this purchase could have been verbally approved by the former Cabinet Secretary, Cabinet personnel stated that the written contract supersedes any verbal agreements. See Exhibit 1 for a copy of the invoices Bluegrass submitted to the Cabinet for reimbursement.

In addition, Cabinet personnel review Oakwood's financial activity within the Bluegrass annual consolidated audited financial statements, yet no assets were recorded for Oakwood. According to the Bluegrass CPA, the house was recorded as an asset of Bluegrass, rather than Oakwood, on the consolidated financial statement because Bluegrass' name appeared on the deed. Further, the CPA stated he would not have expected an asset to be recorded for Oakwood because any assets purchased for Oakwood would be recorded on the state's financials.

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Cabinet staff also provided the auditors with emails to support that there were questions internally when Bluegrass submitted the invoices to request reimbursement under the transition contract. One of these emails contains the following statement: “There is like \$300,000 and some odd thousand dollars listed as administrative support. This does not include personnel or computer expenses as they are reported separately. The total bill is over \$600,000 for about a two or three week period. Please advise if we are to just pay based upon the invoiced amount or ask for additional detail.”

Cabinet did not request additional information regarding Bluegrass summary invoice that included house purchase

In response, the employee was told to pay the invoice as submitted “with the understanding that we can get the backup documentation at any time.” The email goes on to state a concern for a delay since Bluegrass must pay the payroll for three places and they are busy getting ready to take over Oakwood on November 1st. However, the email ends with the following question, “[w]ould you want to ask them to plan to give us a detailed expenditure listing with the next invoice or a detailed listing for expenditures for through the transition period, once the transition period is closed?” The Cabinet has no other documentation to support whether this information was ever requested.

After recent news media attention, the house and the furniture purchased with Cabinet funds were sold to an individual for \$292,000 and \$9,500 respectively. According to Cabinet staff, the house was bought with their money and was their asset. Additionally, because it was not known that Cabinet funds were used to purchase this house, Cabinet staff are now concerned about how much of the annual budget was used to maintain the house and pay for its utilities or other expenses.

The current President/CEO for Bluegrass has stated that the proceeds will go back to Bluegrass that provides significant services to the state and can be viewed as additional incentive to Bluegrass for the successful transition of the operation of Oakwood. It would be beneficial for the Cabinet and Bluegrass to move forward and negotiate how these funds should be handled to maintain a cooperative and productive working relationship.

Recommendations

We recommend that the Board discuss the purchase of the house and furniture with the Cabinet in order to negotiate how the proceeds from the sale of the house and furniture should be resolved. Considering that the house did reduce the amount of lodging and travel costs that would have been reimbursed by the Cabinet, this cost should be reasonably estimated by Bluegrass. This cost estimate should be reviewed for reasonableness by the Cabinet since no documentation to support these costs was maintained by Bluegrass. Further, the Cabinet and Bluegrass should review the annual budgets for Oakwood to determine if these costs included expenses related to the house. Finally, we recommend that these discussions consider the proceeds from the sale, along with any related expenses paid by the Cabinet through Bluegrass’ annual budget for Oakwood, be reduced by the amount Bluegrass estimates would have been spent for travel had the house not been purchased.

Findings and Recommendations

Finding 3: The Board did not take actions to address inherent conflicts of interests created by personal relationships that existed between Bluegrass employees.

Inherent conflicts of interests due to personal relationships were found in three instances among Bluegrass employees. In two instances, the relationships began after the individuals were already employed at Bluegrass, while another spousal relationship was clearly known by Bluegrass prior to the individuals being employed. This relationship did not initially create a conflict because there was not a direct line of supervision between the spouses until one was promoted into a supervisory role responsible for oversight of the other. Despite the knowledge of these personal relationships, the Board did not take immediate action to address the potential conflicts. In at least one instance, the Board's actions perpetuated the inherent conflicts of interests.

Conflict involving President/CEO and Director of Information Technology

In September 2009, the Director of Information Technology (IT) married the President/CEO's step-daughter and became her son-in-law. Because the Director of IT was supervised directly by the President/CEO, this created an inherent conflict of interest as the President/CEO was in the position to directly influence the Director's job duties, compensation, and benefits. While there was no evidence that the Director of IT received preferential treatment upon his marriage to the President/CEO's step-daughter, the Board should have considered that a potential conflict could exist and addressed the issue. Until recently, Bluegrass policies regarding employment of relatives did not address what steps should be taken when employees become immediate family members post-employment.

In July 2012, the Board approved a reorganization plan to change Bluegrass' management reporting structure so that the Director of IT reports to a vice president instead of the President/CEO. Based on the recommendation of the President/CEO to the Board's HR Committee, the full Board approved the reorganization plan to reestablish its use of vice president positions. Three vice presidents were appointed and report directly to the President/CEO with all the previous direct reports to the President/CEO now reporting to one of the three vice presidents. The President/CEO's recommendation to the Board and the Board's action were initiated after potential conflicts were disclosed in news media reports earlier this spring.

While the recent recommendation by the President/CEO and the action by the Board to alter the reporting structure were appropriate, the organization should have taken these steps when it became aware of the impending marriage. At a minimum, the Board should have ensured action was taken to address the supervisory structure for these two positions to eliminate the appearance that a conflict of interest existed.

Findings and Recommendations

**Conflict involving
former
President/CEO
and Vice President**

Just prior to May 2008, a former Bluegrass employee reported to a Board member that the President/CEO at that time was in a relationship with the Vice President of Administration and Operations who was directly reporting to him. The Board member asked the former employee to file a formal grievance so that the matter could be handled through Bluegrass' formal grievance policy. According to the former employee, a formal grievance was not filed because she had no grievance; the employee just thought the Board should be aware of the relationship due to the potential risk to the organization. While the issue was brought to a Board member's attention, and informally discussed by the Board member with other Board members, the issue was not formally presented by a Board member during a meeting and no formal action was taken by the Board to address the issue.

At some point, after the former employee's notification of the relationship to a Board member, the former President/CEO initiated a meeting with the Board to discuss the matter. The former President/CEO stated that he recognized the potential conflict and resigned his position as President/CEO. His resignation was announced to the Board during its May 2008 Board meeting. The former President/CEO stated that he continued in that position until after the October 2008 Board meeting only at the request of the Board.

There was no policy in place for staff to report a personal relationship occurring between an employee and their immediate supervisor to allow management the opportunity to address the supervision of the employee. The Board Chair stated that the Board believed a relationship between the two individuals could create a conflict if the former President/CEO continued, as he had for several months, to supervise the Vice President. While appropriate action was ultimately taken by those involved in the conflicted situation, a policy established to address relationships among employees and supervisors would have benefited the organization.

**Boards continued
employment of
former
President/CEO**

Upon notifying the Board of his intent to resign in May 2008, the former President/CEO suggested to the Board his conditions for continued employment as a contract employee of New Directions, the for-profit subsidiary of Bluegrass. Per meeting minutes of the May 8, 2008 Board meeting, the former President/CEO requested the following accommodations for continued employment:

- [Former President/CEO] would be CEO of Bluegrass New Directions (only) with no responsibilities for the other Bluegrass corporations and their operations,
- Board provided vehicle, [Former President/CEO] will have ownership conveyed to him upon retirement,
- Continuation or conversion of life insurance,
- Continued involvement in MHCA and IIMHL to include membership and attendance at meetings,

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- Understanding that [Former President/CEO] will be free to pursue non competing business opportunities,
- Continuation of all benefits,
- Access to [Executive Assistant] as needed,
- An equipped office at an off-site location,
- Annual salary rate of \$200,000.00,
- Necessary business expenses,
- Well thought out and orchestrated timing of announcement and transition of duties when [Former President/CEO] steps down as President and CEO,
- Annual salary review in August 2008, with amount that is contributed to [Former President/CEO] Deferred Compensation Account fully vested immediately.

After presenting these items for consideration to the Board of New Directions, the meeting minutes document that the Board of New Directions, after discussing the matter, made a motion, seconded, and passed the motion unanimously to approve all of the accommodations cited. According to a former Board member, when the former President/CEO resigned and “they hired him back on at this unbelievable salary to run a little dinky company,” the former Board member resigned. By this action, the Board of New Directions approved paying Bluegrass’ former President/CEO a \$200,000 salary to operate an organization with no direct employees on staff and a significantly smaller budget than that of Bluegrass.

On June 19, 2008, the former President/CEO contracted with New Directions serving as its Chief Operating Officer (COO) effective September 1, 2008. Within two years of becoming the New Directions COO on September 1, 2008, the former President/CEO eventually moved into the role of a consultant on contract (Contractor) and then independent consultant (Consultant) for New Directions. His salary was modified as his positions changed. See Appendix 1 for a timeline of the former President/CEO’s roles at Bluegrass and New Directions from February 18, 1999 to June 30, 2012.

Conflict involving President/CEO and Bluegrass’ New Directions Contractor

In December 2008, the former Vice President of Administration and Operations, who was known to be in a personal relationship with the former President/CEO, was selected by the Board to serve as Bluegrass’ Executive Director with the position title later changed to President/CEO of Bluegrass. These executives were married in 2009. As the President/CEO, she is responsible for all entities under the Bluegrass corporate umbrella, including both its non-profit corporations and the for-profit corporation, New Directions. According to the President/CEO, while she is responsible for the income, revenues, and contracts of all the organizations including New Directions, she has never supervised her spouse while he continued to be employed and under contract with New Directions.

Findings and Recommendations

The President/CEO stated that her spouse's contracts with New Directions were entered into by the Board and that she had to deal with this decision by the Board. The President/CEO stated that it was the Board who decided how much supervision the former COO, Contractor, and Consultant would need and believes the Board inserted itself in the management of New Directions to provide as much arms length as they could between her and her husband while they served in these roles.

*New Directions
infrequently
discussed by the
Board*

Through a review of Board meeting minutes for the period of January 1, 2008 through June 30, 2012, and in interviews with Board members, various Bluegrass personnel, and the former President/CEO, auditors found the operations and finances of New Directions was discussed infrequently by the Board. According to the former President/CEO, who served as the COO and later as a consultant for New Directions, he met with the Board as deemed necessary to discuss his work assignments. He stated that once he and the Board agreed on the direction of the work he was to perform, he proceeded to accomplish the work assigned.

As for day-to-day oversight, the former Bluegrass President/CEO in his capacity as the former New Directions COO and former Consultant stated that "after 40 years in the public sector you don't need a lot of day-to-day supervision." He noted that because he was the former President/CEO of the Bluegrass organizations he purposefully stayed away from the main campus as he felt that was the appropriate thing to do for whoever took over the leadership role at Bluegrass. He conducted his work as the COO, Contractor, and Consultant offsite from the main campus but would occasionally "slip in the backdoor" at meetings to speak with the Board.

*President/CEO
signed timesheets
for 526 hours of
work paid to her
husband*

Through a review of the timesheets submitted by the former COO, Contractor, and Consultant between June 2008 and June 2012, auditors found that the current Bluegrass President/CEO signed her husband's timesheets on 32 occasions. Most of these occasions occurred while he served as a Consultant for New Directions between November 2010 and March 2012. In total, the President/CEO approved over 526 hours of work time to be paid to her husband. According to the President/CEO, her signature meant nothing about supervision but was needed to process the timesheets through payroll.

By its own actions, the Board entered into the contracts with the former President/CEO to function as a COO for New Directions and later as a Contractor and Consultant. However, there was little indication that oversight by the Board occurred. The only evidence supporting his work with New Directions was the Board's meeting minutes that rarely discuss New Directions and the timesheets he submitted that were either unsigned or were signed by his spouse, the President/CEO of Bluegrass.

Findings and Recommendations

No evidence that Bluegrass' President/CEO determined husband's salary or benefits

The Board's continuous contracting with the former President/CEO after a personal relationship was known to exist with the person hired as the new President/CEO displayed that the Board continued to inadequately address this inherent conflict. Because of the ongoing relationship between the current President/CEO and the former President/CEO, the Board should have taken steps to sever any supervisory oversight of this working relationship once the Board was aware of the issue. While the President/CEO did not determine her husband's salary and benefits or sign the contract for his services, the appearance of an inherent conflict exists. No evidence was found that this hindered any decisions made by the President/CEO; however, the appearance of a conflict cannot be denied or ignored.

Conflict involving Facility Director and Compliance Director

In 2006, Bluegrass began its management of the Oakwood facility in Somerset, Kentucky. According to the current Bluegrass HR Director, as part of the Bluegrass plan for management of the Oakwood facility, the former President/CEO recruited the services of a married couple from Florida who were known for their work in operating a facility similar to Oakwood in that state. The couple was hired to serve as an Assistant Facility Director and Compliance Officer at Oakwood. While the couple may have been hired concurrently, no conflict existed at this time because neither spouse was placed in a supervisory position over the other in the organizational reporting structure.

On June 16, 2008, the Assistant Facility Director was promoted to Facility Director and became responsible for direct supervision of his spouse, causing an inherent conflict of interest. According to the HR Director, the President/CEO did not consider the couple's situation as one that would require an alternative reporting structure because the Facility Director does not make the final decisions on Oakwood's personnel or budget issues. These decisions are made by the President/CEO and the HR Director of Bluegrass.

To gain a better understanding of the Facility Director's level of involvement in the personnel decisions involving his spouse, auditors requested and examined the annual performance evaluations of Oakwood's Director of Compliance for 2009 through 2011. The performance evaluation documents indicate that both the Facility Director and the President/CEO performed the evaluations. However, email documentation maintained by Bluegrass shows the 2009 and 2010 evaluations were actually completed by the Facility Director, the employee's spouse, and then emailed to the President/CEO for her final approval. The President/CEO did not offer any input into the evaluations performed by the Facility Director in 2009 and 2010, but there was documentation that indicates the President/CEO verbally discussed the evaluation with the Facility Director in 2011.

Findings and Recommendations

While it appears Bluegrass has attempted to provide a secondary level of review to offset potential conflicts in this situation, this process is insufficient to address the inherent conflict that exists. Someone other than the Facility Director, perhaps someone responsible for facility compliance at the regional level, should be the person responsible to supervise this employee and perform the evaluation. The evaluator could accept input from various sources, including the Facility Director, but the evaluation should be conducted by an independent supervisor that is not married to the employee.

Recommendations We recommend the Board revise its nepotism policy to require employees to report to the HR Department when a personal relationship develops between an employee and their immediate supervisor. Bluegrass should consider not only personal relationships through marriage but also situations where a supervisor and employee are dating. This disclosure should be evaluated by the HR Director and presented immediately to the Board's HR Committee for consideration as to how the situation should be addressed in a reasonable and effective manner. The recommended action by the HR Committee should then be reported to the full Board during its regularly scheduled monthly meeting. This policy should include a statement that, by reporting a relationship, the employees will not be adversely affected but that the lack of reporting could have an impact on their employment with Bluegrass.

We recommend the Board develop and implement a process by which it may receive and investigate anonymous concerns without a formal grievance having to be filed. The lack of a formal grievance should not preclude the Board from investigating significant information brought to the Board by a reliable source, especially one of Bluegrass' executives. This process could include the provision that the Board may appoint a committee from its body to evaluate and investigate the reported issue or a Board attorney could evaluate the situation. Upon conclusion, this committee should report its findings to the Board and any recommendations deemed necessary to resolve the issue.

Finally, we recommend the Board carefully consider the personal relationships of its senior management when entering into contracts for employment or consulting services. Without adequate separation of duties and independent oversight, the Board should not hire or contract with an individual that has a personal relationship with, or is an immediate family member of, Bluegrass' President/CEO. The Board should take every precaution to ensure that its leadership is independent and not involved in potential biases that could affect their decision making ability.

Findings and Recommendations

Finding 4: Cash reserves for Eastern State Hospital and Oakwood have been maintained or increased during our examination period; though each has a stable funding source.

Due to the stability and reliability of the contract revenue Bluegrass receives from the Cabinet to operate Eastern State Hospital and Oakwood, the need for cash reserves for these organizations is reduced. Based on a negotiated annual budget, the Cabinet provides monthly payments to Bluegrass for each facility. While the benchmark of 90 days of cash on hand is a recommended reserve amount for nonprofit organizations, a single standard does not apply to all nonprofits. The variables involved in this determination should be the stability of cash receipts and the effect that reserving cash has on the services provided or the potential to expand services. Maintaining a high amount of cash reserves for organizations that have stable income could prevent a beneficial expansion of services and compensation benefits. Efforts must continually be taken to ensure that funds are used to effectively carry out the mission of each organization, while also considering the amount of cash reserves required for the business to remain financially secure.

Different organizations need different amounts of cash on hand. The variables involved in this determination should be the stability of cash receipts, source of cash reserves, and the effect that reserving cash has on the services provided. Nonprofits in the healthcare industry have been making efforts to increase the number of days of cash available in reserves in the event that a client's insurance or Medicaid does not pay timely. The publicized concerns related to the use of managed care organizations have also impacted Bluegrass' concerns about the timeliness of client payments. Bluegrass has an additional financial concern of increasing employer costs related to the Kentucky Retirement System for over 2,100 of their employees.

Cabinet concerned by cash reserves for Eastern State Hospital and Oakwood

While the Cabinet is pleased with Bluegrass' overall financial management, Cabinet staff expressed concern regarding the amount of cash reserves for Eastern State Hospital and Oakwood. For Eastern State Hospital, the Cabinet pays Bluegrass a contracted amount each month according to an approved budget based on estimated operating costs plus an eight percent administrative fee. This monthly fee is paid by the 5th of each month. Therefore, Bluegrass could have excess revenue if Eastern State Hospital's operating costs are less than expected. However, according to the Cabinet, this contract stipulates that excess revenue should go back into community support services to provide alternatives for hospitalization. At the end of each audit, if there are excess revenues, a plan should be submitted as to how excess funds will be used to develop community alternates to hospitalization for adults with severe and persistent mental illness.

Oakwood's contract with the Cabinet is also based on an approved annual budget amount but it is paid on a reimbursement basis. At the end of each month, Bluegrass submits a detailed summary of expenses plus the eight percent administrative fee, which is reviewed and paid by the Cabinet; however, the annual amount paid cannot exceed the approved budget amount at the beginning of the year. Therefore, cash reserves are not expected by the Cabinet because the administrative fee would be going to the main organization as administrative costs and not staying with Oakwood.

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Method of payment to Eastern State Hospital and Oakwood reduces risk of untimely payments

Due to the method of payment from the Cabinet for operating these two organizations, the risk of not receiving timely payments for incurred costs is greatly reduced. According to the Cabinet, in FY 2014, Eastern State Hospital's contract will be paid in the same manner as the Oakwood contract, which is on a reimbursement basis not to exceed a negotiated annual amount. After this change, cash reserves for either facility would not be expected by the Cabinet. The Cabinet staff stated that maintaining cash reserves for the Bluegrass CMHC is reasonable because it provides services to individuals that may not be able to pay or clients whose services are paid by Medicaid or a managed care organization that could have delays in providing payments.

Cash reserves for organizations should be evaluated separately

Considering that the Board is providing oversight for two separate contracts with the Cabinet, the cash reserves for each organization should be evaluated separately. In fulfilling its contractual obligations, a determination should be made regarding whether there are cash reserves for these organizations and how any excess revenue should be administered. If reserves are included in the negotiated budget with the Cabinet, the need and purpose of these reserves should be understood by the Board. However, the Board meeting minutes did not document that the Board separately evaluates the cash reserves associated with Eastern State Hospital and Oakwood.

According to the CPA that conducts Bluegrass' financial statement audits, a large cash reserve is a positive situation and indicates how well run Bluegrass is and why the state seeks out Bluegrass to operate state facilities. The CPA had not recommended a specific number of days to maintain cash on hand and agreed that the organization most affected by Medicaid and managed care payment delays is Bluegrass' CMHC.

Bluegrass' audited consolidated financial statements contain a Balance Sheet and Statement of Operations that includes separate reporting for Eastern State Hospital and Oakwood. This financial information was used to calculate the number of days of cash on hand that Bluegrass maintained from FY 2009 through FY 2012 for these two organizations. To calculate the number of days of cash on hand, the following formula was used:

$$\frac{\text{Cash and Cash Equivalents Plus Short Term Certificates of Deposit}}{\text{(Total Expenditures Less Depreciation and Amortization)/365}} = \text{Days of Cash on Hand}$$

The following table illustrates the information needed to perform the cash on hand calculation and the calculated number of days that Bluegrass had cash on hand at the end of each fiscal year.

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Table 3: Cash on Hand Calculations for Eastern State Hospital and Oakwood

	FY 2009	FY 2010	FY 2011	FY 2012
Eastern State Hospital				
Cash and Cash Equivalents	\$7,295,213	\$5,010,932	\$7,390,805	\$7,460,258
Certificates of Deposits – Short-Term	196,000	98,000	98,000	98,000
Total Expenditures	\$35,414,649	\$36,397,483	\$38,104,337	\$37,360,952
Depreciation and Amortization	0	0	0	0
Number of Days Cash on Hand	77	51	72	74
Oakwood				
Cash and Cash Equivalents	\$5,490,698	\$7,064,009	\$10,019,174	\$12,793,462
Certificates of Deposits – Short-Term	0	16,184	200,000	200,000
Total Expenditures	\$69,673,364	\$69,020,023	\$64,049,093	\$50,296,709
Depreciation and Amortization	0	0	0	0
Number of Days Cash on Hand	29	37	58	94

Source: Auditor of Public Accounts based on the audited financial statements provided by Bluegrass.

Once the most liquid and short-term assets are exhausted, organizations must then depend on their long-term investments. To make decisions about the amount of cash reserves needed, long-term investments should also be evaluated for each organization. Bluegrass has invested conservatively in long-term certificates of deposit and does not invest its resources in the stock market. The following table details the number of days of cash on hand along with Bluegrass’ long-term investments maintained for each organization during recent years.

Table 4: Summary of Bluegrass’ Cash on Hand and Long-Term Investments

	FY 2009	FY 2010	FY 2011	FY 2012
Eastern State Hospital				
Number of Days Cash on Hand	77	51	72	74
Long-Term Certificates of Deposit	\$490,000	\$589,000	\$1,247,000	\$1,275,000
Oakwood				
Number of Days Cash on Hand	29	37	58	94
Long-Term Certificates of Deposit	\$0	\$485,000	\$1,305,000	\$1,305,000

Source: Auditor of Public Accounts based on the audited financial statements provided by Bluegrass.

Findings and Recommendations

According to Bluegrass’ Board meeting minutes, recent actions approved by the Board have involved the use of cash reserves to address employee morale issues resulting from news media reports. In June 2012, the Board approved an employee appreciation bonus of 3 percent of the employee’s base pay for the calendar year to staff at the CMHC, Eastern State Hospital, and Oakwood. In addition, a cost of living increase for FY 2013 was approved for employees of the CMHC and Eastern State Hospital of four percent for employees paid under \$50,000 and three percent for those paid over \$50,000. According to the Board minutes for June 14, 2012, it was estimated that the appreciation bonus for the calendar year would entail using “all of our bottom line and an additional \$823,648 in reserves.” The routine annual cost of living raise “would further reduce reserves during FY 2013 by \$1,697,617.”

Recommendations

We recommend that the Board request and review an analysis of any cash reserves related to Eastern State Hospital and Oakwood separately so that any funding and stability concerns can be evaluated individually. The Board should evaluate the amount of cash on hand for each organization to determine whether there is excess revenue. We further recommend that this analysis include a review of any long term certificates of deposit to ensure that complete information is considered by the Board. In addition, the Board should have an understanding of the purpose of any cash reserves to make informed decisions when approving the negotiated budgets for each organization.

We also recommend the Cabinet perform an analysis of the cash reserves and long term certificates of deposit for Eastern State Hospital and Oakwood to ensure the reserves were accumulated appropriately. Excess revenue related to Eastern State Hospital should be spent on additional community support services as required by the contract. Cash reserves and excess revenue related to Oakwood should be questioned by the Cabinet to determine whether there are issues with Bluegrass’ reimbursement requests.

**Finding 5:
Consolidation of
board governance,
management, and
infrequent
reporting of New
Directions creates
the appearance
that the Bluegrass
entities are not
truly separate.**

During this examination, auditors reviewed the relationship between the non-profit organizations of Bluegrass and the for-profit entity, New Directions. During the examination, we found that Bluegrass New Directions was created as a separate legal entity wholly owned by Bluegrass, but the operations and governance of these entities were often the same. By operating with the use of the same personnel, resources, and board governance, it becomes difficult to make a distinction between the organizations. Auditors believe these commonalities, coupled with conflicts of interests, infrequent reporting or discussions of its for-profit subsidiary operations, leads to confusion among board members and the general public regarding whether these organizations are truly separate and distinct entities. Given the public nature of the services Bluegrass organizations provide through the CMHC and contracts with the Cabinet to operate two state facilities, the organizations must clearly distinguish their actions to provide greater transparency and accountability.

Findings and Recommendations

Board Governance

While the for-profit and non-profit organizations under the Bluegrass umbrella are created as separate legal entities, with separate articles of incorporation and bylaws, the boards of these organizations and management often operate the organizations as if they are a single entity. The boards of Bluegrass Regional MH/MR Board, Bluegrass Regional Psychiatric Services, Bluegrass Oakwood, and Bluegrass New Directions, as well as the other subsidiaries, contain the same membership and hold their meetings concurrently with one set of minutes maintained for the meeting to document discussion of the boards. The Bluegrass President/CEO, who is responsible for the operation of each of these organizations, stated that it is easy to ebb into one meeting stating that the Board's discussion may change from one topic to another and that these topics could affect more than one of the organizations managed by Bluegrass.

In reviewing board meeting minutes, auditors found inconsistencies with how the Board managed the consolidated meetings of the various boards. In most cases, the conversations did ebb and flow as if the various non-profit organizations and the for-profit organization were one consolidated organization. However, on occasion, the Board would identify that it was taking an action specifically as the Board of Bluegrass New Directions.

Board minutes do not consistently distinguish which Board is taking action

On August 28, 2008, Board meeting minutes document that the Board went into executive session and discussed the Executive Benefit Plan and the evaluation of the Bluegrass President/CEO. In executive session, the former President/CEO requested the Board fund the Bluegrass Executive Benefit Plan for the coming year; then a motion was made, seconded, and approved unanimously by the Board. Before returning to regular session, the Board then reviewed the evaluation of the former President/CEO and approved a salary recommendation from the HR Committee. For these two actions, the governing body taking action was identified as "the Board" despite the fact that the boards responsible for these two issues were legally two separate bodies. When inconsistencies in how the Board handled some of its discussions and decisions were identified, the President/CEO acknowledged that the organization could do better.

While the Board may believe it reasonable to conduct meetings of each board concurrently to save time and allow the discussions to ebb and flow from topic to topic, official action taken by the boards should distinctly identify by which governing body the action is being taken. In other words, if an action is taken that pertains only to the for-profit organization, the boards would benefit from identifying for the official record that the action is that of the New Directions Board.

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Bluegrass and subsidiary organizations bylaws differ regarding board membership

In addition, auditors found the bylaws for the four main organizations of Bluegrass have different requirements for board membership size. While the boards appear to have had enough members to hold a meeting with a quorum sufficient to meet the requirements of the various bylaws, the bylaws of Bluegrass Oakwood and Bluegrass Regional Psychiatric Services require the body of the membership at a minimum to consist of 23 and 36 members, respectively. However, at the beginning of this examination auditors found the Board membership consisted of 20 members, which is the minimum required by Bluegrass Regional MH/MR Board and Bluegrass New Directions. Although the Board may conduct meetings of each board concurrently, Bluegrass should also be mindful of this variance in the organizations' bylaws. Each board should operate in accordance with its own bylaws.

Auditors also found that the bylaws of Bluegrass Oakwood and Bluegrass Regional Psychiatric Services state that the Chair of the Board shall be the Chief Executive Officer of the organization. Since this does not appear to be how the organizations are functioning, it would be appropriate for the boards of these two organizations to either comply with the organizations' bylaws or to reexamine the bylaws and make the necessary changes so that the bylaws and the operations of the organizations agree.

The boards may also benefit from having legal counsel present for meetings to assist the boards while conducting their meetings. Until recently, Bluegrass Regional MH/MR Board had employed the services of an in-house attorney. In an interview, the former Executive Counsel stated that while he attended some of the monthly board meetings, his involvement was not as extensive as other executive management such as the CFO and President/CEO. Despite his role as Executive Counsel, the former employee felt he was involved to some extent, but noted that longevity with the organization counted more towards your involvement than the position you held.

Management

Similar to the way the boards of the various Bluegrass organizations have conducted their meetings, the operations of the various Bluegrass organizations are centrally handled by and are the responsibility of the executive management of the Bluegrass Regional MH/MR Board, Inc. While there is nothing wrong with having centralized management of its organizations, the complexity and inconsistency in which management has been engaged to operate the organizations has caused a great deal of confusion even among its board membership.

*Bluegrass
President/CEO
retires in 1999 to
begin service as
employee of New
Directions
performing same job
duties*

In 1999, the President/CEO, at that time, was retiring from Bluegrass and its Board decided to establish a for-profit subsidiary, New Directions. The Board hired its President/CEO as the President/CEO of the for-profit subsidiary. In addition, an intercompany agreement between New Directions and Bluegrass was entered into for the for-profit to provide management services to the non-profit organization. By this action, the President/CEO was allowed to retire from the non-profit, receive payment from his Kentucky Employee Retirement System (KERS) account and continue operating Bluegrass and all its subsidiaries as he had previously. Several Board members noted that this allowed the organization to keep the former President/CEO without having him “double-dip” in KERS, because the for-profit does not participate in KERS. Bluegrass Regional MH/MR participates in KERS as a mental health board. See Chapter 1, introduction and background page 5 for additional details regarding the non-profit’s inclusion in the Kentucky Retirement Systems.

According to the former President/CEO, the creation of New Directions was, in part, to protect the non-profit status of Bluegrass as the Cabinet was asking Bluegrass to initiate managed care and Bluegrass believed this would result in Bluegrass having unrelated business income. While managed care did not become a reality, the for-profit organization was already formed and the former President/CEO stated that he began to think of ways the new for-profit could continue to operate and benefit Bluegrass. Between 1999 and 2002, New Directions only had one contract for services that generated revenue, which was the intercompany agreement with Bluegrass to provide the non-profit with a President/CEO. In 2002, New Directions began entering into contracts with outside organizations to provide after-hour answering services to other entities and later entered into contracts to provide other services such as information technology support and computer software applications developed by Bluegrass.

In 2008, the former President/CEO under contract with New Directions announced his intent to no longer serve as the CEO of Bluegrass and entered into another contract with New Directions, as its COO. Shortly after this announcement, the Board of Bluegrass hired its Vice President of Administration and Operations, with whom the former President/CEO had a personal relationship, to serve as the former President/CEO’s replacement. In conjunction with this new contract for COO services, Bluegrass entered into a second inter-company agreement with New Directions for the for-profit to provide consulting services to the Bluegrass non-profit for the period of time that the former President/CEO would be serving as COO at New Directions.

The former President/CEO served as COO for New Directions from October 2008 until January 2010 when he entered into another contract with New Directions moving into the role of a consultant on contract (Contractor) and then independent consultant (Consultant) for New Directions. See Appendix 1 for a timeline of the former President/CEO's roles at Bluegrass from February 18, 1999 to June 30, 2012.

While the current President/CEO is responsible for all entities under the Bluegrass corporate umbrella, the continued employment and contracting, by the Board of New Directions, with the former President/CEO of Bluegrass between 2008 and 2012, has created confusion among the public it serves and its Board as to the leadership of its for-profit. One former Board member stated that he was uncertain who was in the leadership role at New Directions since the former President/CEO had officially resigned in his capacity as a contractor with New Directions in June 2012, despite the fact that this former Board member was serving as a Board member at the time.

In addition to the continued contracting with the former President/CEO, auditors believe the personal relationship between the former President/CEO and the current President/CEO has also contributed to confusion expressed by those in the public. See Finding 3 for more information on the inherent conflict that existed due to this personal relationship.

Financial Reporting

While the Board receives regular monthly reporting for Bluegrass Regional MH/MR, Bluegrass Oakwood, Bluegrass Psychiatric Services, and its HUD operations, the Board did not receive routine reporting for its for-profit organization, New Directions. According to one former Board member, after news media reports this past spring regarding the agency's for-profit subsidiary, he found that the monthly reports did not include financial information pertaining to the for-profit organization. The Board member assumed that the financial information for the for-profit was consolidated in the monthly reports. Upon realizing this information was not provided to the Board, he expressed his desire for additional financial reporting to the Board.

According to the Chief Financial Officer (CFO), although the Board does not receive a financial report for the for-profit except at year end, the CFO provides the Audit and Finance Committee of the Board with a quarterly update on the for-profit corporation. In terms of budgets, she stated that she would tell the board about the budget of New Directions and the HUD organizations but would not have a formal presentation for those organizations as the Board's focus was on the three larger non-profit companies. The CFO pointed out that the Board could ask questions about the for-profit financials, but that most questions from the Board related to the larger budgets.

Findings and Recommendations

Current and former Board members interviewed, along with the current and former President/CEOs, describe the financial and operational activities of New Directions as small and requiring little attention from executive management and the Board. While it may be appropriate to focus attention on the larger amounts, the Board is the same Board for all the organizations under the Bluegrass corporate umbrella and, as such, has the same fiduciary responsibility to the for-profit as it does the other organizations. Routine reporting to the Board of financial activity of the for-profit is also important as the organization is incurring expenses that are unique to that organization, specifically lobbyist fees. Further, because Bluegrass employees provide staff support for New Directions, the Board should have an understanding of the amount of time and cost involved for staff to perform work at New Directions.

Bluegrass lobbying expenses are incurred by its for-profit subsidiary

Beginning in January 2012, management started incurring 100 percent of its lobbyist expenses under New Directions. The President/CEO stated that while the non-profit organization does have non-public funds such as private insurance money and interest on reserves that can be used to cover the costs of lobbyists, the organization took the action to charge these costs to its for-profit subsidiary out of an “abundance of caution” after receiving criticism for incurring lobbyist expenses as a non-profit by the public. See Finding 7 for additional information pertaining to lobbying expenses.

While examining Bluegrass’ Consolidated Financial Statements for fiscal years 2009 through 2012, auditors noted New Directions has recorded a loss for three of the last four fiscal years. According to a former Board member, the losses incurred by New Directions are something that has recently been discussed. According to the CPA performing the annual audit, the majority of the losses by New Directions were the result of depreciation expense for software developed by New Directions. The losses for fiscal years 2009, 2010, and 2011 were (\$10,850), (\$360,727), and (\$187,734) respectively. In fiscal year 2012, depreciation expense was down to \$680, and New Directions reported income of \$43,155 for that fiscal year.

More routine reporting of the for-profit subsidiary financials to the Board may encourage more frequent discussion of the organization by Board members and management. Through these discussions, the Board may gain a better understanding of the for-profit’s operations, financial and other activity, and management.

Bluegrass Regional MH/MR is a non-profit company, serving the Cabinet as a mental health center under KRS 210.370, and, as such, participates in KERS. Given that the organization is providing a public service on behalf of the Cabinet and it is operating two state facilities through contracts with the State, the boards and management of these organizations must consider its actions when conducting business and make a reasonable effort to provide greater transparency and clarity.

Findings and Recommendations

Recommendations We recommend the Board of Bluegrass, along with the boards of its subsidiaries, ensure these organizations are clearly operated as distinct organizations and specifically identify the governing body taking formal actions while in meetings of the boards. To assist the boards in their efforts to provide greater transparency and to guide the boards while conducting business of the non-profits and for-profit collectively, we recommend the boards engage the services of a legal counsel for the purpose of providing advice during board meetings.

We recommend the boards of each Bluegrass organization, along with management, review the bylaws of each organization to ensure that the boards are operating in agreement with their bylaws.

We recommend executive management provide the Board of New Directions monthly financial reports using the same format currently used in reporting financial activities of the non-profit organizations to the other boards. This should include a combined balance sheet and statement of operations to date and in comparison to the prior year.

**Finding 6:
Approximately
\$38,000 of credit
card purchases
during an 18-
month period was
not supported by
detailed receipts.**

Credit card expenditures totaling almost \$38,000 initiated by the current President/CEO and the former Consultant for New Directions, also the former President/CEO, were not supported by detailed receipts. While explanations for the purposes of the charges were provided during the examination, certain charges were questioned as excessive or inappropriate due to a lack of a documented business purpose. In addition to credit card purchases, our review of expenditures included employee reimbursements and payments to vendors for the period January 2011 through June 2012. Detailed receipts and a documented business purpose are needed to minimize the risk that Bluegrass is paying for unnecessary, excessive, or personal expenses.

**Credit Card
Purchases**

Bluegrass maintains several credit cards to be used for purchases related to serving Bluegrass' clients and purchases for the general operation of the organization. For the examination period, we reviewed credit card purchases from American Express, Visa, Hobby Lobby, Home Depot, Lowe's, Discover, and Target. A review of several purchases made using these credit cards found a lack of supporting documentation and no documented business purpose. The following table provides the amounts paid during this period for each of the credit cards:

Chapter 2
Findings and Recommendations

Table 5: Credit Card Expenditures Reviewed

Credit Card	Amount Paid	Amount Not Supported by Receipts
American Express	\$34,947	\$32,614
Visa	58,138	5,346
Hobby Lobby	1,985	N/A
Home Depot	16,131	N/A
Lowe's	118,388	N/A
Discover	159,712	N/A
Target	2,242	N/A
Total	\$391,543	\$37,960

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

No receipts attached to credit card statements

We found that the receipts for purchases were attached to the majority of the credit cards except for those cards issued to Bluegrass' President/CEO and the former Consultant for New Directions. The President/CEO had charges totaling \$26,122 and the former New Directions' Consultant charged \$6,492 on their assigned American Express cards. No receipts were provided for charges on these two American Express cards. In addition, a Visa card used by the President/CEO during the examination period had \$5,346 of expense charges that had no receipts to support the purchase. In total, almost \$38,000 in credit card charges were made during the period examined without the support of a detailed receipt.

The Bluegrass CFO was also assigned an American Express card and \$915 in charges were made to this card during the examination period. Auditors found that all of these charges were supported by an original detailed receipt.

The American Express cards included charges for out-of-state travel, as well as local meals and gasoline expenses. The former New Directions Consultant used his credit card routinely to purchase gasoline, though his contract did not indicate that this type of charge would be reimbursed. According to Bluegrass management, the Visa card was used to make payments to vendors that do not accept American Express charge cards. The charges to the Visa card were primarily business expenses for background checks, utility bills, and medical prescriptions.

According to the CFO, it was the practice that the President/CEO was not required to maintain the receipts for the expenses incurred on her assigned credit card. However, this practice is not reflected in the credit card policy provided by Bluegrass, nor does it address why the former New Direction's Consultant is not required to maintain receipts.

Bluegrass provided auditors with an Executive Staff Credit Card Usage policy that relates to Bluegrass' American Express credit card spending only and not the other credit cards used throughout the organization. According to this policy, the President/CEO designates the users of the American Express card. The policy requires each user to supplement the monthly statement with a written description of the transactions made using the credit card, but it does not specifically state that an actual, itemized receipt is required. The Board Chair is required by this policy to review the monthly American Express invoice for appropriateness and may ask for additional documentation.

Board Chair was not aware that itemized receipts were not attached

The monthly American Express statements for the President/CEO and the former New Directions' Consultant were approved by the Board Chair for payment. However, during interviews with the Board Chair, it was stated that he was not aware that the itemized receipts were not attached, which may indicate that a thorough review was not performed or that the monthly credit card statement was considered to be the invoice. The credit card statements did have handwritten notations regarding certain expenditures, but it was not clear who made the notes. For example, a restaurant charge may have a list of names but not the business purpose for the meal. Any gas purchase would have a note that said "Board Vehicle" but no additional information. According to the Bluegrass CFO, the Board Chair did not request any other documentation after his review of the expenditures.

The current President/CEO's contract at Bluegrass states that the employee "shall be reimbursed for reasonable and appropriate business expenses upon the provision of receipts for expenses." In addition, the contract states that the employee "shall have the full use and operating expenses of an Employer provided vehicle." This contract does not state that a credit card will be provided nor does it provide guidelines for its use; however, the contract clearly states that receipts are required for reasonable and appropriate business expenses and that vehicle expenses will be paid by Bluegrass.

The contract for the former Consultant with New Directions, who is also the former Bluegrass President/CEO, states that the Consultant "shall be reimbursed for business expenses incurred in performing the duties assigned by the Employer." The contract did not address issuing a credit card or provide a specific provision for paying any vehicle operating expenses for the former Consultant.

According to the CPA that performs Bluegrass' financial audits, the lack of receipts for the current President/CEO and the former New Directions Consultant was previously brought to the attention of management. He stated that management was aware of the issue and comfortable with the decision not to require the original receipts to support the credit card statements.

Findings and Recommendations

Given that the former New Directions' Consultant was also the former President/CEO for Bluegrass, it appears that the use of an American Express card without requiring receipts for purchases was a benefit that the Board allowed to continue even though it was not included in the Consultant's contract. During the examination period, the former Consultant incurred expenses similar to the current President/CEO for local gasoline purchases and meals.

Other questioned credit card purchases were identified due to the lack of a documented business purpose. While these receipts were signed by a supervisor with a location and accounting code written on the receipt, there was typically no documentation stating the need or business purpose for the charge. While those accounting for these expenses had an understanding of the financial accounting codes used to record the transactions in the accounting system, a written explanation of the purpose for the expense was not provided. For example, there were credit card charges for 11 gift cards in different amounts totaling \$2,000, a 25 day car rental expense for \$2,500, 30-day plans with AT&T, a \$450 purchase of tickets to the Eastern Kentucky University Center for Performing Arts, and a \$346 purchase of six football and six basketball tickets for University of Kentucky games.

After discussing these expenditures with the CFO, an explanation of the purchases was provided. The explanations provided for these examples included giving staff awards, renting a vehicle due to garage repairs being made for a van used to transport children, and items purchased for clients who then reimbursed Bluegrass with their own money. Written explanations for these types of purchases would allow a reviewer to determine whether expenses were excessive or inappropriate.

Considering the inherent risk associated with the use of any credit card assigned to staff, the original detailed receipts are necessary to document the purchases made by all Bluegrass employees. Without these receipts, the Board cannot ensure that excessive or personal expenses are not being paid by Bluegrass. Providing the New Directions Consultant with a company credit card also elevates this risk and illustrates the Board's inability to sever this former relationship.

Employee Reimbursements

Reimbursements requested by employees during the period examined totaled \$27,808. We reviewed a sample designed to examine all of the reimbursements made to employees that received \$3,000 or more during this period. This resulted in reviewing reimbursements to four employees who received a total of \$19,597. The reimbursements were for out-of-state travel, conferences, meetings, and the purchase of work-related materials. This review found that all of the receipts were attached to each of the reimbursement requests. While an explicit statement of the business purpose may not have been provided for all of the expenditures, the business purpose could be determined from the information contained on the travel authorization from supported by detailed receipts.

Findings and Recommendations

Payments to Vendors

The examination also included a review of the payments made to a sample of Bluegrass' vendors during this review period. The amount of the payments reviewed totaled over \$2.9 million dollars. These payments were supported by invoices as appropriate and the review procedures were consistent with the policy. The only issue identified during this review was related to the monthly lobbying invoices that did not provide any detail of the services performed. See Finding 7 for more information on this issue.

Recommendations

We recommend that the Board broaden their credit card policy to include use and review procedures for all of Bluegrass' credit cards. We recommend the adopted policy require the card user to provide itemized receipts to support all expenses. We also recommend the policy require a purchase to have a documented need or purpose to ensure that expenditures are completely supported prior to payment. This policy should apply to all Bluegrass employees, including contract consultants or employees, without exception. If an adopted policy determines a minimum dollar amount for which a receipt is not required, this policy should be consistent and apply to all staff and not just the President/CEO.

To limit the organization's risk of abuse or fraud, we further recommend that the Board review the number and type of assigned credit cards to ensure that each card is necessary. In addition, the Board should take actions to ensure that the credit card assigned to the former Consultant with New Directions is canceled.

We recommend that the Board Chair or designated committee of the Board determine whether the President/CEO has submitted required documentation for credit card charges. If required documentation has not been provided, the policy should state a reasonable time period for the documentation to be provided and a time period requiring reimbursement.

Finding 7: Bluegrass spent \$172,025 in lobbying expenses from January 2011 through September 2012 without adequate documentation of lobbying activities.

Bluegrass maintained contracts with three entities for lobbying services instead of employing someone within the organization to perform this responsibility. These contracts did not require the lobbyists to provide information or details of any lobbying activities conducted. Contracts were written so that invoices were only required if the entities requested reimbursement from Bluegrass for incurred out-of-pocket expenses. In our review of the lobbying expenses, we found that the contracted monthly payment amount was made regardless of whether an invoice was submitted. For the period of January 2011 through September 2012, Bluegrass paid \$172,025 for lobbying services, yet there is no documentation of what actual services were provided.

Findings and Recommendations

Bluegrass entered into lobbying contracts with two separate individuals and one firm. According to the contracts with the two individuals, they are obligated “to guide legislation and conduct legislative public relations related to the proposed new Eastern State Hospital and Oakwood.” Additionally, New Directions agreed to compensate each of these two individuals a total of \$20,000 per year. Payments of \$1,665 are paid each month without an invoice being submitted to Bluegrass. For both of the individual contracts, invoices are only required for the months in which expenses are incurred. Bluegrass, in addition to the \$20,000 payment, agreed to reimburse “for all reasonable and documented out-of-pocket expenses incurred” that can include “telephone, express mail, computer time, postage, mileage, food, lodging, conferences, and similar items up to a maximum expense limit of \$100 per month, without prior written approval.” Bluegrass can approve, in advance, larger expenses to be reimbursed if the expense is reasonable and documentation is provided.

The lobbying firm was contracted to provide lobbying services but these services are not defined in the firm’s contract with Bluegrass. During calendar year 2011, Bluegrass agreed to pay the firm \$5,500 per month for their lobbying services. According to the firm’s contract for calendar year 2012, the contracting party was changed to New Directions and the monthly fee was reduced to \$4,500 per month. According to the contracts for both years, invoices are only required if the firm is requesting reimbursement of any reasonable and customary out-of-pocket expenses incurred in connection with the conducted activities. Per the contract, Bluegrass did reserve the right to reject any such expenses that it deems to be either unreasonable or not customary.

The following table illustrates the amounts paid to each of the individuals and the firm for the period of January 2011 through September 2012:

Table 6: Bluegrass’ Lobbying Expenses

Lobbying Provider	Calendar Year 2011	January 2012 through September 2012
Individual A	\$20,000	\$15,005
Individual B	20,000	15,005
Firm	61,515	40,500
Totals	\$101,515	\$70,510

Source: Auditor of Public Accounts based on the agreements provided by Bluegrass.

Findings and Recommendations

Lobbying invoices provided no detail of services provided

For the period under review, the two individuals that had lobbying contracts with Bluegrass did not submit invoices and no other expenses were requested to be paid in relation to the services provided. However, the firm did submit receipts for its services at the beginning of each month, but their invoices did not provide any detail of the actual services performed. In calendar year 2011, the firm had additional expenses submitted for reimbursement of \$1,515, typically for restaurant charges. The receipts were attached to support the additional expenses and noted which individuals attended, but the receipts did not indicate the business purpose of the meal.

In July 2012 the Bluegrass President/CEO wrote a letter to the Board enumerating the recent activities performed by the contracted lobbyists but there is no documentation to support these efforts by the lobbyists. In interviews with auditors, the President/CEO stated that while the invoices may not be detailed, she is in constant contact and discussion with Bluegrass' contracted lobbyists.

Contracts do not require lobbying activities to be documented and the contract with the lobbying firm does not provide guidance regarding the types of lobbying activities desired by Bluegrass. While the combined amounts paid to the lobbyists on contract could possibly be less than hiring a fulltime staff member, Bluegrass management and Board members would be more informed of the activities performed and the events attended if a staff person oversaw the lobbying activities ensuring documentation regarding the services provided.

Recommendations

We recommend that Bluegrass amend all of its lobbying contracts to include additional language regarding the lobbying activities desired for Bluegrass to succeed in their mission. Further, we recommend the contract require that all lobbying activities conducted by any lobbyist should be reflected in every invoice. We recommend any additional expenses beyond the agreed upon lobbying activities be documented by the actual receipt, the business purpose of the activity or expense, and a description of the lobbying activity associated with the expense. In addition, we recommend that Bluegrass determine whether there is a continued need for three separate contracts and if these are necessary expenses. Also, the Board should ensure that public funds derived through state contracts are not used to pay for lobbying expenses. The requirement of additional documentation of lobbying activities conducted each month will facilitate this review and ensure transparency regarding the benefits Bluegrass is receiving for these payments.

**Finding 8:
Bluegrass policies should be strengthened to achieve greater accountability.**

Through our evaluation of Bluegrass policies related to a number of administrative issues, opportunities were indentified for Bluegrass to strengthen its policies and achieve greater accountability. In addition to the recommendations related to specific audit findings, there were additional policy weaknesses that should be addressed by the Board.

Findings and Recommendations

Formal Grievances

Within its policies, Bluegrass has established a process to receive and evaluate formal grievances from clients and employees. While this process provides an outlet for clients and employees to have their grievances vetted by the Bluegrass organization, the policy does not address how anonymous concerns may be reported directly to the Board and the process the Board will follow to address the matter. Further Bluegrass' policies do not include a process for individuals outside of Bluegrass, such as citizens and contractors, to anonymously report concerns pertaining to potential fraud, waste, or abuse within its organization.

According to the Board Chair, individuals inside and outside of the organization are allowed to bring issues to the Board; however, he stated that the Board typically encourages those individuals to go through the formal grievance process if they desire to report a concern. If anonymous reports come to the Board, the Board Chair stated that the Board would address them and make a decision on how to proceed. While it does appear that the Board may address matters presented directly to its members, this is a stated practice and not a formal policy. Auditors believe the Board would benefit from formalizing this practice in a written policy and designating a person or committee of the Board to specifically receive these concerns. This person or committee should be responsible directly to the Board and be required to notify the Board of each concern received. The Board should then be apprised of how concerns were addressed, any related findings, and recommendations resulting from the individual's investigation.

Internal Audit

After conducting interviews with Bluegrass personnel and reviewing its annual consolidated financial reports for the last four fiscal years, auditors believe the Bluegrass organizations would benefit from the existence of an internal audit function due to the size of its operations and complex programs. An internal auditor could work to ensure that expenses are being accounted for correctly and that financial control policies are being consistently followed. An internal auditor also would allow for an ongoing review of financial activity and controls which should be reported directly to the Board or a designated committee of the Board.

The internal auditor position, or someone designated by the Board with such responsibilities, would provide a means by which concerns voiced by individuals could be investigated in a timely manner. The individual responsible for the internal audit function could receive the anonymous concerns, analyze the information provided, then investigate the matter and report back to the Board.

Ideally, the individual filling this position would be hired directly by the Board and report to the Board's Audit and Finance Committee to ensure independence from the current Bluegrass management structure. Given that the Board meets on a monthly basis and their role is limited in oversight of daily operations of Bluegrass and its subsidiary organizations, this resource would also provide the Board with a means to address areas of interest to the Board in a more independent and efficient manner.

Findings and Recommendations

Gifts and Honoraria

Bluegrass has a well-developed code of ethics policy, but it does not include any statements concerning the acceptance of gifts and honoraria. While its ethics policy does not address gifts and honoraria, Bluegrass has included within its Purchasing & Operations Departmental Guidelines a statement which states, “[n]o employees shall solicit or accept gratuities, favors, or anything of value from contractors, potential contractors, or parties to agreements with the Board.” While its guidelines do address an employee’s ability to accept gifts, auditors believe this statement should also be included within the Bluegrass code of ethics as it establishes the ethical standards that govern the conduct of all Bluegrass employees.

Executive Staff Disclosure Statements

Board members for Bluegrass have reviewed and signed a Corporate Compliance Acknowledgement form, in which they acknowledge their responsibilities as a Board member. The form explains their unique functions as Board members and the expectations of the President/CEO of Bluegrass. It further explains conflict of interest and confidentiality. Although all of the Board members have signed this form, there is no requirement for the President/CEO or executive staff to review or disclose any conflict of interest. A Corporate Compliance Acknowledgement form should be developed specifically for the President/CEO and executive staff to disclose any conflict of interest that may arise.

Compensation Package

The full compensation of all executive staff, including contributions made to each employee participating in the Executive Benefit Plan, is not provided to the Board for review and to provide an opportunity for inquiry or discussion, as only a total amount of compensation and no individual detail is provided to the Board. There is no official procedure or policy for implementation and/or usage for the Executive Benefit Plan. The President/CEO of Bluegrass should be required to report the executive level salaries, along with their complete compensation, to the Board on an annual basis. See Finding 1 for additional information relating to the Executive Benefit Plan.

The compensation package for the President/CEO and other staff states that a position within Bluegrass can be developed even if no existing classification/position is in place. When the new classification/position is created, all of the job information goes to the HR department, but not to the Board for their information or review. It could be beneficial for the President/CEO of Bluegrass or the human resources director to advise the Board or a committee of the Board when new job classifications/positions have been requested to be developed so the Board is advised and has the opportunity to discuss the position, if desired.

Procurement of Goods and Services

Bluegrass has a defined procurement policy for the purchase of goods and services, but the policy does not establish a procurement threshold at which expenditures over a specified dollar amount are required to be preapproved by the Board, or a committee of the Board. Establishing a procurement threshold will assist the Board in its governance of the Bluegrass organizations and provide greater transparency and accountability.

Findings and Recommendations

In light of concerns received by this office, auditors examined the process by which Bluegrass procured its employee insurance. The specific concern auditors received related to the President/CEO and her step-daughter and whether a conflict existed when the Third Party Administrator (TPA) with which her step-daughter is currently employed was selected as a vendor by Bluegrass. Auditors examined this issue and found no evidence that a conflict existed.

The President/CEO disclosed her step-daughter's employment with the TPA to the former Board Chair and former HR Committee Chair for their consideration prior to the vendor selection. In addition, the TPA stated that while it was an informal discussion he did mention to an employee of Bluegrass the TPA's employment relationship with the President/CEO's step-daughter. Further, the step-daughter does not appear to have had direct involvement in the Bluegrass insurance account.

While this matter appears to have been handled appropriately by the Board and the President/CEO, auditors suggest the Board consider requiring bidders to submit a disclosure or certification of any financial interests that may exist between the vendor, its employees, and Bluegrass. This action would formally place some responsibility on the bidder to make the disclosure to the organization.

Travel Policies for Executive and Non-Executive Staff

Bluegrass does not have a policy requiring its President/CEO to submit for review or approval by the Board any out-of-state travel plans and/or estimated costs prior to the travel. Though a formal policy was not in place, the executive staff travel vouchers reviewed by auditors exhibited evidence of review by the President/CEO, CFO, or the Board Chair for out-of-state travel of non-executive staff.

The Board does not have a formal written travel and expense policy established to provide guidance to employees regarding allowable or unallowable expenses. The only guidance Bluegrass provides to employees regarding travel is within the instructions on the training/travel request form and the travel voucher form. The instructions simply explain how to properly complete the form and direct that the form should be completed on a monthly basis. Though a formal policy was not in place, Bluegrass staff, excluding the President/CEO, did submit their travel plans to their supervisors for prior approval and once the employee's travel was completed, the travel forms showed the employee's supervisors did review and approve the vouchers upon the employee's return.

Gifts and Entertainment

Bluegrass does not have a policy concerning the expenditure of funds for gifts and entertainment. While Bluegrass has expended funds to provide for appreciation to its employees, no egregious expenses were identified during our period of review. Although auditors did not question these expenses, Bluegrass should develop a gift and entertainment policy to provide specific guidance regarding the purpose and the maximize expenditure amount authorized, as well as the procedures for all staff to follow.

Findings and Recommendations

**Reimbursements
Made by
Employees**

During the examination, auditors identified eight instances between February 2011 and March 2012 when the President/CEO reimbursed Bluegrass for personal travel expenses placed on a Bluegrass credit card. In each instance, the President/CEO reimbursed the organization immediately after the charge; however, Bluegrass does not have a policy to address the reimbursement of personal expenditures and, as such, has not formally established a time frame by which the employee should reimburse the organization for such charges. While the reimbursements were made in a timely manner to the organization, the Board has no formal policy to ensure that personal expenses are paid back to the organization timely.

**Vehicle
Purchasing**

The Board does not currently have a policy relating to the purchase of fleet vehicles or a policy stipulating the appropriate method to be used to dispose of these Board assets. To ensure fair and consistent treatment, a Board policy to address vehicle procurement and disposal would benefit the organization.

Recommendations

We recommend the Board establish a comprehensive organizational structure and process by which they may receive, analyze, investigate, and resolve anonymous concerns from employees, business associates, customers, and the general public. The policy developed should ensure that the process is sufficiently independent to offset any risk of internal influence over the process. Once the policy is developed, it should be formally documented in writing and disseminated to its employees and made available to the public. The information should be easily accessible through the Bluegrass internet website.

We recommend the Board consider the creation of an internal audit function. We recommend the Board hire the person for this position and structure reporting of the internal auditor so that information is provided by the internal auditor directly to the Audit and Finance Committee of the Board.

We recommend the Board revise its current ethics policy to include a statement specifying the ability of an employee to accept gifts and honoraria.

We recommend the Board revise its policy to require a Corporate Compliance Acknowledgement form to be completed by its President/CEO and executive staff to disclose any conflicts of interest that may exist.

We recommend the Board require Bluegrass management to provide annual reporting to the Board, or a committee of the Board, of all executive level salaries, along with their complete compensation packages. This information should also include each executive employee's compensation for at least a three-year period to give the Board a historical perspective to compare when considering future compensation for these individuals.

We recommend the Board, or the HR Committee of the Board, be advised by the HR Director when a recommendation by management has been made to create a new management classification/position. The request should be reviewed by the Board or a designated committee, to allow for Board discussion and inquiry.

We recommend the Board consider requiring contractors participating in a bid process to submit a disclosure or certification of any financial interests that may exist between the vendor, its employees, and Bluegrass. If the Board implements this requirement, the procurement policies should be revised to include this new requirement. The policy should include a specific party or designated Board committee responsible for obtaining the disclosure information from bidders. The disclosures should then be shared with the Board when a recommendation as to the winning bidder is made to allow for greater transparency and accountability. Once the policy is revised, Bluegrass management should disseminate the policy to its staff responsible for the procurement process to ensure their understanding of the new disclosure requirement. When bids are sought, Bluegrass staff should ensure contractors are advised of this requirement. If a bidder does not submit the required disclosure or certification, as with other bid disclosure requirements, this should be considered grounds for disqualifying the bid.

We recommend the Board develop and implement a written travel policy for all staff, including the President/CEO. At a minimum, the policy should include allowable costs relating to lodging, meals, acceptable entertainment, personal mileage reimbursement, rental cars, and airfare. This policy should also define allowable costs and acceptable reimbursement of the employee's expenditures. The policy should require the President/CEO and executive staff to submit their travel itinerary and estimated expenses to the Board or a Board committee for review prior to traveling out-of-state. Subsequent to the travel, actual out-of-state travel amounts should be reported to the Board.

We recommend the Board develop and formalize in writing a gift and entertainment policy to provide specific guidance and procedures for all staff to follow. The policy should determine what is to be considered an acceptable gift amount and the policy should provide guidance for what Bluegrass deems reasonable entertainment expenses.

We recommend the Board develop a formal written policy to ensure that personal expenses are paid back to the organization timely. This policy should specify the period of time employees are allowed to make reimbursement to Bluegrass and the subsequent actions that will be taken if reimbursement is not made. Once the policy is approved by the Board, Bluegrass management should disseminate the policy to its employees.

We recommend the Board develop a formal written policy to address the procurement process to be followed when purchasing or disposing of fleet vehicles. The use and assignment of vehicles owned by the organization should be addressed within this policy. In addition, the practice of providing a vehicle should be reviewed and monthly vehicle allowances considered. The policy should include following the IRS guidelines for personal use of a vehicle.

**Timeline of Events Affecting the Management and Operations of
Bluegrass and its For-Profit Subsidiary, New Directions**

Date	Description
2/17/1999	Articles of Incorporation for Bluegrass New Directions, Inc. signed. Articles were filed with the Kentucky Secretary of State's Office on February 18, 1999.
2/18/1999	Employment contract signed with Bluegrass President/CEO to serve as President/CEO of Bluegrass New Directions, Inc. effective April 1, 1999.
2/18/1999	Intercompany agreement entered into between Bluegrass Regional Mental Health - Mental Retardation Board, Inc. and its subsidiary Bluegrass New Directions, Inc. for Bluegrass New Directions to provide management services to Bluegrass effective April 1, 1999.
3/31/1999	President/CEO retires from Bluegrass Regional MH/MR.
4/1/1999	Retired President/CEO of Bluegrass Regional MH/MR begins employment as Bluegrass New Directions President/CEO. As the President/CEO of Bluegrass New Directions, he is performing the same services he provided while previously serving as the President/CEO of Bluegrass Regional MH/MR Board, Inc.; however, he now provides this same service per an intercompany agreement between Bluegrass Regional MH/MR and New Directions.
8/6/1999	Board of the Bluegrass New Directions, Inc., executes the Deferred Compensation Plan for its President/CEO, to be effective retrospectively on April 1, 1999. According to the Deferred Compensation Plan, the purpose of the Plan is to "provide a means for the Company to reward the President and Chief Executive Officer for his valuable service to the Company and to enable the President and Chief Executive Officer to defer a portion of his Compensation." Payment of the vested amount in the participant's account is not to be made until at the end of the month in which the participant ceases to be an employee of Bluegrass New Directions.
8/17/2000	Employment contract for Bluegrass New Directions President/CEO revised to include a reference to Deferred Compensation Plan.
5/8/2008	President/CEO notifies Board of his intent to resign. Effective date of retirement not known at time of announcement.
6/19/2008	Intercompany agreement entered into between Bluegrass Regional MH/MR Board, Inc. and its subsidiary Bluegrass New Directions, Inc. for Bluegrass New Directions to provide Bluegrass Regional MH/MR Board, Inc. employee(s) with "assistance, advise and counsel to management" of Bluegrass to "assist it in the operation and delivery of its services for a period of time to be agreed upon through a letter of understanding executed by both the parties to this agreement subsequent hereto."

**Timeline of Events Affecting the Management and Operations of
Bluegrass and its For-Profit Subsidiary, New Directions**

Date	Description
6/19/2008	Bluegrass New Directions President/CEO enters into new employment contract with Bluegrass New Directions, Inc. to serve as its COO. The contract is effective September 1, 2008 through August 31, 2009. Given that the COO is the only employee of New Directions, Inc., it is understood that he will provide the "assistance, advise and counsel to management" of Bluegrass Regional MH/MR as is stipulated through the intercompany agreement in place.
10/18/2008	Bluegrass Regional MH/MR Board approved contract for an Interim Executive Director to be effective October 20, 2008 through December 31, 2008.
12/4/2008	Vice President of Administration & Operations named new Executive Director of Bluegrass, effective December 8, 2008. Through Board Resolution, the new Executive Director will have signatory authority over all disbursements of Bluegrass Regional MH/MR and its subsidiary corporations. The resolution also recommends the former President/CEO who resigned months prior, "remain the signatory authority...until appropriate documents are executed transitioning" the new Executive Director into these capacities. In August 2009, the Board changes the Executive Director title to President/CEO.
12/17/2009	Board unanimously approved hiring the Bluegrass New Directions COO as a consultant through Bluegrass New Directions.
1/21/2010	Contract employment agreement unanimously approved on December 17, 2009 is signed. Contract is retroactive to January 1, 2010 and ends October 31, 2010. Through this contract as a consultant, the former COO, who is also the former President/CEO of Bluegrass Regional MH/MR and Bluegrass New Directions, receives a continuation of current life insurance coverage along with other benefits.
10/2010	Former President/CEO, who served as former COO, and as a contract consultant for Bluegrass New Directions, terminates his "employment" status and becomes an independent contractor for Bluegrass New Directions, Inc.
6/28/2012	Bluegrass New Directions Consultant writes letter to Bluegrass Board Chair terminating his contract as a consultant with Bluegrass New Directions.

EXHIBIT



1351 Newtown Dr.
 Lexington, Ky 40511
 Phone: 859 253-1686
 Fax: 859 255-4866
 Finance Fax: 859 254-2743
 www.bluegrass.org

*Bluegrass Regional Mental Health-Mental Retardation Board, Inc.
 Bluegrass Regional Psychiatric Services, Inc.
 Bluegrass New Directions, Inc.*

Oakwood Transition Invoice

Document ID Number: PON2 729 0600001986 1
 Contract Period: 9/12/2006 - 10/31/2006
 Billing Period: 9/12/2006 - 9/30/2006

Service Performance		
Travel	\$481.74	
Training		
Supplies	\$2,368.66	
Administrative Support	<u>\$320,621.53</u>	
Subtotal Service Performance		\$323,471.93
Staff		
Personnel	\$57,312.56	
Fringe	<u>\$14,328.14</u>	
Subtotal Staff		\$71,640.70
Technology Infrastructure		
Telephone Systems		
Information Systems Upgrades	<u>\$217,681.50</u>	
Subtotal Technology Infrastructure		<u>\$217,681.50</u>
Subtotal Expenses All Categories		\$612,794.13
Administrative Fee		
8% of Total Expense		\$49,023.53
Total Invoice		<u><u>\$661,817.66</u></u>

PRC-729-060009237

VC0000092324

*Providing Mental Health, Mental Retardation and Substance Abuse Services in
 Anderson, Bourbon, Boyle, Clark, Estill, Fayette, Franklin, Garrard, Harrison, Jessamine, Lincoln,
 Madison, Mercer, Nicholas, Powell, Scott, and Woodford Counties*

PRC-729-0600099663

Oakwood Transition Invoice

Document ID Number: PON2 729 0600001986 1

Contract Period: 9/12/2006 - 10/31/2006

Billing Period: 10/01/2006 - 10/31/2006

Service Performance

Travel	\$12,042.65	
Training		
Supplies	\$639.04	
Administrative Support	<u>\$33,758.23</u>	
Subtotal Service Performance		\$46,439.92

Staff

Personnel	\$400,000.00	
Fringe	<u>\$100,000.00</u>	
Subtotal Staff		\$500,000.00

Technology Infrastructure

Telephone Systems	\$239,937.00	
Information Systems Upgrades	<u>\$915,643.76</u>	
Subtotal Technology Infrastructure		<u>\$1,155,580.76</u>

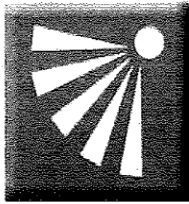
Subtotal Expenses All Categories \$1,702,020.68

Administrative Fee

8% of Total Expense \$136,161.66

Total Invoice \$1,838,182.34

**BLUEGRASS REGIONAL MENTAL HEALTH - MENTAL RETARDATION
BOARD, INC. RESPONSE**



bluegrass

A System of Care Providing Recovery Based Behavioral Health and IDD Services

December 19, 2012

Hon. Adam Edelen
Auditor of Public Accounts
209 St. Clair Street
Frankfort, Kentucky 40601

Re: Audit of Bluegrass Regional Mental Health-Mental Retardation Board, Inc.

Dear Auditor Edelen:

Thank you for the thorough examination of financial activities, policies, procedures and controls at Bluegrass Regional Mental Health-Mental Retardation Board, Inc. ("Bluegrass"). Please accept this letter as Bluegrass' response to the draft report dated December 11, 2012, and the observations and recommendations contained in that report.

Bluegrass has become one of the largest community-based mental health centers in the United States through the hard work of its two thousand employees. Our board is proud of these professionals who collaborate daily to help provide superior mental health care to over 29,000 persons in Kentucky. We are confident no question or concern about patient care was noted by your investigators, and we take great pride in the high quality of service our staff provides our clients. Bluegrass' Board of Directors serves voluntarily, and takes seriously its oversight of a corporation that has an annual budget of over \$170 million.

However, your report has noted that there are areas within Bluegrass that can be improved. The Bluegrass' Board of Directors assures you that we will study the findings and recommendations in the report, discuss these findings and recommendations with our employees and take action to preserve the integrity of our policies and procedures at Bluegrass. One way we will address many of the issues in the report is to develop a systematic approach and review of our policies and procedures, as well as supporting documentation.

In response to the recommendation that the Board request and review the cash reserves related to Eastern State Hospital and Oakwood and evaluate these individually, please know that the Bluegrass Board of Directors reviews the balance sheet of each company monthly and looks at the cash on hand and their current liabilities. Both of these contracts are short term (two years' duration) and may be terminated with appropriate notice during their term. Neither company has excess revenue to meet contingent liabilities, and Eastern State Hospital employees hired before 2011 are allowed to accumulate sick leave under Kentucky Employee Retirement System and credit this time towards retirement as time worked. This is a large liability payable to Kentucky Employee Retirement System and there is no accurate manner to manage the cash needs because an employee's retirement date is an individual choice. Having cash reserves to meet this

Bluegrass Regional Mental Health-Mental Retardation Board, Inc.
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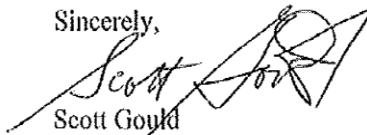
estimated liability is believed to be a necessary and prudent method of accounting to properly remit cash to Kentucky Employee Retirement System.

An immediate measure we will take is to start the discussion of addressing an internal auditor position who will report to Bluegrass' Board of Directors. We have always had tremendous respect for the ethical behavior of each member of our executive team, and we believe the internal auditor could complement our existing staff and will help insure transparency and confidence in Bluegrass' corporate structure. Within the last few months, the existing corporate compliance officer's responsibilities were modified and expanded. This officer is authorized and expected to serve the board directly.

Another step that needs prompt attention is resolving the valuation of the residence in Pulaski County; we will work with the Cabinet for Health and Family Services to determine an appropriate resolution for this property.

Please know that all of the recommendations made in your report will be examined on the premise that Bluegrass' Board of Directors will act to safeguard our clients, our employees and the taxpayers.

Sincerely,

A handwritten signature in black ink, appearing to read "Scott Gould", written over a horizontal line.

Scott Gould
Chair, Board of Directors

CABINET FOR HEALTH AND FAMILY SERVICES RESPONSE



**CABINET FOR HEALTH AND FAMILY SERVICES
OFFICE OF THE SECRETARY**

Steven L. Beshear
Governor

275 East Main Street, 5W-A
Frankfort, KY 40621
502-564-7042
502-564-7091
www.chfs.ky.gov

Audrey Tayse Haynes
Secretary

December 19, 2012

Auditor of Public Accounts
Attn: Brian Lykins
209 St. Clair Street
Frankfort, KY 40601

Dear Mr. Lykins:

Thank you for providing the Cabinet for Health and Family Services, Department for Behavioral Health, Developmental and Intellectual Disabilities the opportunity to comment on the draft report prepared by the APA with regard to policies, procedures, controls and financial activities of Bluegrass Regional Mental Health – Mental Retardation Board, Inc. The Department has reviewed the recommendations and offers the following responses.

**Finding 2 House Purchase
APA Recommendation:**

We recommend that the Board discuss the purchase of the house and furniture with the Cabinet in order to negotiate how the proceeds from the sale of the house and furniture should be resolved. Considering that the house did reduce the amount of lodging and travel costs that would have been reimbursed by the Cabinet, this cost should be reasonably estimated by Bluegrass. This cost estimate should be reviewed for reasonableness by the Cabinet since no documentation to support these costs was maintained by Bluegrass. Further, the Cabinet and Bluegrass should review the annual budgets for Oakwood to determine if these costs included expenses related to the house. Finally, we recommend the proceeds from the sale, along with any related expenses paid by the Cabinet through Bluegrass' annual budget for Oakwood, be reduced by the amount Bluegrass estimates would have been spent for travel had the house not been purchased.

DBHDID response:

It is the opinion of the Department for Behavioral Health and Developmental and Intellectual Disabilities (DBHDID) that Bluegrass should not be allowed to benefit from this transaction since approval for the purchase was not requested by Bluegrass and exceeds what is usual and customary. Bluegrass made the decision to purchase without consulting or requesting approval from DBHDID management. The justification provided by Bluegrass pertains to a verbal agreement with the former Cabinet Secretary. As stated in the report, the former Cabinet Secretary cannot recall approving the purchase.

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While DBHDID would have approved reasonable travel expenses, the fact Bluegrass disregarded procedures should negate allowing Bluegrass to negotiate a settlement or submit estimates.

There are certain issues that cause concern and should not be overlooked:

- In the event a verbal agreement had existed, a verbal agreement would not have superseded the written contract.
- Purchase of a house was never identified as a capital acquisition on the invoices submitted.
- The house as an asset would have required Bluegrass to identify the asset and remove the purchase cost prior to filing the annual Medicare cost report. Bluegrass would have been allowed to submit depreciation expense. To our knowledge, this did not occur and would have resulted in an overstatement of expenditures. Given that DBHDID is now aware of the overstatement, DBHDID will be required to file amended cost reports. This could result in a potential payback by DBHDID.
- DBHDID management was aware of the house, however Bluegrass led DBHDID management to believe the house was purchased with Bluegrass funds and was not a state asset. Bluegrass is required to provide DBHDID a copy of its audited financial statements. As referenced in this report Bluegrass recorded the asset under the CMHC and not under the Oakwood subsidiary. A review of the financial statements would have led DBHDID to believe the asset was not purchased with state funds.

DBHDID is required to support the payment of any travel costs to ensure accurate cost reports for the reporting period(s) the house or related expenditures were submitted on the cost report. Without adequate documentation, DBHDID is at risk for disallowance of the expenditures.

Given the fact that DBHDID will be responsible for supporting any allowable travel costs for this time period, it should be the responsibility of DBHDID to prepare estimates based on available data. Bluegrass will be afforded the opportunity to submit documentation to support the occupancy by specific staff utilizing the home from September 1, 2006 through June 16, 2008. Due to the sale of the home and related proceeds, estimated travel expenditures will be limited to the difference in the original purchase price and the sale price.

Finding 4 Cash Reserves

APA Recommendation:

We recommend that the Board request and review an analysis of any cash reserves related to Eastern State Hospital and Oakwood separately so that any funding and stability concerns can be evaluated individually. The Board should evaluate the amount of cash on hand for each organization to determine whether there is excess revenue. We further recommend that this analysis include a review of any long term certificates of deposit to ensure that complete information is considered by the Board. In addition, the Board should have an understanding of the purpose of any cash reserves to make informed decisions when approving the negotiated budgets for each organization.

We also recommend the Cabinet perform an analysis of the cash reserves and long term certificates of deposit for Eastern State Hospital and Oakwood to ensure the reserves were accumulated appropriately. Excess revenue related to Eastern State Hospital should be spent on additional community support services as required by the contract. Cash reserves and excess revenue related to Oakwood should be questioned by the Cabinet to determine whether there are issues with Bluegrass' reimbursement requests.

DBHDID Response:

The Department concurs with recommendation.

Based on the findings and recommendation of the Auditor, DBHDID will examine further the required distributions related to profit and management fees to ensure the funds are being distributed as required under the terms of their contract. Additionally, cash reserves and investments resulting from DBHDID contracts will be examined to ensure BG is fulfilling its mission as a partner to deliver mental health service to the community. Any cash reserves or excess revenue beyond those allowed by the contract will be addressed with Bluegrass and adjusted accordingly. It is the intent of DBHDID to work with each community mental health center as a partner in the delivery of community services. As such DBHDID will review all contracts to ensure specific requirements are clearly stated and implemented to ensure that any profit derived from operational contracts is used to further community services and not retained as excess working capital or rolled into long-term investments.

Please contact me if you should have questions or require further clarifications.

Sincerely



Beth Jurek
Executive Director
Office of Policy and Budget

c: Secretary Audrey Haynes
Commissioner, Stephen Hall
Deputy Commissioner, Betsy Dunnigan