

# **PERFORMANCE AUDIT REPORT**

## **Reviewing the Kansas Development Finance Authority's Selection of Bond Counsel and Costs of Issuing Bonds**

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
May 1998**

# ***Legislative Post Audit Committee***

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## ***Legislative Division of Post Audit***

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May, 21, 1998

To: Members, Legislative Post Audit Committee

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This report contains the findings, conclusions, and recommendations from our completed performance audit, *Reviewing the Kansas Development Finance Authority's Selection of Bond Counsel and Cost of Issuing Bonds*.

This report includes several recommendations to ensure that the Authority's bond counsel selection process is as fair and objective as possible, which would eliminate the suspicion of favoritism surrounding the process. In addition, the report recommends improving the Authority's oversight of the cost of bond rating trips by adopting guidelines for when bond rating trips should be taken and for the appropriate levels of spending on those trips. Finally, the report recommends that the Authority require appropriate supporting documentation for travel expenses to ensure that it does not reimburse costs that aren't actually incurred.

We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton  
Legislative Post Auditor



**EXECUTIVE SUMMARY**  
**LEGISLATIVE DIVISION OF POST AUDIT**

**Question 1: Are The Kansas Development Finance Authority's  
Procedures For Selecting Bond Counsel Unduly Restrictive?**

**The Authority uses a competitive bid process in selecting bond counsel, although it isn't required to do so.** *Kansas law doesn't require the Authority to follow the State's competitive bid processes, but Authority officials have had a longstanding policy of using a competitive process to select its bond counsel.* .....page 3

*Through the Authority's competitive process, Gilmore & Bell, P.C., a firm described as "one of the nation's leading public finance law firms," has been selected to handle most of the bond counsel services for the Authority's State-agency bond issues—currently about 90%. Gilmore & Bell's dominance as the Authority's bond counsel has led other competing law firms to contend that the Authority has designed its selection process to give an advantage to that firm.*

**Some aspects of the Authority's process for handling or evaluating bid proposals increase the opportunity for manipulating the selection process.** *The Authority's selection process should be open, fair, and as objective as possible. Although we found that the Authority's process for selecting bond counsel has some strengths, we also found the following weaknesses:* ..... page 4

- *The Authority doesn't disclose in advance how it will evaluate firms that have submitted bids, which leaves it open to charges of favoritism and manipulation. In addition, the relative "weight" assigned to each criterion varies from bond to bond.*
- *The Authority opens and distributes bids as they arrive, which increases the risk of the information being shared with other bidders.*
- *The President of the Authority has the primary responsibility for rating the experience and professionalism of each bidder, and told us he doesn't follow any objective guidelines when rating bidders. Having only one person responsible for ratings increases the opportunity for bias, and the lack of guidelines makes the Authority's evaluation of bidders' experience and professionalism very subjective.*
- *The mathematical formula the Authority uses to rank bids is heavily influenced by the amount bid by the high bidder, which can have unintentional effects on the outcome. Two sets of bids that are exactly the same except for the amount of the high bid will result in different scores for the rest of the bidders.*

**Some aspects of the Authority's process for evaluating or selecting bond counsel appear to be unduly restrictive, and to give an advantage to one firm.** *The experience requirements frequently were so* ..... page 8

specific that only a firm that had done similar work for the Authority in the past could qualify, which favors Gilmore & Bell. In addition, there's no "upper limit" on experience, so whichever firm had the "most" experience would always get the maximum score for experience.

The Authority's recent decision to group all bonds for Regents institutions into one program will limit firms' opportunities to bid on the Authority's work. Regents bonds include some relatively simple transactions and others that are more complex, which means the firm selected (Gilmore & Bell) must be able to handle the most complex bond issues. Smaller firms, which could handle many of the less-complex issues, won't have the opportunity to bid on that work. Although the Authority is required to review the status of program counsel at least every three years, it's doubtful any changes would be made because no other firm could match Gilmore & Bell's experience with Regents-related bond issues.

**The Board recently decided to exclude solo practitioners from serving as primary bond counsel, which may legitimately reduce the number of participants in the bidding process.** ..... page 10  
*Based on recommendations from the Authority's staff, the Authority's Board of Directors decided to exclude solo practitioners from serving as primary bond counsel. This decision eliminates two of the six firms that regularly bid for Authority work. The six bond attorneys we interviewed generally disagreed with the Board's decision to exclude solo practitioners, while other issuers' opinions on the matter were mixed.*

**Conclusion** ..... page 11

**Recommendation** ..... page 11-12

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**Question 2: Are the Costs the Kansas Development Finance Authority Charges Against Bond Issues for State Agencies Reasonable and Necessary?**

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**The types of expenses we reviewed in this audit constitute only a small portion of the total costs of issuance for which the Authority bills state agencies.** ..... page 13  
*A "cost-of-issuance" account is established for each bond, from which are paid such things as fees for bond underwriters, bond counsel, financial advisors, bond rating agencies, and other administrative costs. For this audit, legislative concerns centered primarily on the appropriateness of the travel costs the Authority charged to cost-of-issuance accounts, including meals, entertainment, hotels, and the like. The travel-related costs for the six bonds we sampled averaged less than one-tenth of one percent of the total proceeds from the bonds, and less than 3% of the total issuance costs. Most of the travel expenses for the bonds the Authority issues for State agencies relate to trips to New York City to meet with bond rating agencies.*

**Because of its philosophy of being a visible and proactive player in the bond market, the Authority makes multiple bond rating trips each year and takes along everyone it thinks will be needed to answer any possible questions that could arise.** ..... page 15  
*The Authority general-*

ly makes 2-3 bond-related trips to New York City each year, and takes 7-10 people per trip. It's difficult to definitively say whether the Authority has made too many rating trips or taken too many people on the trips, because such decisions are based on the Authority's professional judgment about whether those trips and those peoples' attendance will result in better ratings—and thus lower interest rates—for the bonds being issued. Still, we questioned whether two of the six trips we reviewed were necessary, and whether all of the people who attended were necessary for three of the six trips. We calculated the Authority spent about \$13,000 in travel, food, and lodging costs for 11 officials who may not have been needed.

It would be very difficult to tell whether the Authority's approach to bond rating trips has had an impact on lowering bond interest rates. According to bond experts, many factors affect the interest rate a bond receives, including market conditions on the date of sale, size of the issue, ratings, the economy, and the like. Based on analytical information we've seen, if Kansas bonds achieve better interest rates than others, it may be because of Kansas' history of fiscal conservatism and generally steady economy.

**A number of the Authority's expenses during bond rating trips exceeded reasonable and necessary levels.** ..... page 19  
*As an independent instrumentality of the State, the Authority isn't subject to the expenditure limits that govern State agencies' travel. Nonetheless, its travel expenses should be limited to reasonable and necessary levels. The Authority's transportation and lodging costs appeared to us to be reasonable. However, the cost of numerous meals was more than reasonable and necessary. Some of the Authority's dinners topped \$100 per person, with a large number of people present. None of these meals involved bond rating analysts or insurers; rather, all the meals and other related expenses we saw for the six bonds in our sample were for staff of the Authority and the people who accompanied them.*

*In addition, we identified some expenditures the Authority charged to bonds that can't be classified as "official business," including theater tickets on both Board of Regents trips we reviewed, and the use of bond funds to cover some of the costs of officials' spouses attending ratings trips.*

**Although we focused this part of our review on rating trips, we also identified some questionable costs that occurred at other times.** ..... page 21  
*As we reviewed expenditure vouchers, we noticed some expenses not associated with rating trips that seemed to us to be higher than necessary, or to be inappropriate. For example, the Authority spent \$1,551 at a Topeka restaurant for a closing dinner for the Board of Regents' second bond issue, and charged that dinner to the bond's-issuance costs, even though no business was conducted at the dinner.*

**The President of the Authority appears to have violated State laws when he stayed in a hotel suite owned by a company he regulates as the State's Consumer Credit Commissioner.** ..... page 22  
*The President made three bond-related trips to New York City between Christmas and New Year's Day in 1994, 1995, and 1996. Each of these trips was for four nights. On each trip, he stayed in a two-bedroom suite in the Essex House overlooking Central Park. This suite is owned by Household International,*

*the parent company of Household Finance Company, which the President regulates in his position as Consumer Credit Commissioner. The President appears to have violated the State's ethics laws by staying in this suite, which would have a commercial value of approximately \$650 a night if it were available to the public.*

*Furthermore, the President requested and received a total of \$1,200 in reimbursements for lodging costs he never actually incurred while staying in the Essex House. After his December 1994 trip, the President wrote a personal check to Household International to "repay" the company at \$140 a night for the four nights he stayed in its suite. The President used an uncanceled copy of this check to support his claim for a \$280 reimbursement from the Authority for the two nights he was in New York City on official business. Household International never cashed his check. The President said he told a company official he'd feel much better if the company were reimbursed, even though the room was for official Authority business. He told us after about 90 days he dropped the issue, intending to settle it some other way.*

*Even though his personal check to Household International was never cashed, the President kept the \$280 reimbursement he'd received from the Authority. This same process was repeated in 1995 and 1996, when he received reimbursements of \$296 and \$630. These situations have been reported to the Attorney General and to the Governmental Ethics Commission.*

**Conclusion** ..... page 24

**Recommendations** ..... page 25

**Appendix A: Arkansas Development Finance Authority's Bond Counsel Selection Criteria** ..... page 27

**Appendix B: Agency Responses** ..... page 28

This audit was conducted by Cindy Lash, Anthony Perez, and LeAnn Schmitt. Randy Tongier was the audit manager. If you need any additional information about the audit's findings, please contact Ms. Lash at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call (785) 296-3792, or contact us via the Internet at: [LPA@mail.ksleg.state.ks.us](mailto:LPA@mail.ksleg.state.ks.us).



## **Reviewing the Kansas Development Finance Authority's Selection of Bond Counsel and Costs of Issuing Bonds**

The Kansas Development Finance Authority was created to help State agencies, localities, and other entities obtain long-term financing for capital improvements and other projects. The Authority is governed by a Board of Directors, but general management of the Authority is the responsibility of its President. The Authority contracts for many of the bond-related services it needs to carry out its work, including bond counsel and underwriter services.

Several law firms have expressed concerns to legislators that the Authority's procedures for selecting bond counsel may be unduly restrictive, and may have resulted in a single law firm receiving most of the Authority's bond counsel work. In addition, legislators have expressed an interest in knowing whether certain costs being charged to bonds issued for State agencies are reasonable and necessary. To address these concerns, this performance audit answers the following questions:

- 1. Are the Kansas Development Finance Authority's procedures for selecting bond counsel unduly restrictive?**
- 2. Are the costs the Authority charges against bonds issued for State agencies reasonable and necessary?**

To answer these questions, we interviewed Authority officials about their procedures for selecting bond counsel, reviewed their rating and selection process for seven bonds, and interviewed officials with finance authorities in six other states, as well as officials with the Kansas Department of Transportation and the Kansas Turnpike Authority. We also interviewed representatives of six law firms that have bid on the Authority's work.

To determine whether costs charged against bonds for State agencies were reasonable, we reviewed detailed travel records for six bonds that included ratings trips to New York City. We interviewed authority officials, representatives of bond ratings agencies, and finance development authorities in other states. We also spoke with private companies to determine reasonable and customary rates for business travellers in New York.

In conducting this audit, we followed all applicable government auditing standards set forth by the U.S. General Accounting Office.

Our findings begin on page 3 after a brief overview of the Authority.

## **Overview of the Kansas Development Finance Authority**

A 1987 report from the Legislative Commission on Kansas Economic Development concluded that Kansas had no mechanism to access the bond markets for projects that needed long-term financing. The report noted that changes in the 1986 tax code had resulted in a shift in the supply of long-term capital, that banks were no longer able to provide government entities with the capital needed for long-term financing, and that the bond market was replacing bank financing.

The Commission recommended that Kansas establish a multi-purpose bond issuing agency. It further recommended that this new agency should have total flexibility to secure bond deals, carry its own insurance to secure high bond ratings, be fully financially self-sufficient, be separate from any other State agency, and be managed by a private-sector-like board and staff that was driven by performance. The Commission recommended the agency's design follow the successful examples of similar agencies in Arkansas and Massachusetts.

### **The Legislature Created the Kansas Development Finance Authority As an Independent Instrumentality of the State in 1987**

Its primary purpose is to improve the State's ability to finance capital improvement projects, and to improve access to long-term capital financing for State agencies, political subdivisions, public and private non-profit organizations, and businesses.

By law the Authority can issue revenue bonds and other debt instruments to finance such things as agricultural business enterprises, educational or health care facilities, housing developments, and industrial enterprises. Projects it has financed over the years include the purchase, construction, and renovation of State buildings; water and sewer projects for Kansas localities, loans to beginning farmers, and job training needs for Kansas businesses.

Because by law the "faith and credit" or "taxing" power of the State can't be obligated to pay debt service on bonds, the bonds the Authority issues are special obligations that must be repaid solely from other revenue sources (such as student fees, water fees, loan repayments, and the like).

**The Authority is governed by a six-member Board of Directors.** The Board consists of the President of the Authority (who serves as an ex-officio, non-voting member), and five public voting members appointed by the Governor to four-year terms, subject to Senate confirmation. The Governor appoints the President, who serves at the Governor's pleasure, and also designates the Chair and Vice-Chair of the Board.

The Authority's staff includes the President and 11 full-time-equivalent staff. Three of those full-time-equivalent positions are shared through intergovernmental exchange agreements between the Authority and the Department of Administration.

## **Are the Kansas Development Finance Authority's Procedures For Selecting Bond Counsel Unduly Restrictive?**

The Authority has chosen to follow a competitive bid process in selecting bond counsel, even though it's not required to do so. Because of that choice, we would expect the Authority's selection process to be open, fair, and as objective as possible. However, some procedures it follows in handling and evaluating bid proposals increase the opportunity for manipulating the process and leave the Authority open to charges of favoritism. In addition, other parts of the process seem to be unduly restrictive, and to give an advantage to one firm. These and other findings are described in the sections that follow.

### **The Authority Uses a Competitive Bid Process In Selecting Bond Counsel, Although It Isn't Required to Do So**

Kansas law makes the Authority's President responsible for selecting bond counsel and other bond-related professionals. However, the law doesn't require the Authority to follow the State's competitive bid processes in making selections, nor does it place any other restrictions or requirements on the way the Authority makes its selection.

Given this flexibility, the Authority could simply hire one or more firms to serve as bond counsel for all the bonds it issues. The Nebraska Investment Finance Authority has adopted this approach. It has used the firm of Kutak Rock exclusively as its bond counsel for the past 20 years, according to an official with that agency.

Authority officials told us there were advantages to this approach, because it would ensure they'd always have the very best bond counsel for each bond issue. It also would eliminate the need for—and staff time involved in—issuing requests for proposal, evaluating the bids submitted, and selecting bond counsel for each bond issue. However, they noted there were ramifications to this approach, including political considerations and the risk that the bond counsel firm it selected could dissolve or encounter other problems.

For these and other reasons, Authority officials have had a longstanding policy of using a competitive process to select its bond counsel. They said their philosophy was that competition encourages firms to keep service at a high level, keeps bond service costs more competitive, and prevents the Authority from becoming overly reliant on one firm.

**Through the Authority's competitive process, the firm of Gilmore & Bell, P.C., has been selected to handle most of the bond counsel services for the Authority's State-agency bond issues—currently about 90%. Authority staff noted that this firm is good to work with, is very accommodating, produces excellent documentation, and usually has the lowest fees. They also said a bond counsel's rep-**

utation is an important factor in the marketability of bonds, because purchasers rely on the bond counsel's opinion regarding the legality and tax-exempt status of the bond.

The Fall 1997 edition of *The Bond Buyer's Municipal Marketplace Directory*, (commonly known as the Red Book), describes Gilmore & Bell as "one of the nation's leading public finance law firms," and noted the firm has ranked 3rd among law firms in the United States in total tax-exempt long-term bonds handled for each of the last 4 years, and has ranked 1st in Kansas and Missouri for the last 10 years

Gilmore & Bell's dominance as the Authority's bond counsel has led other competing law firms to contend that the Authority has designed its selection process to give an advantage to that firm. The remainder of this question describes our findings regarding the Authority's process for selecting bond counsel.

### **Some Aspects of the Authority's Process for Handling Or Evaluating Bid Proposals Increase the Opportunity for Manipulating the Selection Process**

Given the Authority's decision to select bond counsel on a competitive basis, the selection process used should be open, fair, and as objective as possible. For that to happen, we generally would have expected the Authority to do the following:

- prepare a request for proposals that clearly defines the services needed, and clearly specifies the minimum qualifications and the criteria to be used in evaluating the bids
- send the request for proposals to all qualified parties
- keep the bids sealed until the final deadline for submitting bids
- evaluate the bids received based on agreed-upon qualifications and criteria.
- award the bid to the highest-ranked bidder, unless there is a legitimate, clearly-documented reason to do otherwise.

To evaluate the Authority's system for hiring bond counsel, we reviewed available records, interviewed Authority staff, and reviewed the documentation related to the Authority's selection of bond counsel for a sample of seven bonds issued in fiscal years 1996-1998. (Those bond issues are shown in the box on page 5.)

Although we found that the Authority's process for selecting bond counsel has some strengths, we also found numerous weaknesses that could give someone the opportunity to manipulate the outcomes of the bidding process. These weaknesses leave the Authority open to charges that its decisions are biased in favor of Gilmore & Bell. Our reviews didn't uncover any evidence of overt manipulation of the selection process, but such actions would be difficult to uncover if they did occur. The problems we identified are described below.

**The Authority doesn't disclose in advance how it will evaluate firms that have submitted bids, which leaves it open to charges of favoritism and manipulation.** The Authority evaluates bidders for each bond it issues based on three crite-

ria—experience, professionalism, and cost. The relative “weight” assigned to each criterion varies from bond to bond. For example, experience may be assigned a greater weight for a complex bond issuance, while the price bid may be assigned a greater weight for a bond that is fairly straightforward. The following table shows the weights assigned for the seven bonds in our sample.

		Criteria Used for Evaluating Bids										
		Experience with Regents Financings	Experience with State Lease Financings	Experience with Higher Education Student Fee Financings	Experience with Regents & KSU	Experience with Higher Education Student Housing Financing	Experience with Regents & WSU	Experience with Similar Transactions	Experience Subtotal	Professionalism and Ability to Perform in a Flexible and Timely Manner	Cost of Services	
Name of Issue	Amount of Bond	%	%	%	%	%	%	%	%	%	%	Contract Award
Wichita State Univ. Housing	\$14,055,000					30	10		40	10	50	Gilmore & Bell
Kansas State Univ. Parking & Farrell Library	\$5,930,000			25	15				40	10	50	Gilmore & Bell
Univ. of KS Housing(Templin)	\$4,100,000	30							30	10	60	Gilmore & Bell
Board of Regents (GI & G2)	\$109,280,888	30							30	20	50	Gilmore & Bell
Regents Center Refunding	\$3,255,000	15							15	10	75	Gilmore & Bell
Kansas Public Water Supply Revolving Loan Fund (1997 1 & 2)	\$45,420,000						40		40	10	50	Gilmore & Bell
Dept. of Admin. Memorial Hall Renovation Notes	\$300,000		30						30	10	60	Gilmore & Bell

For these seven bonds, we found the Authority didn’t include its evaluation criteria and weights in its Requests for Proposals. We couldn’t tell when these weights actually were finalized because that information isn’t dated. However, the Authority’s President stated it was before the bids were returned. Officials said such weights normally were determined by the President, with input from the General Counsel and the Chief Financial Analyst.

The Authority's practices in these areas have led some firms to charge the agency is changing weights to favor Gilmore & Bell after it receives the bid responses. Because we weren't able to independently verify when weights actually were assigned, we analyzed the bonds in our sample to see whether changes in those weights could have affected the final bid awards. We found that even small changes in these weights could have a significant impact, as follows:

- for 2 of the 7 bonds, changing the weights assigned from one commonly used pattern (40% experience, 10% professionalism, and 50% cost) to another commonly used pattern (30% experience, 10% professionalism, and 60% cost) would have resulted in a firm other than Gilmore & Bell being awarded the contract. In both cases, the actual contract went to Gilmore & Bell, which bid a much higher price than the second-ranked firm.

The Authority's President told us he'd included weights in the agency's Requests for Proposals in the past, but had discontinued the practice after firms complained about the weights he'd chosen. Nonetheless, disclosing weights in advance would help give bidders a clearer idea of how they will be evaluated, ensure those weights aren't changed after responses are received, and allay concerns about favoritism and manipulation. Further, two of the three bond issuers we interviewed during this audit that use weighted criteria in their evaluation of bids said they disclose the criteria and weights in the Request for Proposals.

We also think the State might get more competitive bids if the complete evaluation criteria were known in advance. For example, if a firm knew it was weaker than others on a particular criteria, it might bid a more competitive price to compensate.

**The Authority opens and distributes bids as they arrive, which violates a basic tenet of competitive bidding—the premise that no bidder will have access to others' bids before the bidding deadline.** Gaining such access would give bidders who get access to bid information a competitive advantage over other bidders. We also noted that many of the Authority's Requests for Proposals directed bidders to send a copy of their response to someone else—often the agency for which bonds were being issued, and occasionally the State Budget Director or the Authority's financial advisor. An official in the Division of Purchases told us this practice was “out of the ordinary.”

This practice also can subject the system to abuse. The more people who have access to bid information before the deadline for submission, the greater the risk of this information being shared with other bidders.

**The Authority's evaluation of bidders' experience and professionalism is very subjective, and having only one person responsible for rating these criteria increases the opportunity for bias.** Evaluation of professional services is difficult and always somewhat subjective. Nonetheless, it's important to try to establish evaluation criteria that are as objective as possible.

The President of the Authority has primary responsibility for rating the experience and professionalism of each of the bidders. He makes the final decision, although he routinely seeks verbal input from the Authority's General Counsel and the Chief Financial Analyst.

The President told us he doesn't follow any objective guidelines when rating bidders, even on experience. When we asked why some firms' scores varied from issue to issue, the President said he purposefully doesn't look to see how he had previously scored them. He said he tries to look at what's in front of him and consider his personal experience. He also said he tries not to look at cost information before doing the subjective scoring on experience and professionalism.

The potential for intentional or unintentional bias to affect the ratings is increased by the lack of structure and guidelines for evaluating firms' experience and professionalism. The risk of bias occurring is compounded when only one person makes the final rankings, as in this case.

Other state finance authorities we talked with also tended to be subjective in their rankings, but all had more than one person responsible for doing the evaluations:

- *Arkansas Development Finance Authority*—A seven-member committee of Authority management staff conducts the bid evaluations. (This agency had the most specific evaluation criteria of any issuer we talked with, as summarized in Appendix A.)
- *Indiana Bond Bank*—The Executive Director and Chairman of the Board evaluate bid proposals.
- *Iowa Finance Authority*—Staff from the State Treasurer's Office, the Authority, and the agency for which the bonds are being issued evaluate the bid proposals.
- *Missouri Health and Education Facilities Authority*—The agency for which the bonds are being issued evaluates the proposals.
- *Oklahoma Development Finance Authority*—The Vice President and his staff evaluate the bid proposals.

**The Authority's method of evaluating the prices firms bid can have unintentional effects on the ranking.** Firms may structure their bids in many different ways. As a result, when the Authority receives bids it determines what each firm's total bid would be, per \$1,000 of bond being issued. Bids then are assigned points using a mathematical formula that assigns the low bid a value of 10 (the highest score possible), and assigns other bids a relatively lower score.

We found that this mathematical formula is heavily influenced by the amount bid by the high bidder. As the example on the next page shows, two sets of bids that are exactly the same, except for the amount of the high bid, will result in different scores for the rest of the bidders.

These differences also can affect who is awarded the bid. The bid information in the top portion of the table reflects actual numbers from bids received for the Wichita State University Housing System project. In the bottom portion of the table, we reduced the amount of the high bid to demonstrate how the high bid could change the outcome.

<b>Firm</b>	<b>Bid (in thousands)</b>	<b>Points for Cost</b>	<b>Original Total Score</b>	<b>Original Rank</b>
<i>Perry, Hamill &amp; Fillmore</i>	7.67	500	840	2
<i>Logan, Riley, Carson &amp; Kaup</i>	8.63	480	820	3
<i>Nichols &amp; Wolfe</i>	10.96	431	810	4
<b><i>Gilmore &amp; Bell</i></b>	14.56	356	855	1
<i>Burke, Williams, Sorensen, &amp; Gaar</i>	23.98	160	530	5

<b>Firm</b>	<b>Bid (in thousands) w/High Bid Adjusted</b>	<b>Revised Points for Cost</b>	<b>Revised Total Score</b>	<b>Revised Rank</b>
<b><i>Perry, Hamill &amp; Fillmore</i></b>	7.67	500	840	1
<i>Logan, Riley, Carson &amp; Kaup</i>	8.63	472	812	2
<i>Nichols &amp; Wolfe</i>	10.96	403	782	4
<i>Gilmore &amp; Bell</i>	14.56	297	796	3
<i>Burke, Williams, Sorensen, &amp; Gaar (adjusted)</i>	16.98	226	596	5

As the bottom half of the table shows, if the high bid for this bond issue had been somewhat lower, the highest-ranked proposal would have been the one submitted by the firm of Perry, Hamill & Fillmore, rather than by Gilmore & Bell. It appeared to us that this “glitch” in the formula wasn’t intentional, but it will need to be fixed to avoid the unintended and illogical effect it has on the bid evaluation process.

**Some Aspects of the Authority’s Process for Evaluating Or Selecting Bond Counsel Appear to be Unduly Restrictive, And To Give an Advantage to One Firm**

As noted earlier, the firm of Gilmore & Bell receives most of the Authority’s bond counsel business. We found two aspects of the Authority’s evaluation and selection process—one longstanding and one more recent—appear to give Gilmore & Bell an advantage over other firms.



**The Authority usually sets such specific experience requirements for the bonds it issues that the firm that does most of its work generally has an advantage over other firms.** These experience requirements are established by the Authority's President.

Based on our review of the seven bonds in our sample, we identified problems with the way these experience requirements were set. They frequently were so specific that only a firm that had done similar work for the Authority in the past could qualify. In addition, there's no "upper limit" on experience, so whichever firm had the "most" experience would always get the maximum score for experience.

Because Gillmore & Bell does most of the Authority's work, these practices favor that firm, as illustrated in the following examples:

*For the recent bond issues for the Board of Regents Crumbling Classroom project (\$159 million total), the Authority required experience with Kansas Board of Regents financings. Because all Regents' financings are done by the Authority, and because Gilmore & Bell has done almost all of this work, that firm scored the highest points for experience and was awarded the contract. Other firms might have had experience serving as bond counsel for non-Regents colleges or universities, but that experience wouldn't count.*

*For the bonds issued to build a parking garage and renovate the library at Kansas State University, the Authority required both experience with higher education student fee financings, and experience with Board of Regents and Kansas State University. Because Gilmore & Bell has done this work for the Authority in the past, it would always receive the highest experience ranking for bond issues with similar requirements.*

**The Authority's Board recently decided to group all bonds for Regents institutions into one program, which will limit firms' opportunities to bid on the Authority's work and again favor one firm.** In the past, the Authority has issued bonds for State agencies either singly, or grouped as a "program" when the Authority was issuing a series of similar bonds.

When a series of similar bonds was issued, the Authority selected a firm as bond counsel at the beginning of the series, and retained that bond counsel throughout the program. An example would be the State Energy Conservation Improvement bonds, under which the Authority has issued a series of eight series of bonds since 1990, all to finance energy conservation improvements in a variety of State facilities. The firm of Nichols and Wolfe, Chartered has served as bond counsel throughout that series.

In October 1997, the Board decided to group all bonds for the Board of Regents and all Regents institutions into one program. Board and staff members cited the desire to reduce the number of requests for proposals sent out, save staff time, and have greater document consistency as reasons for grouping all Regents' bonds.

In making this change, the Authority created a grouping much larger than any of its programs in the past. Perhaps more importantly, it combined some types of bonds that are relatively simple transactions with others that are more complex, which meant the firm selected had to be able to handle the most complex bond issues. Smaller firms, which could handle many of the less complex issues, now will not have the opportunity to bid on that work separately.

The Board's decision in this area significantly reduces the opportunity for other firms to serve as bond counsel on Regents-related bond issues in the future. Although the Board's new procedures also require the Authority to review the status of program counsel at least every three years and consider whether new bids should be taken, it's doubtful that any changes would be made because no other bond counsel could match Gilmore & Bell's experience with Regents-related bond issues.

Authority staff we talked with suggested the Regents program could be broken into several smaller programs, based on size or type of issue.

### **The Board Recently Decided To Exclude Solo Practitioners From Serving as Primary Bond Counsel, Which May Legitimately Reduce The Number of Participants in the Bidding Process**

A June 2, 1997, memo to the Authority's Board of Directors said the staff believed it was important to disallow solo practitioners because the Authority couldn't afford to risk losing its bond counsel in the middle of structuring an issue, and because bond counsel must have the capability and availability of personnel to provide service in a timely and efficient manner. (The latter reason is also a recommendation of the National Association of Bond Lawyers.) The memo concluded that solo practitioners didn't have the necessary reinforcement personnel or resources to meet these criteria.

The Board decided to exclude solo practitioners as primary bond counsel in October 1997. This new policy will prevent two of the six firms that regularly bid for Authority work from doing so in the future. One of these two firms has successfully handled a program for the Authority since 1990.

**Bond attorneys we interviewed generally disagreed with the Board's decision, but other issuers' opinions on the matter were mixed.** We asked six bond attorneys who've bid on bonds issued by the Authority in the past what they thought of this restriction. One solo practitioner said the exclusion was somewhat discriminatory, and several noted that the same problems could arise in a larger firm in which only one specific bond counsel does the work. Several attorneys pointed out that solo practitioners could cover themselves with insurance and by associating with other attorneys.

Officials at other state finance authorities we talked with said the issue of hiring a solo practitioner had never come up before. Their reactions were mixed. Three of those officials said they didn't see why it would be a problem as long as the solo

practitioners met their qualifications. However, another issuer said he didn't see how a solo practitioner could possibly have the qualifications necessary to do complicated bond work.

Although this new policy will limit the number of potential bidders for the Authority's work, we concluded it stems from legitimate concerns about the risks of using solo practitioners as the Authority's primary bond counsel.

### **Conclusion**

Authority officials have expressed their commitment to hiring the best bond counsel to handle the bonds issued on behalf of State agencies. Although it isn't required to select its bond counsel competitively, the Authority has chosen to do so. Given that choice, its selection process should be as fair and objective as possible, provide a level playing field for qualified bond counsel firms, and result in qualified firms being selected to carry out the Authority's work on behalf of its bondholders.

The weaknesses and problems we identified with the Authority's competitive selection process have undermined the integrity of the process, and some of the Authority's decisions have had the effect of favoring one firm. Although we didn't see any evidence of an inappropriate selection of bond counsel, we did see aspects of the process that either made an inappropriate selection more likely, or that resulted in the appearance of an inappropriate selection.

By addressing these weaknesses and problems, the Authority can help restore the integrity of its selection process and remove the appearance of favoritism. If the Authority thinks it can't obtain the high-quality bond counsel services it wants through a competitive process, then it should reconsider its options for obtaining those services, and the advantages and disadvantages of each option.

### **Recommendations**

1. To help ensure its bond counsel selection process is as fair and objective as possible, and to eliminate the suspicion of favoritism, the Kansas Development Finance Authority should do the following:
  - a. Formally involve several staff members in developing evaluation criteria and their relative weights before sending out Requests for Proposals to prospective bond counsel firms. In doing so, the Authority should ensure the types of experience it calls for are not so

specific that they unduly limit the number of qualified firms that could effectively compete for that work. In addition, the Authority should consider placing an upper limit on the amount of experience needed to achieve the maximum available points for experience ratings.

- b. Disclose the specific bond counsel evaluation criteria and their relative weights in its Requests for Proposals.
- c. Keep all bond counsel proposals it receives unopened until the bid-closing deadline, and open and distribute all proposals at one time.
- d. For the subjective aspects of evaluating bond counsel proposals, formally involve several staff members in arriving at the evaluation scores.
- e. Adjust the mathematical method for determining bond counsel fee scores so an individual firm's fee score is determined only by its bid and its relationship to the low bid.
- f. Carefully review its use of grouped bond programs to ensure the scope of individual programs isn't so broad that it unduly restricts the number of qualified firms that could effectively serve as bond counsel.

## **Are the Costs the Kansas Development Finance Authority Charges Against Bond Issues for State Agencies Reasonable and Necessary?**

Our reviews for this question focused primarily on travel and entertainment expenses related to bond rating trips, which account for a very small percentage of total bond-issuance costs. Still, we found numerous instances where the Authority charged expenses that we considered to be greater than reasonable and necessary against bond issuance costs for State agencies. These included making more bond rating trips to New York City than may have been necessary, taking more people on those trips than may have been necessary, and spending more than is reasonable and customary in New York for some meals. In addition, some expenses that can't be considered official business were charged to bonds during those trips.

We also found that the Authority's President appears to have violated the State's ethics laws while on three business trips to New York by staying in a private hotel suite valued at approximately \$650 a night that is owned by a company he regulates as Consumer Credit Commissioner. The President also requested and received a total of \$1,200 in reimbursements, mostly from bond proceeds, for lodging costs he never actually incurred while staying in this private suite. These situations have been reported to the Attorney General and to the Governmental Ethics Commission. These and other findings are discussed in more detail following a brief discussion of the scope of this part of our audit work.

### **The Types of Expenses We Reviewed in This Audit Constitute Only a Small Portion of the Total Costs of Issuance For Which the Authority Bills State Agencies**

Federal law allows the proceeds of tax-exempt bonds to be used to cover the administrative costs of issuing those bonds. A "cost-of-issuance" account is established for each bond issue, from which are paid such things as fees for bond underwriters, bond counsel, financial advisors, bond rating agencies, and other administrative costs such as the Authority's issuance fees. In its role as the issuer of bonds, the Authority buys the services of bond professionals and other goods and services on behalf of State agencies, and is reimbursed out of bond's cost-of-issuance funds.

For this audit, legislative concerns centered primarily on the appropriateness of the travel costs the Authority charged against bonds, including meals, entertainment, hotels, and the like. To address these concerns, we focused the scope of our work on these particular expenses, reviewing travel-related costs for a sample of six of the 15 bonds the Authority has issued since the beginning of fiscal year 1996.

More detail about these six bonds can be found in the box on the next page. It's important to remember that travel-related costs for these six bonds averaged less than one-tenth of one percent of the total proceeds from the bonds, and were less than 3% of the total issuance costs.

## Bonds Issued for State Agencies June 1995 - April 1998

Name of Bond	Amount of Bond	Total Costs of Issuance
<b>FY 1996</b>		
Energy Conservation Improvement Program (4-E)	\$2,734,000	\$64,879
Wichita State University Housing (F)	\$14,055,000	\$426,756
Water Pollution Control Revolving Fund (1995-1)	\$6,915,000	\$209,076
Kansas State University Parking & Farrell Library (G & K)	\$5,930,000 combined	\$170,225 combined
State of Kansas Investments in Lifelong Learning (SKILL-1)	\$8,890,000	\$235,000
Energy Conservation Improvement Program (5-1996A)	\$5,105,000	\$109,115
University of Kansas Housing-Templin Hall (1996E)	\$4,100,000	\$135,000
<b>FY 1997</b>		
Energy Conservation Improvement Program (6-1996J)	\$5,600,000	\$126,315
Board of Regents (Notes K-I & Bond K-II)	\$50,000,000 combined	\$765,000 combined
Water Pollution Control Revolving Fund (1997-I & II)	\$39,260,000 combined	\$679,298 combined
Regents Center Refunding (1997C)	\$3,255,000	\$71,696
<b>FY 1998</b>		
Eldorado Correctional Facility (1997J)	\$6,455,000	\$139,420
Memorial Hall (Notes 1997-H)	\$300,000	0
Board of Regents (G-1 & G-2)	\$109,280,888	\$1,115,000
KS Public Water Supp. Revolv. Loan Fund (1997 1-2)	\$45,420,000	\$880,743
<b>Total Number of Bonds</b>	15	
<b>Total Number of Bonds in Audit Sample</b> (% of Total)	6 (40%)	
<b>Total Amount of All Bonds</b>	\$307,299,888	
<b>Total Amount of Audit Sample</b> (% of Total)	\$195,595,888 (64%)	
<b>Total Costs of Issuance</b>		\$ 5,127,523
<b>Total Costs of Issuance for Audit Sample</b> (% of Total)		\$2,890,252 (56%)

**Most of the travel expenses for the bonds the Authority issues for State agencies relate to trips to New York City to meet with bond rating agencies.** These three agencies are Standard & Poor's, Moody's, and Fitch. Their bond rating analysts assign a rating to each bond issued (i.e., AA, AA-, A, BBB, and so on). Bond ratings can have a significant impact on the interest rates State agencies pay to bondholders. In general, the higher the rating, the lower the interest rate.

According to the Authority's President, a typical "rating" trip spans two and one-half days and involves two meetings a day with either a rating agency or a bond insurer. Each meeting lasts 1-3 hours, during which time the "finance team" for each bond—which includes top Authority staff, the bond counsel, the financial advisor, the underwriter, and representatives of the agency for which the bond is being issued—presents information and answers questions about the project, the State's economy, the revenue streams for repaying the bond, and the like.

The six bonds in our sample were chosen because they involved bond rating trips to New York City, and had, in some cases, been identified to us as having potentially excessive costs—either because the trips themselves were unnecessary, more people went on those trips than were needed, or the costs charged while in New York City were unreasonable.

**Because of Its Philosophy of Being a Visible and Proactive Player  
In the Bond Market, the Authority Makes Multiple Bond Rating Trips  
Each Year and Takes Along Everyone It Thinks Will Be Needed  
To Answer Any Possible Questions That Could Arise**

Making bond rating trips when they aren't necessary, or taking more people on those trips than are needed, can add unnecessarily to a bond's issuance costs. Being able to definitively say whether that has occurred is difficult, however, because such decisions are based on the Authority's professional judgment about whether those trips and those peoples' attendance will result in better ratings—and thus lower interest rates—for the bonds being issued.

The Authority generally makes 2-3 bond-related trips to New York City each year. The President told us that members of the finance team decide on a case-by-case basis whether a rating trip is needed. In making this decision, he said, the team considers such factors as the size and complexity of the bond, whether there are likely to be any questions about how the bonds will be repaid, the amount of time that has passed since the last similar issue, and changes in staff at the rating agencies. The President also said he thought face-to-face meetings with rating analysts were essential for some bonds in securing the best possible ratings.

For the six bonds in our sample, the Authority usually took along 7-10 people on each trip. The President told us it was his philosophy to have the people there who could answer any possible questions raised by bond rating analysts. He also said these analysts' opinions about the quality of the State's management team—one of the factors considered in rating a bond—can depend on being able to answer their questions on the spot.

To see what other agencies' practices were regarding the number of trips taken and the people who normally go on those trips, we spoke with officials from finance development authorities in six other states, and with representatives of the Kansas Department of Transportation and the Kansas Turnpike Authority. These other state authorities all issue revenue bonds, like the Kansas Authority, but five of the six issue general obligation bonds, which the Authority doesn't do.

**Other bond issuers we talked with make far fewer bond rating trips than the Authority.** Four of these issuers said they don't go on bond rating trips at all, and four said they go only under certain circumstances. The four issuers that don't go on bond rating trips cited the following reasons why not:

- Kansas Turnpike officials said they don't have their bonds rated because they insure them, which results in a AAA rating for their bonds.
- Iowa Finance Authority officials said they rely on the rating agencies to base their decision on the financial data the Authority sends them.
- Missouri Health and Educational Facilities Authority officials said they leave it up to the underwriter and the institution for which bonds are being issued to secure the bond rating.
- Indiana Bond Bank officials said their financial advisor is responsible for contact with rating agencies on specific bonds. However, they said occasionally the governor and the treasurer have gone on such trips.

The four issuers that said they go on bond rating trips under certain circumstances told us the following:

- Oklahoma Development Finance Authority officials said they would conduct a rating trip only for a bond issue greater than \$15-\$20 million. They said they haven't been on such a trip in the last three years.
- Arkansas Finance Authority officials make a rating trip every year or two, to try to develop a level of comfort with rating agency staff. Trips aren't usually focused on a single bond issue.
- Nebraska Development Finance Authority officials make an annual trip to New York to present State information, but don't conduct trips for specific bond issues.
- Kansas Department of Transportation officials said they made three rating trips between 1992 and 1998 for bonds for the Comprehensive Highway Program, a \$1.2 billion project.

It's clear the Authority goes on more bond rating trips to New York City than the other similar issuers we contacted. However, analysts at the three bond rating agencies told us it was common for public bond issuers to meet with them about specific bonds. They said face-to-face meetings could be helpful because those meetings allowed them to explore issues in greater detail, and because having the issuer explain more complex information in person could increase their understanding of the bond. Two of the three said such trips could potentially result in a better rating for the bond.

**Given the nature of two bonds in our sample, we questioned whether rating trips for those bonds were necessary.** Although the decision to go on a bond rating trip is subjective and depends on a variety of factors, we still questioned whether the trips associated with two of the six bonds we reviewed were necessary.



The rating trip for the second Board of Regents bond in November 1997 seemed unnecessary because that bond, although very large at \$109 million, was the second in a series and didn't differ significantly from the first bond. In addition, the Authority had conducted a rating trip on the first bond only one year earlier. The cost of this rating trip was approximately \$16,300.

The President told us he thought this trip was important because one of the rating agencies had changed its criteria somewhat, and the Authority's finance team thought they might be able to get an improved rating. (However, they were unable to do so.) In addition, he noted that the first issue had been a combination of short-term notes and long-term bonds, while the second issue was exclusively long-term bonds. Finally, he cited the size of the bond and turnover on the Board of Regents since the last bond was issued.

The second rating trip we questioned occurred in June 1997 and involved a bond for replacing utilities at the El Dorado Correctional facility. This bond was very small—\$6.5 million—and was part of a series, although it had been several years since the initial bond had been issued. The cost of this rating trip was \$4,000.

Authority officials agreed this bond alone wouldn't have merited a rating trip, but the President said the Governor was considering proposing additional bonds in the future for new prisons, and they wanted to keep the rating agencies apprised of this situation.

**Other bond issuers we talked with generally take fewer people on their bond rating trips than the Authority.** The table below shows, for the six bonds in our sample, how many and what type of people the Authority took on each rating trip. It also shows comparative information for other issuers we talked with.

	KDFA						Other Issuers			
	SRF 1995	WSU 1995	SKILL 1996	Regents 1996	Regents 1997	El Dorado 1998	Arkansas	Oklahoma	Nebraska	KDOT
Bond Issuer Staff	2	2	2	1	1	2	2	1	3	
Agency Reps.	2	3	1	4	4			2		5
Budget Director			1	1	1	1				
Bond Counsel	1	1		2	2	1	1	1		1
Financial Advisor	1	2	1	2	2	1	1	1		1
Underwriter	1		1		2		1			1
Other (Special Counsel State Treasurer)										2
<b>Total</b>	<b>7</b>	<b>8</b>	<b>6</b>	<b>10</b>	<b>12</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>3</b>	<b>10</b>

**The Authority has taken more officials than appeared to be necessary on some bond rating trips.** Both the Authority's President and Board Chair shared their philosophy with us that, within reason, it's better to take more people on a rating trip to answer any possible questions that could be asked, rather than fewer. Representatives of the three rating agencies also told us it was important to bring the relevant people on bond rating trips, but they didn't specify who needed to be there.

At some point, this approach is not likely to be cost-beneficial. Based on our reviews and discussions with bond issuers during this audit, it appeared that the maximum number and type of people that would need to go on a bond rating trip was as follows:

- 1-2 representatives from the bond issuer (like the Authority)
- 1-2 representatives of the State agency for which the bonds were being issued
- the State Budget Director
- one bond counsel
- one financial advisor
- one underwriter

When we applied these criteria to the Authority, we noted that more than this maximum number of people—or more of certain types of people (i.e., more than one bond counsel or underwriter)—went on 3 of the 6 bond rating trips in our sample. We calculated that the Authority spent about \$13,000 in travel, food, and lodging costs for these 11 officials.

**It would be very difficult to tell whether the Authority's approach to bond rating trips has had an impact on lowering bond interest rates.** The President contends that the Authority's approach in this area helps establish good business relationships, results in more positive perceptions of the Authority and the bond issues it's involved in, and results in lower interest rates. The Board Chairman provided a similar perspective. He told us, given the relatively small dollar amounts involved in making bond rating trips, he thought the "down side" to those trips was extremely small, and the potential "up side" was extremely large.

Comparisons done by the Authority's financial advisors generally conclude that bond issues the Authority is involved in do well in the marketplace, achieving interest rates at least comparable to other similar issues. However, those same comparisons point out how difficult it is to find other bond issues that are truly comparable. Our review of the financial advisors' analyses for the six bonds in our sample seemed to show that most of the time, the Authority's issues achieved interest rates within the range of rates for comparable bonds. Occasionally, the interest rates the Authority achieved were at either the high or low end of the range for comparable bonds.

According to bond experts, factors that affect interest rates for a bond issue include market conditions on the date of sale, the size of the issue, the ratings of the issue (which are based on debt factors, financial performance, the economy, and bond

management), the structure of the issue (terms and maturities), and the funding source for repaying the bond.

The impact of the Authority's rating trips on such factors would be indirect and hard to measure, at best. Based on analytical information we've seen, it seems much more likely that if Kansas bond issues achieve better market interest rates than some other bond issues, it's because of Kansas' history of fiscal conservatism and generally steady economy.

### **A Number of the Authority's Expenses During Bond Rating Trips Exceeded Reasonable and Necessary Levels**

Typically, the Authority pays the travel-related expenses for everyone on a bond rating trip, and bills these expenses to the bond's cost-of-issuance fund. Authority staff generally make all plane and hotel reservations and handle meal arrangements.

State regulations limit the amount a State employee can be reimbursed for meals in New York City to a maximum of \$40 a day. As an independent instrumentality of the State, however, the Authority isn't subject to these and other expenditure limits that govern State agencies' travel.

As a reasonable standard for evaluating the Authority's travel-related costs, we compared those costs with the usual and customary prices paid for business travelers in the New York City area.

**The Authority's transportation and lodging costs appeared to us to be reasonable.** Typically, individual round trip air fares from Kansas City to New York were in the \$650-\$750 range, and with one exception, varied from \$282 to \$830. (In one case, a ticket that was purchased two days before the trip cost \$1,543.) Authority officials normally purchased coach tickets on commercial flights for all attendees. On two of the rating trips we reviewed they chartered State-owned planes—either the Governor's plane or the University of Kansas' plane. The per-person cost of using those planes was \$815 and \$900. Those amounts were at the upper end of the range of commercial fares the Authority typically paid.

Lodging costs also were reasonable. The Authority generally housed people at Loews Hotel, where room charges ranged from \$149 to \$182 per night, relatively inexpensive for New York City.

**The cost of numerous meals was more than reasonable and necessary.** We talked with representatives of several private-sector companies to get an idea of what they would expect to pay for an upper-level employee's dinner while on business in New York City. Based on their responses, we chose a maximum of \$50 (including taxes and tip) per person per evening meal as reasonable and customary. The table on the next page presents information about the dinners from our sample of bonds for which the Authority paid more than \$50 per person.

### High-Cost Meals in New York City

<u>Name of Bond</u>	<u>Restaurant</u>	<u>Cost Per Person</u>	<u>No. Attending</u>	<u>Total Cost</u>
Wichita State Housing	Russian Tea Room	\$106	10	\$1,058
El Dorado Correctional	Water's Edge	\$91	6	\$547
Board of Regents, 1996	China Grill	\$86	9	\$772
Board of Regents, 1996	Les Pyrenees	\$59	11	\$650
Board of Regents, 1996	Trattoria Del Arte	\$83	12	\$1,000
Board of Regents, 1997	Manhattan Ocean Club	\$110	16	\$1,755
Board of Regents, 1997	Sardi's	\$68	18	\$1,216

As the table shows, two of these dinners topped \$100 per person. The table also shows that oftentimes a large group of people were present at those dinners. None of these meals involved bond rating analysts or insurers; rather, all the meals and other related expenses we saw for the six bonds in our sample were for staff of the Authority and the people who accompanied them. In other words, these weren't meals where Kansas officials were "wining and dining" the people they were visiting in New York City to try to impress them.

In all, the "excess" costs associated with these meals totaled \$3,270 for the six bonds we reviewed. This figure represents that portion of the cost that was greater than \$50 per person.

**We identified some expenditures the Authority charged to bonds that can't be classified as "official business."** As summarized below, these included costs for entertainment, as well as costs for spouses or others who went on one or more ratings trips but who weren't there in an official capacity.

- On both Board of Regents bonds we reviewed, the Authority bought theater tickets totaling \$675 and \$718 for all attendees (including two airline pilots). Both sets of tickets initially were charged to the bonds' cost-of-issuance accounts. However, after the Authority's Chief Financial Analyst refused to approve the reimbursement for the second set of tickets as a legitimate cost-of-issuance expense, those tickets were charged to the Authority.
- On numerous occasions when officials' spouses attended rating trips, bond cost-of-issuance funds weren't reimbursed, or weren't fully reimbursed, for costs incurred for those spouses. By themselves, these costs amount to slightly more than \$800. For example, we noted that one financial advisor routinely brought his wife on rating trips. There were no additional travel or lodging costs for her, but her meal expenses totaling \$508 were paid, primarily out of the bond's issuance costs, for the six bonds we reviewed.

Another example: a State official who brought his spouse along on a trip told the Authority's President he wanted to reimburse his wife's expenses, and asked how

much he owed. The President quoted a price that was nearly \$300 less than the amount we calculated. The official paid the amount he was told he owed—\$785.

- For 3 of the “expensive” meals listed above, the Authority invited the pilots to eat with the group, and charged their meals to the bonds’ issuance costs. In all, these meals for the pilots of the chartered State-owned airplanes amounted to \$500.

### **Although We Focused This Part of Our Review on Rating Trips, We Also Identified Some Questionable Costs That Occurred at Other Times**

As we reviewed expenditure vouchers, we noticed some expenses not associated with rating trips that seemed to us to be higher than necessary, or to be inappropriate. In some cases the expenses were charged to bonds. In others, they were charged to the Authority. Although many of these expenses weren’t large, in our opinion they don’t represent a prudent use of bond proceeds or the Authority’s funds.

The types of expenses we saw in this area totaled about \$3,500 and occurred between fiscal years 1996 and 1998. They included the following:

- The Authority spent \$1,551 at the Vintage Restaurant in Topeka for a closing dinner for the Board of Regents’ second bond issue, and charged that dinner to the bond’s-issuance costs. In all, 30 people attended, including the finance team, several Regents and staff, some Authority staff, and many spouses, at a cost of slightly more than \$50 per person. The President acknowledged that no business was conducted at this dinner; he said it was a wrap-up celebration for a successful issue.
- The Authority spent \$356 at the Vintage Restaurant for a “kick-off” dinner for the finance team involved in the 1995 State Revolving Fund bond, and charged that dinner to the bond’s-issuance costs.
- The Authority spent \$1,300 to frame 26 copies of a bond as mementos, and charged that cost to the Authority. After the first Board of Regents issue, the President presented framed copies of the bond to members of the finance team, members of the Board of Regents and several of their staff, the Budget Director, the university presidents, and the Governor.
- The President charged \$183 to the Authority for an “appreciation dinner” at the Georgetown Seafood Grill. After attending a conference in Baltimore on a Thursday and Friday, the President stayed over to conduct business in Washington on Monday. He and his wife spent the weekend at the home of relatives, and the President charged the Authority for an “appreciation dinner” for the two couples to repay their hospitality.

**The Authority has almost no formal internal policies to provide its staff with guidance about travel-related costs and practices.** The only written travel policies it has relate to mileage expenses incurred while travelling on Authority business. Written policies don’t need to be elaborate or overly prescriptive, but without some guidance it’s difficult for staff to know what’s allowed or appropriate under cer-

tain circumstances. Given the Authority's stewardship responsibility as a bond-issuer for State agencies, we think it's important that some policies be defined.

Such policies could address broad issues like when it's appropriate to charter an airplane or hold a "closing" or "appreciation" dinner. They also could provide certain cost parameters, like what is a reasonable and acceptable cost for meals. And if needed, they could provide specific guidance in certain areas, like whether movies, laundry, and personal phone calls charged to a hotel room will be reimbursed.

**The President of the Authority Appears to Have Violated State Laws When He Stayed in a Hotel Suite Owned by a Company He Regulates as the State's Consumer Credit Commissioner**

The President made three bond-related trips to New York City between Christmas and New Year's Day in 1994, 1995, and 1996. Each of these trips was for four nights.

**The President appears to have violated the State's ethics laws by staying in a private hotel suite valued at approximately \$650 a night that is owned by a company he regulates.** On each trip, he stayed in a two-bedroom suite in the Essex House overlooking Central Park. This suite is owned by Household International, the parent company of Household Finance Company, which the President regulates in his position as Consumer Credit Commissioner.

The President told us he'd had a standing offer from Household International to use that suite when he was in New York City. Essex House officials estimated for us that a such a suite would have a value of about \$650-\$675 a night. This suite isn't available for public use.

According to the President, for the December 1995 trip there were no rooms available for him and his wife in the Loews Hotel, where Authority officials normally stayed during their New York City trips. Other hotel rooms that were available would have cost the State in the \$250-\$350+ range, he said. However, he said there were no such extenuating circumstances surrounding his stays in December 1994 and December 1996. (We noted that during the 1995 trip, when the Authority had to obtain lodging for the Budget Director at another hotel because of space limitations at Loews, the cost was \$236 per night.)

The President said he didn't see any ethical problem or conflict-of-interest in staying in Household International's suite because he was on Authority business, not on business related to his job as the Consumer Credit Commissioner. He also told us that, in the private sector, such an arrangement would be viewed as a normal part of building relationships with the people you did business with.

The State's ethics law (K.S.A. 1997 Supp. 46-237(a)) states that:

“No state officer or employee, candidate for state office or state officer elect shall accept, or agree to accept any economic opportunity, gift, loan, gratuity, special discount, favor, hospitality, or service having an aggregate value of \$40 or more in any calendar year from any one person known to have a special interest, under circumstances where such person knows or should know that a major purpose of the donor is to influence such person in the performance of their official duties or prospective official duties.”

Because each stay in the Essex House was for four nights, the President accepted something valued at approximately \$2,600 a year, for a total of \$7,800.

**The President requested and received a total of \$1,200 in reimbursements for lodging costs he never actually incurred while staying in the Essex House.** After his December 1994 trip, the President wrote a personal check to Household International for \$560 to repay the company for the four nights he stayed in its suite. That payment represented \$140 per night, which was the rate he would have paid had he stayed in the Loews Hotel. The President used an uncanceled copy of this check to support his claim for a \$280 reimbursement from the Authority for the two nights he was in New York City on official business.

Household International never cashed his check. According to the President, an official at Household told him “it would be too difficult and not necessary to accept and process the payment.” The President indicated he told the Household International official he would feel much better if the company were reimbursed, even though the room was used for official Authority business. He told us that after about 90 days he dropped the issue, intending to settle it some other way.

Even though his personal check to Household International was never cashed, the President kept the \$280 reimbursement he’d received from the Authority.

This same process was repeated in 1995 and 1996—the President wrote a personal check to Household International for his use of the hotel suite, submitted his uncanceled check as documentation to support his claim to be reimbursed for the days he stayed at the Essex House while on official business, and kept the reimbursement even though Household International never cashed his personal checks. The amounts involved each year are shown in the following table:

<u>Date of Trip</u>	<u># of nights stayed</u>	<u># of nights President charged to Authority</u>	<u># of personal nights</u>	<u>Amount of President's check to Household</u>	<u>Amount President reimbursed by Authority</u>
12/29/94 to 1/2/95 Thursday - Monday	4	2	2	\$560	\$280
12/25/95 to 12/29/95 Monday- Friday	4	2	2	592	296
12/26/96 to 12/30/96 Thursday - Monday	4	3	1	840	630
<b>Total</b>	<b>12</b>	<b>7</b>	<b>5</b>	<b>\$1,992</b>	<b>\$1,206</b>

In response to our request for copies of the canceled checks he'd sent to Household International, the President initially told us he would give us those copies. However, he later gave us a copy of two cashier's checks he'd written dated April 21, 1998. One was to the Authority for \$1,206 to repay it for the reimbursements he'd received and never returned in 1994, 1995, and 1996.

It appears to us that the President's actions could be classified as presenting a false claim, which would be a criminal violation. However, the President told us it was never his intent to defraud the Authority of this \$1,206. He said he'd always intended to clear this matter up, and his motive was never to gain financially from this situation.

The other cashier's check was to Household International for \$1,500. In a letter to Household, the President indicated this check was to repay the company at \$300 per night for the five "personal" nights he stayed in the Essex House suite. (This \$300 figure is the amount Household International officials said they tell their employees to report for tax purposes when they stay in the suite free of charge.)

The President's \$1,500 repayment to Household International is based on a different premise than his original checks to the company—this time he apparently was repaying Household International only for his personal nights of stay, not for all 12 nights he was there. The President told us he saw no problem with Household International paying for the seven nights in the suite while he was on Authority business, because he said the State benefitted by not having to pay any lodging costs for him during those nights.

Both situations have been reported to the Attorney General and to the Governmental Ethics Commission.

### Conclusion

The Kansas Development Finance Authority's general philosophy about rating trips is to be visible in the bond market, and make sure that representatives are available to immediately answer any questions rating analysts might ask. This approach arguably may increase the likelihood of a higher bond rating, and lower interest costs for State agencies. However, not all bond issuing authorities share that perspective, and it's difficult to determine whether interest rates are influenced by the Authority's approach.

The President also has told us he wants to make these trips as enjoyable as possible for the participants. Unlimited by any guidelines for appropriate levels of spending, the Authority's practices in this area can result in issuance costs being charged to State agencies that some might



consider to be excessive. Although the amount of costs we identified as potentially excessive isn't large compared with the total dollars involved, or even compared with total issuance costs, it calls into question the Authority's stewardship over bond-related moneys.

Finally, although the Authority's President has indicated he didn't see any conflict of interest in accepting free lodging while on Authority business from a company he regulates as Consumer Credit Commissioner, we think this action not only violated the State's ethics laws, but also potentially compromised the integrity of the Authority and the Consumer Credit Commissioner's Office.

### **Recommendations**

1. To help ensure that costs incurred for bond rating trips and other agency activities are reasonable and necessary, the Kansas Development Finance Authority should do the following:
  - a. Develop general guidelines for when a bond rating trip should be taken, and who should participate. In developing these guidelines, the Authority should consult with its Board and bond professionals, including the rating companies.
  - b. Adopt guidelines for appropriate levels of spending for transportation, lodging, and other costs. In developing these guidelines, the Authority should consult with its Board and representatives of those agencies for which it issues bonds, those who actually pay those costs.
2. To help reduce the likelihood of any future reimbursements for costs that aren't actually incurred, the Authority should require that all appropriate supporting documentation be submitted for all expense reimbursement claims. Such documentation generally would include independently prepared receipts showing the nature and amount of the expenses, and clearly indicating the claimant had paid the expenses.



## Appendix A

### Arkansas Development Finance Authority's Bond Counsel Selection Criteria

*The following criteria and scores are part of the Request for Proposals the Arkansas Development Finance Authority sends to potential bond counsel.*

<i>Factor</i>	<i>Point Range</i>
1. Firm's recent experience as bond counsel for debt financing for _____ projects.	
a. Prior experience with municipal bond issues	0-10
b. Size and number of prior bond issues and experience in complex bond financings of prior bond issues—select 3 past deals as bond counsel and summarize their similarity to this program and their successfulness.	0-10
c. Response to Arkansas presence issue including relevance of presence to this transaction	<u>0-3</u> 0-23
<b>(ADFA will assign negative points for inadequate responsiveness in prior bond issue procedures.)</b>	
2. Organization, size and structure of firm:	
a. Number of employees currently engaged in securities transactions	0-5
b. Number of employees currently engaged in municipal bond transactions	<u>0-5</u> 0-10
3. Qualifications of staff to be assigned:	
a. Bio on staff assigned to this program or to ADFA	0-5
b. Team members demonstrated ability, years and type of experience	<u>0-10</u> 0-15
4. Responsiveness of written proposals to the purpose and scope of services:	<u>0-4</u> 0-4
5. Responsiveness of proposal on fee issue	0-15
<i>Maximum Points</i>	<b><u>0-67</u></b>

## **APPENDIX B**

### **Agency Response**

On May 11, 1998, we provided copies of the draft audit report to the Kansas Development Finance Authority. This appendix contains two responses--the Chairman of the Board has responded on behalf of the Authority, and Mr. Caton has responded on his own behalf.



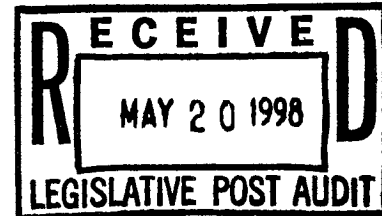
# KANSAS

KANSAS DEVELOPMENT FINANCE AUTHORITY

Bill Graves  
Governor

Wm. F. Caton  
President

May 20, 1998



Ms. Barbara Hinton  
Legislative Post Auditor  
Legislative Division of Post Audit  
1200 Merchants Bank Tower  
8th & Jackson  
Topeka KS 66612-2212

RE: Kansas Development Finance Authority Audit

Dear Ms. Hinton:

We have reviewed your draft report of the performance audit of Kansas Development Finance Authority ("K DFA"), and generally agree with the findings and recommendations of the Post Audit. This letter serves as the Authority's official response. Bill Caton will respond independently in his own capacity. Following are our comments concerning the various issues identified in the report.

**1. Are the Kansas Development Finance Authority's procedures for selecting bond counsel unduly restrictive?**

You note in your report that K DFA uses a competitive bid process to select bond counsel, although it is not required to do so. You further note that because K DFA has determined to use a competitive selection process that it is imperative that K DFA ensure that the selection process is fair. We agree the process must be fair and will incorporate your suggestions as follows:

- prepare requests for proposals that clearly define the services needed, and that states as clearly as possible the qualifications needed and the criteria to be used in evaluating the proposals
- send the request for proposals to qualified parties
- keep the proposals sealed until the final deadline for submitting the responses
- evaluate the proposals received based on agreed-upon qualifications and criteria
- award the work to the highest-ranked firm, unless there is a legitimate, clearly-documented reason to do otherwise

Ms. Barbara Hinton

Page 2

May 20, 1998

Most of these procedures are, in fact, already in place. Several suggestions will, however, be incorporated immediately.

Your recommendation states:

1. To help ensure that its bond counsel selection process is as fair and objective as possible, and to eliminate the suspicion of favoritism, KDFA should do (certain things as set out in your report).

First your recommendation is that the State might receive more competitive bids if the complete evaluation criteria (which should be developed by several staff members) and relative weights assigned to each category were provided to prospective bidders in advance, and that once the proposals are received the evaluation process would be less subjective if more staff members were involved in scoring the proposals. KDFA staff agrees that this is a fairer method, and will adopt this recommendation, providing evaluation criteria and weights assigned, (as developed by several staff members with board input), to prospective bidders in advance, and assigning at least three staff and/or board members to evaluate every proposal.

Second, because of the need to review proposals thoroughly and to extract the salient information for purposes of evaluation, the proposals were not kept sealed until the final deadline for submission, and instead, proposals were reviewed and analyzed as they arrived. Future proposals, however, will not be opened until the deadline.

Third, you note that the mathematical formula for determining the bond counsel fee is confusing. This formula will be adjusted in accordance with your suggestion to result in the assigned scores being equitable and not skewed by an inordinately high or low bid.

Fourth, you suggest that we carefully review our grouped bond programs to ensure that the scope of the individual programs is not so broad that it unduly restricts the number of qualified firms that could effectively serve as bond counsel. The Authority board and staff will review identified programs to determine if any are unnecessarily broad in scope.

Authority staff researched and prepared a bond counsel selection survey and recommended practices memorandum in 1997. After review and consideration, the KDFA Board of Directors adopted one of the recommended practices: a combination method which utilizes a Request for Qualifications, a Request for Proposals, and selection of Program Counsel. Various programs were identified, e.g. Board of Regents, Department of Corrections, IMPACT. Since this method was adopted in January, two programs have been bid, Board of Regents and IMPACT, and two separate firms were chosen to provide bond counsel services. KDFA anticipates that requests for proposals will be solicited from qualified firms on other programs in the near future, and that additional firms may be selected to serve as counsel on those programs.

**2. Are the costs the Authority charges against bonds issued for State agencies reasonable and necessary?**

This question is essentially concerned with whether certain costs, commonly referred to as "costs of issuance", which are charged against bond issuance costs for a particular transaction, are reasonable and necessary. You state in your report that you believe in numerous instances the Authority charged expenses that you consider to be greater than reasonable and necessary, including making more bond rating trips to New York City than may have been necessary, taking more people on those trips than may have been necessary, and spending more than is reasonable and customary in New York for meals and entertainment.

The Authority agrees with the analysis and conclusions of Post Audit wherein it was determined that certain of the costs of issuance charged against the six bond issues that comprised the report sample were greater than was reasonable and necessary.

While the Authority believes it is important to develop relationships and a degree of visibility with market professionals, including rating agency and municipal bond insurance personnel, the Authority also recognizes that it is important to ensure that costs associated with bond issues are closely controlled.

Post audits recommendations are:

1. To help ensure that costs incurred for bond rating trips and other agency activities are reasonable and necessary, KDFFA should do the following:
  - a. Develop general guidelines for when a bond rating trip should be taken, and who should participate. In developing these guidelines, the Authority should consult with its Board and bond professionals, including the rating companies.
  - b. Adopt guidelines for appropriate levels of spending for transportation, lodging, and other costs. In developing these guidelines, the Authority should consult with its Board and representatives of those agencies for which it issues bonds.

To ensure that in the future, costs are contained and kept at reasonable and prudent levels, the Authority board and staff will promulgate specific policies regarding appropriate and necessary travel and what constitutes reasonable travel expenses. While we note that the Authority schedules ratings trips for only those issues it believes require special explanation of the finance structure or underlying revenue stream (typically only one or two issues a year), we acknowledge that to assure that expenses are maintained at a reasonable level, the policies developed need to address not only what expenses are appropriate and reimbursable, but such policies must also provide guidelines for determining when travel is necessary in the first place, and which personnel are deemed integral and should be included in particular travel plans.

Ms. Barbara Hinton  
Page 4  
May 20, 1998

We are also cognizant of the fact that certain entertainment expenses, e.g., tickets for the theater, concerts, sporting events, and so forth should not be charged to costs of issuance or be eligible for other reimbursement by the Authority or any other agency.

2. To help reduce the likelihood of any future reimbursements for costs that aren't actually incurred, the Authority should require that all appropriate supporting documentation be submitted for all expense reimbursement claims. Such documentation generally would include independently prepared receipts showing the nature and amount of the expenses, and clearly indicating that the claimant had paid the expenses.

To implement this recommendation, Authority board and staff agree that upon completion of any travel, each staff member or members will be required to prepare an expense report which will include independently prepared paid receipts for all expenses submitted for reimbursement. This report will be submitted to the KDFFA Board of Directors for their review and approval. Copies of the reports will be provided to anyone else upon request.

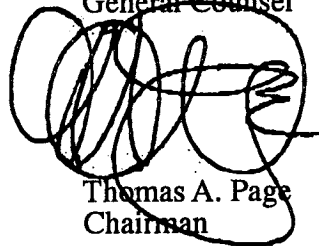
KDFFA staff have already developed policies which address certain other office matters, e.g. telephone use and petty cash funds. These policies and the travel and expense reimbursement policies when finalized by the Board will also be provided upon request to anyone seeking a copy.

Thank you for allowing us the opportunity to respond to your evaluations and recommendations.

Very truly yours,

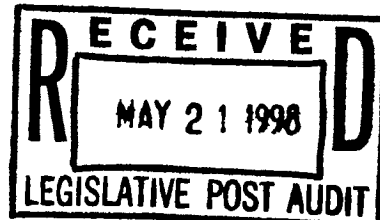
*Rebecca E. Floyd*

Rebecca E. Floyd  
General Counsel

A large, stylized handwritten signature in black ink, appearing to read "Thomas A. Page".

Thomas A. Page  
Chairman





# KANSAS

KANSAS DEVELOPMENT FINANCE AUTHORITY

Bill Graves  
Governor

Wm. F. Caton  
President

## INITIAL RESPONSE TO LEGISLATIVE POST AUDIT REPORT

William F. Caton

May 21, 1998

In February, 1992, when Governor Finney appointed me as President of Kansas Development Finance Authority ("KDFFA"), in addition to continuing as Consumer Credit Commissioner, she had two directives for me. First, she instructed me that KDFFA was not a state agency by design and that I should manage it the same as if it were my own business. Secondly, and I can almost quote verbatim, she said, "Bill, do not let the bond houses (meaning the investment banking firms) run KDFFA!" I took these charges very seriously and built a management style founded on the good advice of Governor Finney. I believe this management style is the basis for some of the concerns addressed by the Legislative Post Audit ("LPA") report, which I will address in the order presented in the report.

### SELECTION PROCESS OF BOND COUNSEL

The desire for KDFFA to utilize a competitive selection process to retain bond counsel is a directive from past KDFFA boards and was in place when I came to KDFFA. I have had many discussions with past boards and the current board about this process and was basically directed to continue the process, improve the process, and *document* the process, which has led to the place where we are today. It would be my personal preference to acquire the *best* qualified, competent bond counsel firm available that has a proven track record, subject to affordability, and deal with the political issues that process would initiate. I have publicly said many times in the past that this process has been the single least enjoyable part of my job and that I am not sure there is a "good" or "best" way to select finance professionals.

However, I do believe that, if KDFFA continues to utilize a competitive selection process for the selection of bond counsel, the recommendations and suggestions by the LPA would improve the integrity of the process. With the assistance of KDFFA staff, I have attempted to secure the best services for the transaction or program at an affordable price. We have painstakingly made changes and improvements to our process in response to concerns voiced by respondents long before this LPA report. There has never been any intent to devise or manipulate a system that favored a certain firm or preclude a certain firm from potentially providing services to KDFFA.

It is my opinion that the LPA has adequately addressed this portion of the audit.

## TRAVEL RELATED COSTS OF ISSUANCE

As I indicated in my opening statement, my business philosophies and management style are at question when conclusions are made that ratings trips were not necessary or expenses were excessive or inappropriate. I do understand that to reach their conclusions, LPA must set a target or baseline from which to judge. The target or baseline must be relevant to the type of business being addressed; multi-million dollar public bond issues with the intent to receive the best ratings possible. LPA made great efforts to understand the uniqueness of KDFA, even as it is related to other state-wide issuers, and to understand my business philosophies, and have apparently concluded that certain trips, meals and other expenses were unnecessary or excessive compared to their baseline. I will try to briefly explain my rationale why I disagree with LPA's findings on each separate item.

### Unnecessary ratings trips:

Board of Regents 11/97 - LPA aptly explained the reasoning behind the decision to make the trip in their report, a business decision that was made by the *whole finance team*, not just myself or KDFA staff. Additionally, Moody's had changed their ratings benchmarks since the last bond issue, and it was imperative that we attempt to obtain from Moody's an upgrade from A1 to AA3. It was our opinion that the first bond issue had a split rating; S&P AA-, Fitch AA- and Moody's A1. Unfortunately, we were unsuccessful, but still felt it was worth the cost and effort. To place the \$16,300 trip cost in perspective, one basis point (one hundredth of one percent) of interest on \$111 million for fifteen years is approximately \$105,000, *almost seven times the cost of the trip!* The logical business decision is to make the trip, do not leave *anything* to chance.

El Dorado 6/97 - Additional reasons not mentioned by LPA in their report for this trip are: 1) Kansas has not had a corrections bond issue since 1992; 2) Current corrections issues in Kansas needed to be discussed as privatization has become a controversial issue in the financial markets and Kansas was currently analyzing the possibility of prison privatization; and 3) KDFA used this opportunity to have the budget director recap the recently approved budget and finalize face-to-face discussions on the State's Issuer Credit Rating from S&P. I still believe the \$4,000 cost of the trip was necessary and that the trip was successful in obtaining the desired ratings.

### Number of people taken on trips:

The LPA concluded that on the six trips they reviewed, a total of 11 unnecessary people participated in the trips at an expense of \$13,000. It appears from the table in their report that most of the additional people would be agency representatives. One of the key elements which make up the rating of a bond issue, and possibly one of the most difficult to evaluate, is management capabilities of the obligor of the revenue bond. It has been my business

philosophy to emphasize this aspect to the rating agencies and provide them face-to-face discussions with those who will be responsible for management of the revenues pledged to the bonds. I believe this approach has been extremely successful and has contributed to the good ratings we have received on the various bond issues.

The LPA report states, "The impact of the Authority's rating trips on such factors (lower interest rates) would be indirect and hard to measure, at best. Based on analytical information we've seen, it seems much more likely that if Kansas bond issues achieve better market interest rates than some other bond issues, it's because of Kansas' history of fiscal conservatism and generally steady economy." *This topic is one of the focal points of each of our ratings presentations. We stress this issue, which is usually written in the actual ratings write-up issued by the rating agencies and read by the prospective bond investors.* I do believe our efforts to highlight the conservative fiscal management has paid great dividends in lower interest rates.

#### Costs of numerous meals:

The LPA report states that over \$3,700 was overspent on meals during the six ratings trips they reviewed, basing the appropriate price of dinner at \$50 per person. It is extremely difficult to have a nice sit-down dinner in New York for \$50 per person. My observation of menu prices in New York, which typically *everything* is a la carte, is that they are considerably higher than the Midwest and that \$70 to \$75 per person is a "reasonable" price for the type of business dinner involved.

In conclusion, do I feel the \$50 benchmark set by LPA is too low? Yes. Are these types of business dinners standard in the industry and relevant to the work KDFA does? Yes. Am I going to contest their findings? No.

#### Other expenditures questioned as "official business":

Theater tickets - Very few people from the Midwest have an opportunity to go to a Broadway play. I felt this was a good chance to enjoy the sights and sounds of New York and treat those participating on the trip to this unique theatrical opportunity. Was it necessary? No. Could it have been a personal expense paid by the individuals? Yes. Am I going to contest the findings of the LPA? No.

Spousal Expenses - The financial advisor who routinely brought his wife on ratings trips from New Jersey has had a very lax and beneficial billing policy with the State. He is generally paid on a per hour basis, has never charged us for any travel time, a multitude of phone calls and questions that monthly amount to numerous hours of potential billing and does not charge the State for his time during these business dinners when business is actually discussed. Technically, the \$526 assessed to his wife's expenses on six ratings trips is minuscule compared to what his charges could and should be for his time on these ratings trips. I consider it gratuitous and money well spent.

WGL

The other two examples of the State official undercharged \$300 and the inviting of pilots to dinners at an expense of \$500 are not contested.

Other Expenses - A closing dinner in Topeka for the Board of Regents second bond issue, a "kick-off" dinner in Topeka for the 1995 State Revolving Fund, and framed bond mementos for the Board of Regents issues, all totaling approximately \$3,000, were authorized by me. Although not totally necessary, I felt they were appropriate expenses, expended very frequently in many bond issues and standard in the industry, however, usually not on the expense ledger of the issuer. These expenditures, along with many of the expenditures listed above, are frequently hidden in the cost of issuance by allowing the underwriter or other finance professional to pay for these meals and expenses and bury them in their professional fees. As I stated in my opening remarks, I have taken the position that KDFFA must not allow the finance professionals to control the transactions and have not allowed finance professionals to pay for any of these types of expenses on State bond issues. I do believe that many issuers allow underwriters to pay all expenses on ratings trips, closing dinners, mementos and other items, and allow them to be reimbursed either in their professional fees or without detailed accounting. I believe the open and direct system at KDFFA is much more appropriate as well as much more open to public review and scrutiny. I have heard many stories of lavish trips and dinners at the public's expense that will never be accounted for. Not at KDFFA!

I do believe it would be very appropriate, as suggested by LPA, for KDFFA to formulate formal internal policies regarding travel related costs and practices.

*To summarize my thoughts on the issue of KDFFA travel expenses, if I were the sole proprietor and stockholder of KDFFA, the expenditures would have been the same!*

At this point in time, I would like to discuss an issue that I believe puts KDFFA board members at a disadvantage if they are expected to oversee day to day operations and oversight of operational policies. By KDFFA's statutes, board members are volunteers (They do not even receive the customary \$35 per meeting afforded to most appointed board members.) and they do not have direct oversight of the president as he, too, is appointed and serves at the pleasure of the governor. It has been my interpretation that the KDFFA board was to have oversight of broad policies and issues relating to public policy and that the president was responsible for the day to day operations.

Do not chastise the board for any perceived lack of oversight on daily operations of KDFFA. The board has no responsibility for policies, practices or lack thereof on the issues addressed in the LPA report.

## **ALLEGATIONS OF VIOLATION OF STATE LAWS**

There have been some very serious allegations against me about violating State ethics laws, and I take them very seriously. Seriously enough that I have retained counsel at significant expense to defend myself against these allegations. The facts have been fairly accurately related in the LPA report but I believe interpretations, intents and other circumstances need to be further explained.

*WJC*

First of all, it is difficult for me to understand the paranoia that government has against good business relationships. I also get quite confused when government promotes "public/private partnerships" and encourages business investments in public undertakings but will not allow healthy business relationships to foster between government and industry. In my past experience as a community banker, all business is based on a good, open relationship with your customer. However, it is recognized that restrictions against influence peddling may be necessary.

At no time have I felt that the circumstances regarding my stay at the Essex House was in any way, shape or form an attempt by Household to influence me in the performance of my official duties as Consumer Credit Commissioner. I even felt that utilizing their suite for K DFA business removed it even further from that realm. Never once has Household ever asked for or received any preferential treatment from the office of the Consumer Credit Commissioner. They are treated exactly like every other licensee.

Consider this. First, if I would have thought it was a violation of law, I would have never done it. Second, if I had thought it was wrong and wanted to do it anyway, there surely would not be any evidence or reimbursements to expose or draw attention to it. You will note that nothing was covered or hidden and that all records were as presented.

The partial reimbursement from K DFA could have been handled better and I should have reimbursed K DFA sooner when officials from Household declined to cash my personal checks. There was never any intent to be reimbursed for any expense I had not actually made and as I indicated to LPA, in my mind it was merely a detail I needed to take care of which ended up being placed too far back on the back burner. Please note, that those amounts have been reimbursed and Household has been paid an amount by me personally that is satisfactory to them that they have subsequently donated to charity, and that amount is equal to the amount Household requires its employees who stay in their Essex House suite free gratis to report to the I.R.S..

*In any case, there was absolutely, positively never any intent to accept any favor in exchange for any favoritism nor to financially gain personally from this situation. Since there is a pending investigation, I will refrain from further discussion regarding this matter.*

## **FINAL REMARKS**

I appreciate the opportunity to respond to this audit and apologize for not being able to appear in person as I am recovering from recent back surgery. Hopefully, I will be able to participate by telephone and be able to answer any questions or concerns of the committee. I do wish to state that the Legislative Post Auditor and her staff were very professional, courteous and thorough during this audit. Again, thank you for the opportunity to respond to this matter.



