



PERFORMANCE AUDIT REPORT

**Wyandotte County: Reviewing the Use of
STAR Bond Moneys Associated With the Kansas
Speedway and the Village West Tourism District**

Executive Summary

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
February 2005**

Legislative Post Audit Committee

Legislative Division of Post Audit

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February 14, 2005

To: Members of the Kansas Legislature

This executive summary contains the findings and conclusions, together with a summary of our recommendations and the agency responses, from our completed performance audit, *Wyandotte County: Reviewing the Use of STAR Bond Moneys Associated With the Kansas Speedway and the Village West Tourism District*.

This report includes several recommendations for the Legislature and the Unified Government of Wyandotte County and Kansas City, Kansas. We would be happy to discuss these recommendations or any other items in the report with you at your convenience.

If you would like a copy of the full audit report, please call our office and we will send you one right away.

A handwritten signature in black ink that reads "Barbara J. Hinton". The signature is fluid and cursive.

Barbara J. Hinton
Legislative Post Auditor

EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

Overview of STAR Bonds and the Wyandotte County Redevelopment Projects

Sales Tax and Revenue (STAR) bonds let local governments use future sales tax revenues to pay current redevelopment costs.page 3

STAR bonds are repaid with sales, use and transient guest taxes generated within a redevelopment district. Approximately two-thirds of the taxes used to repay STAR bonds are State taxes. The bonds can be used to pay for certain redevelopment project costs including property acquisition, site preparation, and bond issuance and financing costs. To use STAR bonds, a local government must establish a redevelopment district with one or more redevelopment projects, and submit a redevelopment plan to the Secretary of Commerce for approval.

The Wyandotte County redevelopment includes the Kansas Speedway and Village West retail and tourism area (See Figure OV-1).page 6

As of December 2004, the Unified Government had authorized \$305 million in STAR bonds for the redevelopment area. The Speedway and Village West have generated more than \$40 million in sales tax revenue in the redevelopment area. Within Village West, under a provision called “waterfall financing”, excess sales tax revenues from one project can be used to repay bonds for other projects. The redevelopment has successfully promoted economic development in Wyandotte County and the State, increasing property taxes, sales tax revenues, and creating new jobs.

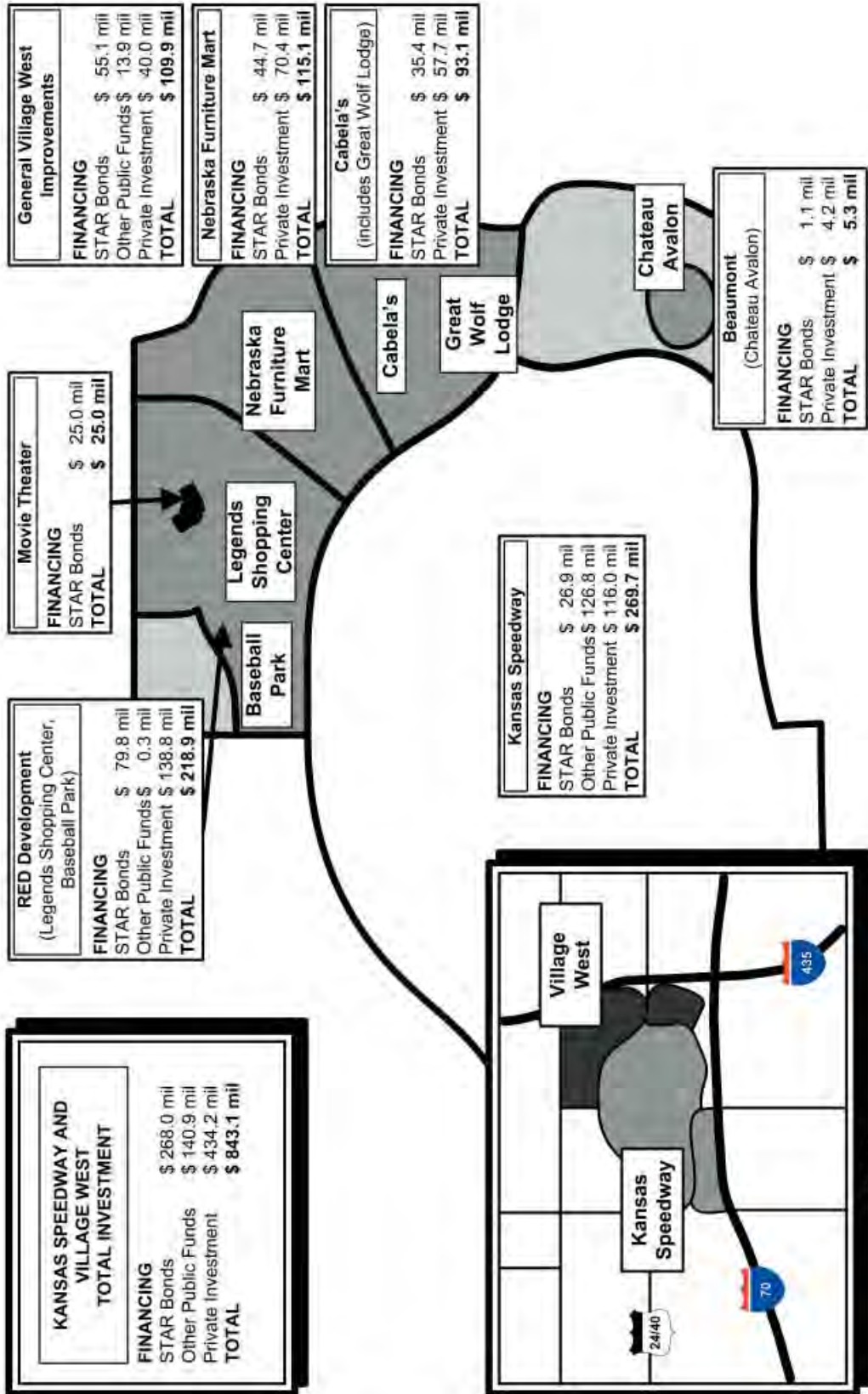
Question 1: Were the Issuance Costs Reasonable for the Bonds That Financed the Development of the Kansas Speedway and the Village West Tourism District?

Local governments enlist the services of bond counsel, bond underwriters, financial advisors, and trustees or escrow agents when issuing bonds. Fees paid to these professionals are referred to as the “cost of issuance.”

Overall, the cost of issuing the bonds for the Kansas Speedway and Village West was in-line with other bonds we looked at.page 13

Compared to similarly-sized economic development bonds from other states, the issuance costs for most of the STAR bonds were among the lowest of the bonds we reviewed. Because the bonds lacked an established revenue history, there was uncertainty about their marketability. As a result, almost 80% of the Speedway and Village West STAR bonds were sold privately to businesses within the redevelopment district. Issuing agents were competitively selected when required by law.

**Figure OV-1
KANSAS SPEEDWAY
and VILLAGE WEST PROJECTS**



The Unified Government paid itself \$450,000 in bond origination fees. Under State law, local governments are allowed to charge bond origination fees when they issue bonds on someone else's behalf, in order to raise moneys to support local economic development. Because about two-thirds of the revenues that will pay back the fees will be State sales tax revenues, and because STAR bonds already raise funds for local economic development, charging bond origination fees appears to us to be unnecessary and redundant.page 16

Question 1 Conclusion. As we've described, the Unified Government charged \$450,000 in bond origination fees when it issued the STAR bonds for the Kansas Speedway and Village West projects. The State authorized such fees in order to support economic development at the local level. However, with the STAR bonds, the State already agreed to forgo future sales tax revenues to encourage economic development in Wyandotte County. In this case, rather than being for economic development, the bond origination fees represent an unnecessary transfer of money from the State to the Unified Government.page 16

Question 1 Recommendations. We recommend that the Legislature amend State law to prohibit bond origination fees when local governments issue STAR bonds for their own projects.page 16

Question 2: Were the Bond Proceeds Spent for Allowable Purposes, and Were the Costs Associated With the Items Purchased Reasonable?

State law allows STAR bond moneys to be used primarily for acquiring property and making infrastructure-related improvements. The law cites 15 allowable uses of STAR bond moneys. Most of those allowed uses are "infrastructure-related" items, such as streets, street lights, sewers, and utility connections. However, STAR bonds can be used for other things such as paying relocation costs for home and business owners who are displaced because of the development, or costs associated with financing the redevelopment project. The law specifically prohibits using STAR bonds to pay for a building that will be owned by or leased to a developer or to acquire personal property.page 17

As of December 2004, \$179 million in STAR bond moneys had been spent on the Kansas Speedway and Village West. Almost \$150 million (15%) of this amount had been spent for Village West. Construction costs accounted for the largest share of the STAR bond moneys spent (\$129 million), followed by fees and commissions (\$24.2 million).page 18

We identified about \$1.5 million in uses of STAR bond moneys that aren't allowable (See Figure II-3). Almost \$1.1 million of this total were funds withdrawn by the Unified Government but never spent. Most of the remaining expenditures were for costs associated with building the Nebraska Furniture Mart store that were charged in error to the STAR bond accounts. Unified Government officials have acknowledged that these payments were made in error and all amounts have been, or will be, repaid to the bond accounts.page 20

**Figure II-3
Summary of Expenditures That
Aren't Eligible for STAR Bond Funding**

Ineligible Use of STAR Bond Funding	Amount	Basis for concluding the expenditure is not eligible for STAR bond funding
1. Withdrawing STAR bond moneys before they are to be spent.		
In 2001, the Unified Government withdrew almost \$21 million from the first Village West STAR bonds for planning and land acquisition costs. As of January 2005, \$1.1 million of these funds had not been spent. <i>The Unified Government has transferred this money with interest with interest back to the bond trustee.</i>	\$1.1 million	STAR bond moneys are for redevelopment project costs and should remain in the bond accounts until they are needed.
2. Using STAR bond moneys to pay for building construction costs.		
In allocating its costs, Nebraska Furniture Mart incorrectly charged the following costs for constructing its building to STAR bonds: <ul style="list-style-type: none"> ➢ \$322,000-\$480,000 in contractor fees for building the store (we could only verify \$322,000) ➢ \$38,000 in construction security costs related to the store <i>Nebraska Furniture Mart representatives indicated this was a clerical error and have repaid \$360,000.</i>	At least \$360,000	State law specifically prohibits the use of STAR bond moneys for any costs connected with constructing a building that will be <u>owned by</u> a developer.
3. Using STAR bond moneys for other unallowable purposes.		
<ul style="list-style-type: none"> ➢ \$6,000 for lobbying fees ➢ \$15 to deliver copies of financial statements to Legislative Post Audit for an unrelated audit <i>Unified Government officials indicated they will recoup these payments.</i>	\$6,000	These aren't costs that are necessary to implement the redevelopment plan.
GRAND TOTAL	\$1.5 million	
Source: LPA review of Venture Partner Agreements, Vendor Contracts, and Bond Payment Applications		

Another \$28 million in expenditures appear to go beyond what legislators envisioned when they passed the lawpage 21
(See Figure II-4). The law primarily addresses using STAR bonds to buy property and make infrastructure-related improvements, but also includes more ambiguous phrases like “including, but not limited to” and “all related expenses” that have been interpreted to allow many types of expenditures that legislators may not have envisioned. These expenditures include \$15 million to build and furnish various wildlife exhibits within Cabela’s, plans to spend \$8.5 million for robotic dinosaurs for a prehistoric themed restaurant, and using STAR bond moneys to pay consultants hired by the businesses locating within the redevelopment.

We also identified a number of questionable agreements associated with the Village West redevelopment.page 21
The Unified Government has entered into a complicated land lease agreement that will pay Cabela’s \$14 million (plus interest) over the next 24 years.

**Figure II-4
Summary of Questionable Expenditures of STAR Bond Moneys**

Questionable Expenditure	Amount	Basis for questioning the expenditure
1. Using STAR bonds for space or furnishings owned by the Unified Government but located inside a private business		
<p>a. The Unified Government used STAR bonds to build and furnish an aquarium, mountain display, and other wildlife exhibits within Cabela's. Although these exhibits are inside Cabela's, they are owned by the Unified Government. Once the Cabela's bonds are paid off, Cabela's will be able to purchase the exhibits for fair market value, less any amounts Cabela's has charged to maintain the exhibits.</p>	\$15.0 million	<p>While they are legally owned by the Unified Government, these displays are essentially a part of Cabela's store—something it appears that legislators never intended to have STAR bonds pay for.</p> <p>An amendment by the 2004 Legislature, after these expenditures were made, would prohibit using STAR bond funds for the furnishings in the future.</p>
<p>b. The Unified Government <u>plans</u> to purchase robotic dinosaurs for T-Rex, a new restaurant-retail business with a prehistoric theme.</p>	\$8.5 million (planned)	<p>After the 2004 amendment was passed, but just before the law went into effect, the Unified Government issued the bonds to pay for the dinosaurs.</p>
2. Using STAR bonds to pay for certain professional fees		
<p>a. Almost \$2 million from STAR bonds were used to pay consultants that helped Nebraska Furniture Mart select the Village West site and maximize its use of STAR bond funding.</p> <ul style="list-style-type: none"> ➤ \$833,000 to KPMG ➤ \$656,000 to Fahnestock (Oppenheimer) ➤ \$465,000 to Rositto and Associates 	\$2.0 million	<p>We think legislators intended to have STAR bonds used to help <u>local</u> governments acquire and develop property. We don't think they envisioned using STAR bonds to help <u>developers</u> select a site and figure out how to maximize their use of public funding.</p> <p>In addition, Fahnestock was paid even though its contract said it would only be paid if STAR bonds were issued to pay for substantially all of Nebraska Furniture Mart's construction and pre-opening costs—a condition that was never met. Nebraska Furniture Mart representatives told us regardless of the contract wording, they always intended to pay Fahnestock as long as a deal involving STAR bond financing was finalized.</p>
<p>b. \$1.2 million in commissions were paid to developers' real estate agents when the developers were given property in Village West. The Unified Government has two of its own real estate brokers to market the Village West property. However, it also agreed to pay additional fees to the venture partners' real estate agents when it gave them the Village West property. These include:</p> <ul style="list-style-type: none"> ➤ \$726,000 to a sister company of RED Development when it was given the property for the Legends Shopping Center ➤ \$434,000 to a real estate agent for Cabela's ➤ \$32,000 to a real estate agent for Applebee's 	\$1.2 million	<p>First, we question whether legislators envisioned having STAR bond moneys used to pay for the <u>developers'</u> real estate agents.</p> <p>Second, experts told us that when several agents are involved, they generally split the total commissions in commercial real estate transactions. That didn't happen in this case. The commissions paid to the developers' agents were added to what the Unified Government already was paying its own agents. As a result, the total commissions exceeded normal rates.</p>

**Figure II-4
Summary of Questionable Expenditures of STAR Bond Moneys**

Questionable Expenditure	Amount	Basis for questioning the expenditure
<p>c. \$460,000 in financial advisory and administrative fees were paid to RED Development's lender. As a venture partner, RED Development was responsible for purchasing its own STAR bonds. Because it didn't have enough of its own funds, it needed funding from a lender. The lender charged RED Development a number of fees, including:</p> <ul style="list-style-type: none"> ➤ A one-time \$315,000 bank advisory fee ➤ \$105,000 in financial advisory fees for research on STAR bonds ➤ \$40,000 for an annual administration fee 	<p>\$460,000</p>	<p>STAR bonds were intended to pay for the Unified Government's borrowing costs, including bond issuance costs, trustee fees, and bond interest. Using STAR bond moneys to pay for RED Development's borrowing costs because it didn't have enough money to buy the STAR bonds appears to go beyond what was envisioned.</p>
<p>3. Using STAR bonds to pay local government salaries</p>		
<p>a. The Unified Government used STAR bond proceeds to reimburse itself for time staff spent on the Speedway and Village West projects. According to Unified Government officials, two positions were created to work on the Village West project full-time. Because these positions were created in the middle of a management downsizing, there was no net increase in the number of positions or total salaries.</p>	<p>\$440,000</p>	<p>We question whether legislators envisioned using STAR bond moneys to reimburse the Unified Government for its employees' salaries when it incurred no additional out-of-pocket costs.</p>
<p>4. Using STAR bond moneys to pay property taxes</p>		
<p>a. STAR bonds were used to pay Nebraska Furniture Mart's property taxes while its store was under construction.</p>	<p>\$161,000</p>	<p>For accounting purposes, property taxes paid while a building is being constructed are considered a cost of acquiring the property. They were paid with STAR bond moneys because of provisions in the law that allow property acquisition costs to be paid.</p> <p>We think legislators intended to have STAR bonds used to help local governments acquire property, not developers. In addition, paying property taxes with STAR bonds runs counter to a primary objective of the redevelopment—preserving and enhancing the Unified Government's tax base</p>

**Figure II-4
Summary of Questionable Expenditures of STAR Bond Moneys**

Questionable Expenditure	Amount	Basis for questioning the expenditure
5. Using STAR bond moneys to pay employees' moving expenses		
a. In 2002 and 2003, moving expenses for 19 Nebraska Furniture Mart employees were paid using STAR bond moneys.	\$143,000	State law allows STAR bonds to be used for relocation assistance, but doesn't say who that assistance is to be provided to. Because the cost of relocating employees is an operational expense, and doesn't constitute a cost of redevelopment, we question whether the Legislature intended for STAR bond moneys to be used for this purpose. We think the law is referring to relocation assistance <u>for property owners whose property was purchased for the redevelopment area.</u>
6. Using STAR bond moneys for other purposes that weren't envisioned		
a. \$18,000 in STAR bond moneys were used for various food expenditures, including \$5,000 for a single barbecue order by one of the construction contractors for a safety meeting.	\$18,000	While it would make sense to pay for food in some cases, such as entertaining potential tenants in the redevelopment, there's no reason to use STAR bonds to pay for barbecue at a safety meeting.
GRAND TOTAL		\$27.9 million
Source: LPA Review of Venture Partner Agreements, Vendor Contracts, and Bond Payment Applications		

The Unified Government also gave two developers—RED Development and Cabela’s—excess land, which they’ve sold for at least \$10 million. As a result of various agreements, Cabela’s essentially will have its store paid for directly or indirectly by the Unified Government (See Figure II-6).

Figure II-6 Sources of Funding for Cabela's Store		
	Budgeted Funding	Effective Funding
Public Funds		
Aquarium, Mountain Display	\$14,960,620	\$14,960,620
Theater Lease	\$0	\$14,000,000
Land Resales	\$0	\$4,120,927 (a)
Total Public Funds	\$14,960,620	\$33,081,547
Cabela's Private Investment (estimated)		
	\$19,212,681	\$1,091,754
TOTAL FUNDING	\$34,173,301	\$34,173,301

(a) In addition, Cabela’s traded 16.5 acres of land to the Great Wolf Lodge, in exchange for an ownership interest in the business. The value of this exchange wasn't available and isn't included in the table.

Source: Cabela’s Bond Transcripts; LPA Review of bond payment applications; Wyandotte County Appraiser’s Office

The Unified Government’s oversight of RED Development’s expenditures has been inadequate. *Three of the Unified Government’s venture partners (Cabela’s, Nebraska Furniture Mart, and Beaumont) submit their STAR bond payment requests to the Unified Government’s master developer for review prior to payment. However, the Unified Government allowed one venture partner, RED Development, to submit more than \$7 million in requests for payment directly to the bond trustee for payment without any review.*

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The State’s oversight of both the Kansas Speedway and Village West redevelopments has been inadequate. *Although the Secretary of Commerce formally approved the Speedway and Village West projects, the State has no other formal involvement with those projects. We perceive several problems with the lack of State oversight including: no formal limit on the amount of STAR bonds that can be issued, an ambiguous definition of what STAR bonds can pay for, no formal role for the State in major agreements, no requirement for an independent audit, and no specific consequences for misusing STAR bond proceeds.*

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Question 2 Conclusion. *No one can argue that the Kansas Speedway and Village West redevelopment projects haven’t been enormously successful at bringing significant development to western Wyandotte County. When the STAR bonds used to help finance them are paid off, these projects are likely to provide significant amounts of sales tax revenues for the County and the State.*

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This success doesn't mean that good judgment, decision making, and oversight shouldn't be exercised to ensure that STAR bond moneys—and the State and local tax dollars that ultimately will be used to pay them off—are spent wisely, reasonably, and only for the purposes allowed and intended. As this audit has shown, that hasn't always happened.

Further, although some have portrayed STAR bonds as an economic development tool with no cost to the State—because the sales taxes that will be generated are all new revenues that otherwise wouldn't have existed—that's not always true. To the extent that purchases are made in a redevelopment district that would have been made anyway at other local retailers, the State is giving up sales tax revenues it otherwise would have received.

As more and more Kansas communities look to use STAR bonds as a way to spur local economic development, the risk that STAR bond moneys will be used in ways that were never envisioned or intended will increase unless changes are made to clarify the law and improve the oversight process.

Question 2 Recommendations. *We recommend that the Legislature amend State law to address the deficiencies in State oversight we've identified. We recommend that the Unified Government review the items we've identified as unallowable, and report back to the Legislative Post Audit Committee on actions it has taken to recoup the moneys. We also recommend that the Unified Government begin requiring RED Development to submit its payment requests to the master developer for review and approval. Finally, we recommend that the Secretary of Commerce not approve any more STAR bond projects until the Legislature has had an opportunity to clarify the STAR bond law.*page 29

Question 3: What Types of Discounts or Other Benefits Have the Kansas Speedway or Other Businesses in the Tourism District Made Available to Unified Government or Board of Public Utilities Employees?

The most frequently identified benefits were discounts on food, merchandise, and hotel rooms. *To determine what benefits had been made available, we contacted management officials from the businesses in Village West, interviewed Unified Government and Board of Public Utilities officials, and surveyed their employees. The most common benefits were discounts on food, merchandise, and hotel stays. According to officials from the Kansas Governmental Ethics Commission, since none of these benefits were offered to specific officials or employees, it's unlikely they were offered to influence a particular person.*page 31

Unified Government officials have access to suites and other facilities at the Speedway and T-Bones ballpark at no cost. *Speedway officials told us they provide a 32- seat luxury suite under an agreement*page 32

with the Kansas City Chamber of Commerce and a group called Wyandotte Development, Inc. They told us the suite is provided at no cost, and is a pass-through benefit to the Unified Government because of economic development efforts the Unified Government undertakes with the Chamber and Wyandotte Development Inc.

The Speedway also granted the Chamber of Commerce and a group called New Century Partnership the use of a hospitality tent for two race weekends each year. That arrangement includes 100 free grandstand tickets. Unified Government officials told us the Chamber allows them to use the tent, and also provides the Mayor and each Commissioner with two free grandstand tickets to each of those events.

In addition, the Kansas City T-Bones Community America Ballpark has provided a 25-seat suite at the Ballpark directly to the Unified Government at no cost.

The Board of Public Utilities paid for its use of facilities at the Speedway and the ballpark. page 33
In 2001, 2002, and 2003 the Board paid to sponsor a race called the "BPU 200." That sponsorship included access to a 32-person suite at the Speedway, 240 general admission tickets to the race event, and 200 tickets to the qualifying event. The Board also acquired access to a 20-seat Ballpark suite as part of an agreement in which they paid \$35,000 to become an advertising sponsor for a scoreboard.

The Unified Government's and Board of Public Utilities' ethics policies address the acceptance of gifts. page 34
Both entities have adopted similar ethics policies governing their officials and employees. Under these policies, an official or employee can accept free meals and tickets to sporting events. Both entities have a contract with a part-time ethics administrator to develop policies, handle complaints, offer advisory opinions, and provide ethics training.

The ethics administrator advised the Unified Government officials that the suites, tickets, and hotel discounts were allowable. page 35
Unified Government officials consulted their ethics administrator for advice on accepting suite and grandstand tickets at the Speedway and Ballpark, as well as free hotel rooms at the Great Wolf Lodge and Chateau Avalon. The ethics administrator wasn't consulted regarding the on-going hotel and restaurant discounts.

Question 4: Do the Costs Associated With a Movie Theater Project Being Built In the Tourism District Exceed Industry Standards?

The Unified Government is building a theater in Village West and will have a management company operate it. page 36
Unified Government officials told us that because Kansas City is the only city of its size without a movie theater, they wanted to incorporate one in the Village West redevelopment district. Because attempts to attract a private theater were

unsuccessful, the Unified Government decided to build its own theater and have a private company manage it.

The costs of constructing the movie theater are higher than industry experts suggest are typical. *Rough estimates provided by theater experts suggested a theater of this size should typically cost about \$13 million to \$15 million to construct and equip. Unified Government officials told us the theater is expensive because it will include a number of special amenities, including more spacious seating and a special balcony level.* page 36

The preliminary financial projections for the theater don't include the full cost of the building. *The financial projections show the theater's building costs as \$1 million a year—equal to the theater lease payment to Cabela's, but only about one-third the true cost of building the theater. Understating the building costs leaves the impression the theater will be making a "profit" when, in fact, it might never be profitable from a normal business point of view.* page 37

The theater management agreement offers the management company substantial benefit without financial risks. *The 20-year management agreement specifies that Phoenix Theatres will receive a \$225,000 consulting fee, a management fee equal to 5% of the gross revenues, and a 50% share of any net income. Two theater consultants told us sharing profits with Phoenix Theatres was unusual since Phoenix has only a minimal financial commitment.* page 38

Question 4 Conclusion. *Because the Unified Government wasn't able to attract a private company to locate and operate a theater in the Village West development district, it has committed to spend \$20 million in STAR bond moneys to build an upscale movie theater itself. That decision has raised questions about the appropriateness of competing with private theaters in the region, the cost and profitability of the theater, the lease-back arrangement that will help Cabela's recoup the cost of building its store, and the management agreement that gives Phoenix Theatres a significant share of the profits without assuming any significant financial risk. These questions again highlight the need for improved State oversight to ensure that the deals being made with STAR bond moneys are allowable and reasonable, and that the State's interests are adequately represented.* page 38

APPENDIX A: Scope Statement page 39
APPENDIX B: Bonds Issued, Sales Tax Revenues, and Debt Service Payments page 41
APPENDIX C: Agency Response page 42

This audit was conducted by Scott Frank, Laurel Murdie, Amy Thompson Ivan Williams, and Chris Clarke. Leo Hafner was the audit manager. If you need any additional information about the audit's findings, please contact Mr. Frank 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 us at (785) 296-3792, or contact us via the Internet at LPA@lpa.state.ks.us.