

Department of Economic and Community Development

December 2003

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**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

State Capitol
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John G. Morgan
Comptroller

December 18, 2003

The Honorable Phil Bredesen, Governor
and

Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

and

The Honorable Matthew Kisber, Commissioner
Department of Economic and Community Development
11th Floor, W. R. Snodgrass Tennessee Tower
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of Economic and Community Development for the period July 1, 2000, through March 31, 2003.

The review of management's controls and compliance with policies, procedures, laws, and regulations resulted in certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/th
03/050



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT**

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May 21, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Economic and Community Development for the period July 1, 2000, through March 31, 2003.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of management controls relevant to the audit and that we design the audit to provide reasonable assurance of the Department of Economic and Community Development's compliance with the provisions of policies, procedures, laws, and regulations significant to the audit. Management of the Department of Economic and Community Development is responsible for establishing and maintaining internal control and for complying with applicable laws and regulations.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The department's administration has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

We have reported other less significant matters involving the department's internal controls and/or instances of noncompliance to the Department of Economic and Community Development's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Department of Economic and Community Development
For the Period July 1, 2000, Through March 31, 2003

AUDIT SCOPE

We have audited the Department of Economic and Community Development for the period July 1, 2000, through March 31, 2003. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of the Community Development Block Grant Program; the Tennessee Industrial Infrastructure Program; the Tennessee Job Skills Program; deferred revenue; expenditures; contracts; the Financial Integrity Act; Department of Finance and Administration Policy 20, "Recording of Federal Grant Expenditures and Revenues"; and Department of Finance and Administration Policy 22, "Subrecipient Monitoring." The audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

AUDIT FINDINGS

The Department Circumvented Controls and Violated *Tennessee Code Annotated*

The department had numerous problems with controls and laws (page 3).

The Department Circumvented the Approval Process for \$2,845,000 TIIP Project

The department did not obtain approval from the State Funding Board for a TIIP project exceeding \$750,000. The department awarded four separate contracts on March 11, 2002, to the Town of Smyrna

for infrastructure improvements related to the expansion of the Nissan North America plant. Four contracts were for the same infrastructure project totaling \$2,845,000 (page 7).

Tennessee Job Skill Grant Award Procedures Were Not Followed

The department awarded job skills grant funds to several large companies without obtaining applications as required by state law. Twenty-five of 26 grant contract files

reviewed (96%) did not have an application (page 9).

The Department Circumvented Internal Controls Over Disbursements

The department circumvented controls, which resulted in insufficient approvals, lack of supporting documentation, improper accounting, and late payments (page 11).

The Department Concealed Transactions Through a Nashville Area Chamber of Commerce Bank Account

The department circumvented internal controls, violated state law, and concealed questionable transactions, including expenditures of \$2,300 for luggage, \$17,523 for sport shirts, and \$748 to department employees for expenses (page 14).

Two Sole-Source Contracts Performed the Same Service Simultaneously

The department had two sole-source contracts performing the same service. By circumventing state contract procedures, the department paid two service providers for the same service during a seven-month period at a total cost of \$70,000 (page 16).

The Department Did Not Comply With F&A's Policy 22, Subrecipient Monitoring

The department did not identify and report its subrecipients to the Department of Finance and Administration in the form of an annual monitoring plan as required by Policy 22 (page 20).

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report, which contains all findings, recommendations, and management comments, please contact

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Audit Report
Department of Economic and Community Development
For the Period July 1, 2000, Through March 31, 2003

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Department of Economic and Community Development For the Period July 1, 2000, Through March 31, 2003

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Economic and Community Development. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

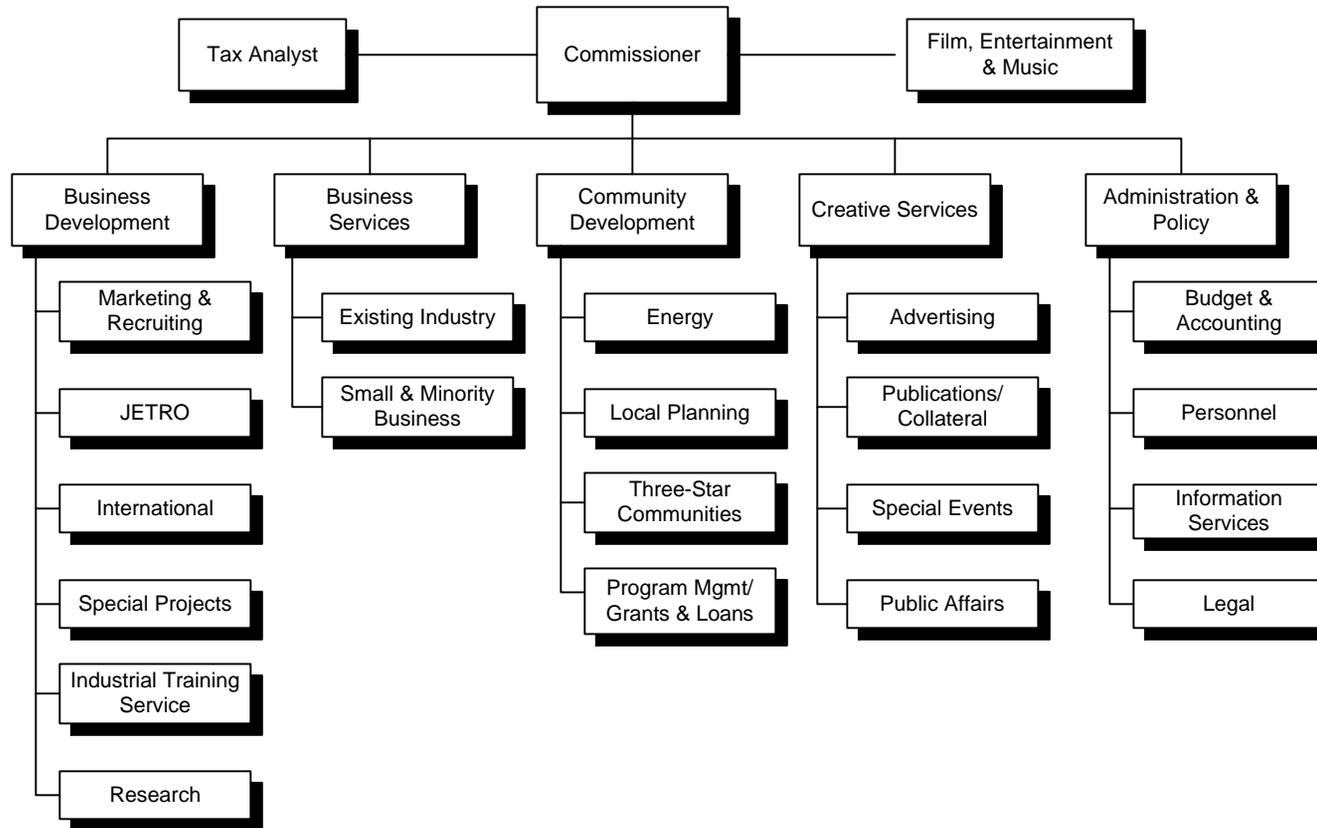
It is the mission of the Department of Economic and Community Development (ECD) to encourage economic growth and maintain a favorable business climate in Tennessee. ECD’s mission is to assist Tennessee communities in preparing and competing for economic development and job creation opportunities. It is also the department’s goal to offer support services for entrepreneurs, existing industries, and new firms, while marketing the state and recruiting new industries domestically and internationally.

An organization chart of the Department of Economic and Community Development is on the following page.

AUDIT SCOPE

We have audited the Department of Economic and Community Development for the period July 1, 2000, through March 31, 2003. Our audit scope included a review of management’s controls and compliance with policies, procedures, laws, and regulations in the areas of Community Development Block Grant Program, Tennessee Industrial Infrastructure Program, Tennessee Job Skills Program, deferred revenue, expenditures, contracts, the Financial Integrity Act, Department of Finance and Administration Policy 20, “Recording of Federal Grant Expenditures, and Revenues,” and Department of Finance and Administration Policy 22, “Subrecipient Monitoring.” The audit was conducted in accordance with auditing standards

Economic and Community Development Organizational Chart



generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

PRIOR AUDIT FINDINGS

PRIOR AUDIT FINDING

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Economic and Community Development filed its report with the Department of Audit on May 29, 2002. A follow-up of the prior audit finding was conducted as part of the current audit.

RESOLVED AUDIT FINDING

The current audit disclosed that the Department of Economic and Community Development has corrected a previous audit finding concerning internal controls over federal reporting.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

As noted in the audit scope, this engagement included reviews of management's controls and compliance with policies, procedures, laws, and regulations in several different programs and areas. The results of these reviews indicated that the department had consistently circumvented the control policies and procedures established by the state and the department as noted in the subsequent sections of the report and summarized in finding 1.

1. The department circumvented internal controls and violated *Tennessee Code Annotated*

Finding

The Department of Economic and Community Development circumvented internal controls and violated state law. Management has developed a pattern of repeatedly bypassing the state's established controls and laws in making expenditures and awarding grants and contracts.

- The department circumvented the approval process for a \$2,845,000 Tennessee Industrial Infrastructure Program (TIIP) project (finding 2).
- The department violated *Tennessee Code Annotated* by awarding Tennessee Job Skills grants without following the prescribed application procedures (finding 3).
- The department has made numerous expenditures, including late payments, without evidence of necessary approvals and detailed supporting documentation. Furthermore, the department has improperly recorded several expenditures as travel in an apparent attempt to circumvent budgetary controls (finding 4).
- The department circumvented internal controls, violated state law, and concealed questionable transactions by creating a fiscal relationship with the Nashville Area Chamber of Commerce (finding 5).
- The department circumvented the state's competitive contracting procedures and hired two contractors to perform the same service simultaneously (finding 6).
- The department circumvented controls and circumvented the state's competitive procurement process through the Akins & Tombras, Inc. contract (finding 7).
- The department circumvented Department of Finance and Administration Policy 22 to avoid compliance with its subrecipient monitoring guidelines (finding 8).

Recommendation

The commissioner should thoroughly review the operations of the department and require strict adherence to the state's established procedures for internal controls and compliance with applicable laws and regulations. Whenever possible, contracts should be awarded on a competitive basis. Expenditures should be adequately documented, approved, and appropriately classified in the accounting records. Grants should not be awarded without evidence of the required application information.

Management's Comment

We concur with the finding. As you will see indicated in our specific responses to each of your findings, we have taken action on a proactive basis prior to your report to address each concern raised.

We have established much needed protocols which were shared with the Comptroller that now govern all economic development relationships, grants and partnerships, and we have taken steps internally to better document in greater detail all purchases and expenditures made by all divisions of the department.

COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM

The Community Development Block Grant (CDBG) Program is authorized under Title I of the Housing and Community Development Act of 1974, as amended by Title 42 of the United States Code, Section 5301. One of the primary objectives of the program is the development of viable communities by providing decent housing, a suitable living environment, and expanded economic opportunities, principally for persons of low and moderate income. CDBG provides eligible cities and counties with annual direct grants that they can use to revitalize neighborhoods, expand affordable housing and economic opportunities, and/or improve community facilities and services, principally to benefit low- and moderate-income persons.

The objectives of our review of the CDBG program were to determine whether

- the department has sufficient controls to ensure the federal program is administered in accordance with the basic laws and regulations governing them,
- the department is in compliance with certain laws and regulations concerning this program,
- federal awards were expended only for allowable activities,
- federal drawdowns were made in compliance with grant rules and regulations,
- the department monitors contractor classifications and wage rates,
- CDBG funds benefit low- and moderate-income persons,
- CDBG funds used for administrative costs were within the limits,
- the department properly recorded program income generated from the use of CDBG funds,
- required reports for federal awards include all activity of the reporting period and are supported by applicable accounting records,
- monitored subrecipient activities provide reasonable assurance that the subrecipient administers federal awards in compliance with federal requirements,
- the state's approval of the request for release of funds and environmental certifications were satisfactory,
- the state was ensuring environmental reviews were performed, and
- loans and repayments were being made in accordance with program requirements.

To accomplish our objectives, we reviewed the most recent Office of Management and Budget Circular A-133 Compliance Supplement and other program guidelines to become familiar with program objectives, program procedures, and compliance requirements. We interviewed key departmental employees and evaluated departmental controls for adequacy. We selected and tested expenditures and related records to determine if costs were for activities

allowed, were considered allowable in accordance with program requirements, and were in compliance with applicable grant rules and regulations. We tested CDBG drawdowns and records to ensure they were made in compliance with applicable grant rules and regulations. We reviewed contractor files to determine whether the department monitored job classification and wage rates. We performed testwork to determine if CDBG funds benefit low- and moderate-income persons, and we reviewed financial and related records to determine whether the amount of CDBG funds used for administration costs were within the limits. We tested a sample of deposits to determine if the department properly accounted for program income. We reviewed reports filed with the U.S. Department of Housing and Urban Development (HUD) during the audit period and traced data in the reports to the accounting records to determine if the reports were properly submitted by the department. We performed testwork to determine if subrecipients were being monitored. We performed testwork to determine if the state's approval of the request for release of funds and environmental certifications were satisfactory. We reviewed subrecipient project files to determine if the subrecipients were monitored in compliance with rules and regulations and the monitoring was documented, and we tested loans awarded during the audit period and related records to determine if loans were awarded in accordance with program requirements. We tested loan repayments made during the audit period and related records to determine if repayments were made in accordance with program requirements and in compliance with applicable grant rules and regulations.

As a result of our review and testwork, we concluded that

- departmental controls are adequate over the CDBG program,
- the department is in compliance with laws and regulations concerning the CDBG program,
- federal awards were expended for allowable activities,
- federal drawdowns were made in compliance with grant rules and regulations,
- the department properly monitors contractors,
- CDBG funds benefit low- and-moderate income persons,
- CDBG funds used for administration costs were within the limits,
- the department properly recorded program income generated from the use of CDBG funds,
- required reports include all activity of the reporting period and are supported by accounting records,
- monitored subrecipient activities appeared to provide reasonable assurance that the subrecipient administers federal awards in compliance with federal requirements,
- the state's approval of the request for release of funds and environmental certifications were satisfactory,
- environmental reviews were documented, and
- loans and repayments were made in accordance with program requirements.

Although we had no findings related to Community Development Block Grant, minor weaknesses were reported to management in a separate letter.

TENNESSEE INDUSTRIAL INFRASTRUCTURE PROGRAM

The Tennessee Industrial Infrastructure Program (TIIP) provides funds to local governments for infrastructure improvements. The program is governed by Public Chapter 842 Section 32. Funds may not be used for “speculative” projects but are restricted to situations where there is a commitment by certain private-sector businesses to locate or expand in the state and to create or retain jobs for Tennesseans. The objectives of our review of this area were to determine whether

- administrative controls were adequate;
- grants awarded were in compliance with laws, regulations, and program requirements; and
- grant payments were made in accordance with grant rules and regulations.

To accomplish our objectives, we interviewed key personnel, reviewed appropriate laws, evaluated administrative controls, and reviewed program objectives and procedures. We selected a nonstatistical sample of grants awarded during the audit period. We tested the grants to ensure they were in compliance with laws, regulations, and program requirements. We selected a nonstatistical sample of grant payments to determine if they were made in accordance with grant rules and regulations.

As a result of our review and testwork, we concluded that

- administrative controls appeared to have been circumvented as noted in finding 2;
- not all grants are awarded in compliance with laws, regulations, and program requirements as noted in finding 2; and
- grant payments were being made in compliance with grant rules and regulations.

In addition to the findings, other minor weaknesses were reported to management in a separate letter.

2. The department circumvented the approval process for a \$2,845,000 TIIP project

Finding

The Department of Economic and Community Development did not obtain approval from the State Funding Board for a Tennessee Infrastructure Improvement Program (TIIP) project exceeding \$750,000. The department awarded four separate contracts on March 11, 2002, to the

Town of Smyrna for infrastructure improvements related to the expansion of the Nissan North America plant. Upon further review, it was discovered that all four contracts were for the same infrastructure project. The total of the four contracts equaled \$2,845,000.

According to Public Chapter 842, Section 32, “No single contract shall be made for more than seven hundred fifty thousand dollars (\$750,000) provided, however, that for extraordinary economic development projects of major employment and investment significance, additional funding may be provided with the approval of the state funding board.” Upon review of the State Funding Board minutes for fiscal years 1999-2002, there was nothing found concerning TIIP grants, specifically the infrastructure improvements in the Town of Smyrna. It appears that this project was divided into four separate contracts in order to circumvent the approval of the State Funding Board.

By circumventing the approval process and not gaining the approval of the State Funding Board for projects surpassing the \$750,000 threshold, the department has violated state law.

Recommendation

The department should stop circumventing internal controls and violating state law. All TIIP programs for infrastructure projects exceeding \$750,000 should be approved by the State Funding Board. Although the project may be an extraordinary economic development project of major employment and investment significance, the department still needs the approval of the State Funding Board.

Management’s Comment

We concur with the finding. The department should in all instances receive approval by the State Funding Board for all TIIP programs exceeding \$750,000.

TENNESSEE JOB SKILLS PROGRAM

The Tennessee Job Skills Program is a workforce development incentive program to enhance employment opportunities and to meet the needs of existing and new industries in the state. The program gives priority to the creation and retention of high-wage jobs and focuses on employers in industries that promote high-skill, high-wage jobs in high-technology areas, emerging occupations, or skilled manufacturing jobs.

The objectives of our review of this area were to determine whether

- administrative controls were adequate;
- grants awarded complied with laws, regulations, and program requirements; and

- grant payments were made in accordance with grant rules and regulations.

To accomplish our objectives, we interviewed key personnel, reviewed appropriate laws, evaluated administrative controls, and reviewed program objectives and procedures. We selected certain grants awarded during the audit period. We reviewed the grants to ensure the awards were in compliance with laws, regulations, and program requirements. We tested grant payments for the same grants to determine if they were made in accordance with grant rules and regulations.

As a result of our review and testwork, we found that

- administrative controls appeared to have been circumvented as noted in finding 3;
- grants were not awarded in compliance with laws, regulations, and program requirements as noted in finding 3; and
- grant payments were generally made in compliance with grant rules and regulations;

In addition to the findings, other minor weaknesses were reported to management in a separate letter.

3. Tennessee Job Skills grant award procedures were not followed

Finding

The department awarded Job Skills grant funds to several large companies without obtaining applications as required by state law. Section 50-7-451, *Tennessee Code Annotated*, states specific information that should be included in a Job Skills grant application. This information includes the number of jobs available; the skills and competencies required for the identified jobs; the starting wages to be paid to trainees on successful completion of the project; the goals, objectives, and outcome measurements for the project; proposed curriculum for the project; project cost per person enrolled, trained, hired, and retained in employment; and any other information deemed necessary by the Department of Economic and Community Development. During the initial internal control review for the Tennessee Job Skills Program, management stated that filling out an application was the initial process for companies to be considered for Job Skills funding.

However, it appears that the awards were made based on funding requests that did not comply with the law. Based on testwork performed, 25 of 26 grant contract files reviewed (96%) did not have an application or other evidence of the required information. The one application tested did not include most of the information outlined by *Tennessee Code Annotated*. The total amount of these 26 contracts was \$30,740,720.35. The 25 contracts awarded without applications totaled \$29,140,720.35.

Recommendation

The Department of Economic and Community Development should not award contracts for the Jobs Skills program without evidence of compliance with all procedures outlined in Section 50-7-451, *Tennessee Code Annotated*. Furthermore, the department should ensure that all grant application forms include the information that is outlined by *Tennessee Code Annotated* and evidence of review by department personnel.

Management's Comment

We concur with the finding. The department should not have awarded contracts for the Job Skills Program without ensuring that all appropriate grant application forms were included in the file.

DEFERRED REVENUE

The primary objectives for this area were to

- determine if earned revenue was transferred from deferred revenue in a timely manner,
- determine if deferred revenue transactions were adequately supported, and
- reconcile the department's deferred revenue account balance with the State of Tennessee Accounting and Reporting System (STARS) account balances at year-end.

We interviewed key personnel to gain an understanding of the department's controls over accounting and transferring deferred revenue. We tested nonstatistical samples of deferred revenue transactions for propriety. Supporting documentation for each selected transaction was obtained and examined to determine if the department made transfers from the account in a timely manner. We documented the purpose of each deferred revenue account and scheduled the activity by month. Additions and deletions were traced to supporting documentation and the accounting records.

Based on the results of our testwork, it appears that deferred revenue transactions were adequately supported. Although accounting entries transferring deferred revenue to earned revenue were not always made timely, we determined that the necessary entries were made in the fiscal year, and the department's account balance reconciled with the STARS balance at year-end.

Although we had no findings related to deferred revenue, minor weaknesses were reported to management in a separate letter.

EXPENDITURES

Our objectives in reviewing expenditures were to determine if

- the department's controls over processing and payment were adequate; and
- expenditures and travel claims were adequately supported, properly approved, properly classified in the accounting records, and paid in a timely manner.

We interviewed key personnel to gain an understanding of the department's controls over expenditures. We selected certain expenditures and travel claims to determine if they were properly supported, approved, complete, timely, and properly classified.

We reviewed selected expenditures and discovered problems with support, approval, classification, and timely payment. The results also indicated management's apparent circumvention of established control procedures in order to make payments. These matters are disclosed in finding 4.

In addition, during our review, it came to our attention that the department had made an arrangement with the Nashville Area Chamber of Commerce to accept deposits and make payments on behalf of the department. This fiscal agent relationship allowed the department to circumvent internal controls, violate state law, and conceal questionable transactions. These matters are discussed in finding 5.

4. The department circumvented internal controls over disbursements

Finding

The department circumvented internal controls over disbursements, which resulted in insufficient approvals, lack of supporting documentation, improper accounting, and late payments. The department has improperly recorded several expenditures as travel in an apparent attempt to circumvent budgetary controls. Nineteen of 108 transactions tested (18%) were not properly approved. Twenty of 108 transactions tested (19%) were not properly supported. Sixteen of 108 transactions tested (15%) were not properly coded to the State of Tennessee Accounting and Reporting System (STARS). Five of 108 transactions tested (5%) were not paid in a timely manner.

Unapproved and unsupported invoices included the following:

- The department paid a \$626 transaction for a Washington dinner charged to a private individual's account.

- A \$2,467 invoice for vending services dated September 27, 2000, in Chicago, Illinois, had a September 5, 2000, memo attached requesting approval for a May 15, 2001, event to be held in Nashville, Tennessee. The department paid \$641 for wine and liquor ordered on April 6, 2001, and \$11,095 for banquet charges dated April 11, 2001. The memorandum attached to these invoices was approval for a reception honoring the departing chairman of the Tennessee Valley Authority to be held at the Executive Residence on April 5, 2001.
- Eleven Diner's Club statements, with total charges of \$254,166, were paid without obtaining additional support or approval of the individual charges on the statements. These charges were for airline tickets and hotels to destinations such as Tokyo, Milan, Barcelona, Memphis, Tri-Cities, and various other destinations. Out-of-state travel authorizations and detailed invoices from the hotels neither accompanied the statements nor were compared with the statements prior to payment.

Unapproved invoices were the following:

- The department incurred expenses for two department employees to stay five nights each at the Opryland Hotel with no approval to pay. Both employees reside in Nashville. Two conferences were held September 17-25, 2002. Approval was not requested for the conferences until November 6, 2002. The \$7,079 invoice included \$573 for speaker gifts and \$539 for lunches, breakfasts, and meetings charged to the hotel rooms.
- Two invoices from the Wildhorse Saloon totaled \$46,565 for the 2002 Governor's Conference reception. The memorandum requesting prior approval of the reception estimated expenditures of \$25,000.
- The department paid \$330 for a nine wood golf club. Accompanying the invoice was a memorandum approving expenses for a trade mission to Japan and Korea.

Unsupported invoices included the following:

- A memo approving the department's participation in an Appalachian Regional Commission conference was attached as authorization to pay four invoices totaling \$2,362 from a Nashville liquor store. The invoices were dated August 6, 2002; August 20, 2002; August 30, 2002; and September 6, 2002. However, the conference was not scheduled until October 29-31, 2002.
- An \$8,403 payment made from a statement only to Masterpiece Creations.

Invoices posted to the accounting records as travel included

- three invoices for liquor purchases totaling \$378,
- a \$21,385 invoice for set-up and dismantle of a trade show booth,
- two payments for receptions totaling \$7,070 at the Wildhorse Saloon,

- a \$14,865 invoice for the production of a promotional music CD,
- a \$35,000 payment for a conference sponsorship,
- a \$9,370 payment to a downtown Nashville hotel for charges related to a conference,
- a \$9,190 payment for shirts and hats,
- a \$100,000 sponsorship payment to the Tennessee Economic Partnership,
- a \$114 invoice for cookies, and
- a \$402 invoice for flowers.

Invoices not paid timely were

- a \$626 invoice from a Nashville liquor store dated July 25, 2002, that was not paid until December 5, 2002; and
- a \$792 invoice from a Nashville hotel dated June 26, 2002, and not paid until September 27, 2002.

Effective internal controls are essential to account for government resources and to ensure that payments are appropriate. Management has the responsibility to institute and maintain control procedures that will ensure all transactions are properly supported, authorized, processed, and paid timely. Management's responsibility for establishing effective internal controls includes effective supervisory review procedures to provide reasonable assurance that errors and irregularities will be detected timely. When there are no controls, payments may be made for unallowable or unreasonable goods and services.

Recommendation

The Commissioner should ensure that internal controls are developed and enforced over disbursements to ensure they are properly approved, supported, accounted for, and paid in a timely manner. Unapproved and unsupported invoices should not be paid. The department should not pay for dinners charged to private accounts. Approvals for events and services should be obtained before the event or service occurs. Diner's Club statements should not be paid until additional support or approval of the individual charges is obtained. Out-of-state travel authorizations and detailed invoices should be obtained and compared with the statements prior to payment. In addition, disbursements should be charged to the proper expenditure classification in the state accounting system. Invoices should be paid in a timely manner.

Management's Comment

We concur with the finding. There were no department-wide internal controls in place prior to January 18, 2003. Since that time, the department has taken a number of steps to better monitor and account for purchases, expenditures, and all travel claims. We also closely adhere to

the policy and practice that all charges made to personal credit cards must be properly documented and be approved only for legitimate state purpose.

5. The department circumvented state purchasing rules, violated state law, and concealed questionable transactions through the creation of a fiscal agent relationship with the Nashville Area Chamber of Commerce

Finding

The Department of Economic and Community Development (ECD) improperly obtained goods and services by using the Nashville Area Chamber of Commerce (Chamber) as a fiscal agent to deposit revenue and pay for those goods and services. This arrangement was primarily under the control, direction, and approval of ECD management and was for the purpose of receiving funds for registration fees and other trade show revenue and making related purchases, including giveaway items. By creating a fiscal agent relationship with the Chamber, the Department of Economic and Community Development avoided compliance with the state’s purchasing procedures, including bid requirements.

According to Chamber records, the arrangement began in January 1994. However, ECD fiscal personnel never provided this information to the auditors when inquiries were made concerning authorized or unauthorized departmental bank accounts. Upon its discovery during the current audit, the fiscal director stated that he was not aware of this arrangement.

According to the unaudited Chamber records, receipts and disbursements were as follows:

For the Fiscal Year Ended June 30	Receipts	Disbursements
1994	\$ 9,100.00	\$ 4,910.10
1995	4,250.00	5,922.94
1996	4,250.00	3,883.69
1997	8,100.00	4,981.16
1998	3,250.00	3,630.26
1999	5,000.00	6,402.68
2000	3,300.00	4,618.51
2001	21,525.00	5,895.54
2002	8,200.00	25,124.42
2003	800.00	1,496.13
Totals	\$ 67,775.00	\$ 66,865.43

The Department of Economic and Community Development rented exhibit booth space at various business and industry conferences. In turn, the department notified potential customers (local and regional chambers of commerce, economic and development agencies, governmental

units, and private businesses) that, for a fee, it would share its booth space with interested parties related to the focus of the respective conference. Interested parties were instructed to make their checks out to the Nashville Area Chamber of Commerce. However, some checks from governments were made out to the State of Tennessee and deposited into the Chamber account. The Department of Economic and Community Development received the checks and forwarded them to the Nashville Area Chamber of Commerce for deposit.

The Chamber fiscal office personnel prepared checks based on requests from ECD. ECD personnel made all decisions related to the procurement of goods and services and any other disbursements of funds. With respect to the giveaways, ECD placed the orders with select vendors, and the goods were shipped to ECD. The invoices for giveaways and expenditures related to the conferences were sent to ECD. ECD then sent memos to the Chamber instructing it to make payment on the invoices.

The manner in which ECD personnel initiated these procurements violated the state's purchasing procedures. Bids were not obtained, and receiving reports were not prepared. Generally, the Department of General Services requires agencies to obtain three informal bids for purchases between \$400.01 through \$2,000. Purchases over \$2,000 must follow the competitive bid process, which is performed by the Department of General Services. The Chamber of Commerce paid for many purchases that were in excess of \$400; however, ECD did not secure three bids. In addition, ECD did not forward purchase requisitions greater than \$2,000 to the Department of General Services to initiate that competitive bid process.

According to Chamber records, disbursements made on behalf and at the request of ECD included the following:

- One disbursement of \$2,300 was paid to a department employee for Hartmann luggage. According to ECD personnel, the luggage was given as a gift.
- One disbursement of \$15,800 was paid to a pharmaceuticals company as a reimbursement of booth space and sponsorship. The pharmaceuticals company rented and occupied the space, and ECD paid for the sponsorship.
- Another payment of \$3,000 was made to a biotech association for reimbursement of booth space and sponsorship.
- Several disbursements were paid to one vendor for 11 events totaling \$17,523 for sport shirts and related apparel for booth workers.
- Six payments were made to another vendor totaling \$15,035 for promotional items.
- Disbursements totaling \$748 were paid to department employees for expenses.

In light of the fiscal agent relationship noted, inquiries were made of ECD personnel as to any other similar relationships. These inquiries did not disclose the existence of other fiscal agent relationships.

Recommendation

The Department of Economic and Community Development should not circumvent state laws, policies, and procedures by arranging fiscal agents for the department. The Commissioner should determine how this relationship with the Chamber developed which allowed the department to circumvent state laws, policies, and procedures, and the Commissioner should take appropriate action to end this arrangement.

Management's Comment

We concur with the finding. As soon as its existence was discovered internally, the department contacted the Attorney General's Office and Comptroller's Office for guidance on how to address it. Upon advice, the department notified the Chamber with instructions that the account be closed and that the funds be transferred to the department.

CONTRACTS

Our objectives in reviewing contracts were to determine if contracts were awarded and extended in accordance with state rules and laws.

We reviewed selected contracts and discovered problems with the procurement and extension of sole-source contracts as disclosed in findings 6 and 7.

6. Two sole-source contractors performed the same service simultaneously

Finding

The Department of Economic and Community Development had two sole-source contractors performing the same service during the same period. Sole-source or non-competitive contracts do not go through the normal state contract procedures. According to Chapter 0620-3-3-03(4) of the *Rules of the Department of Finance and Administration*, non-competitive contracts are justified if there is only one uniquely qualified service provider capable of performing the needed service or if it is in the best interest of the state. Clearly there is more than one qualified service provider in this case.

The original contract was with Technology 2020 Finance Corporation. The objective of the contract was to develop a network and process and analyze applications for the Small and Minority-Owned Telecommunications Business Assistance Program (TAP). The contract amount was \$30,000 for the period July 1, 2001, to June 30, 2002. Technology 2020 Finance Corporation continued to be paid on a monthly basis through April 2003 even though the contract expired on June 30, 2002. In October 2002, the amount was raised from \$2,500 to \$5,000 per month.

The second contract was with Community Resource Development Center, doing business as Nashville Minority Business Center. The objective of the contract was the same as the contract with Technology 2020 Finance Corporation. The contract amount was \$68,000 for the period October 1, 2002, to September 30, 2003. Nashville Minority Business Center received a \$30,000 payment from the department in October 2002. The \$30,000 payment was for six months at \$5,000 per month.

By circumventing the state's controls for competitive procurement, the Department of Economic and Community Development paid two service providers for the same service during a seven-month period from October 2002 to April 2003 at a total cost of \$70,000.

Recommendation

The department should follow state procurement regulations and ensure that non-competitive contracts are only negotiated when only one company can provide the service.

Management's Comment

We concur with the finding. As soon as the issue was brought to the department's attention, we contacted the Attorney General's Office and the Comptroller's Office seeking guidance on how to address it. Upon recommendation of the Attorney General, the department served written notice on Technology 2020 Finance Corporation that their services would be terminated, and recognized the Nashville Minority Business Center as the sole legal contractor for the period ending September 30, 2003.

7. The department did not follow state contract guidelines

Finding

The department did not follow contract rules and regulations in obtaining advertising services. An original contract with Akins & Tombras, Inc., an advertising firm, was approved in 1997, and spanned two years with the option for three one-year extensions. Rather than extend and amend the original contract, the department executed several new contracts over the life of the agreement. The original contract would have spanned five years; however, after all the new contracts were executed, the contract with Akins spanned six years. This is outside the five-year limit on contract length set by the Department of Finance and Administration. When the new contract was approved in 1999, the department made Akins & Tombras, Inc., a sole-source purchase (non-competitively bid). In order to be considered a sole-source provider, the service provider must be the only uniquely qualified service provider capable of performing the needed service, a state agency, or an entity of the federal government; or the contract must be in the best interest of the state or not exceeding \$5,000. According to the Department of Finance and Administration, a procuring agency must submit a request to the Office of Contract Review and secure approval before beginning non-competitive negotiation. There was no explanation given concerning why the contractor was considered a sole-source provider.

The department circumvented controls by executing a new contract, extending the contract to six years, which is more than the time period allowed by the Department of Finance and Administration. Also, by making the contractor a sole-source provider, the department circumvented the state's competitive procurement process.

Recommendation

The department should extend and amend contracts in compliance with guidelines set forth by the Department of Finance and Administration. The department should also follow the Department of Finance and Administration guidelines for making contractors sole-source providers.

Management's Comment

We concur with the finding. As an additional step of accountability, we have reinstated the department's General Counsel who is charged with assuring that the department complies with all policies and guidelines regarding procurement contracts.

FINANCIAL INTEGRITY ACT

Section 9-18-104, *Tennessee Code Annotated*, requires the head of each executive agency to submit a letter acknowledging responsibility for maintaining the internal control system of the agency to the Commissioner of Finance and Administration and the Comptroller of the Treasury by June 30 each year.

Our objective was to determine whether the Department of Economic and Community Development's June 30, 2002, and June 30, 2001, responsibility letters were filed in compliance with Section 9-18-104, *Tennessee Code Annotated*.

We reviewed the June 30, 2002, and June 30, 2001, responsibility letters submitted to the Comptroller of the Treasury and to the Department of Finance and Administration to determine adherence to the submission deadline. We determined that the Financial Integrity Act responsibility letters were submitted on time.

DEPARTMENT OF FINANCE AND ADMINISTRATION POLICY 20, RECORDING OF FEDERAL GRANT EXPENDITURES AND REVENUES

Department of Finance and Administration Policy 20 requires that state departments whose financial records are maintained on the State of Tennessee Accounting and Reporting System (STARS) fully utilize the STARS grant module to record the receipt and expenditure of all federal funds. Our objectives were to determine whether

- appropriate grant information was entered into the STARS Grant Control Table upon notification of the grant award, and related revenue and expenditure transactions were coded with the proper grant codes;
- the department made drawdowns at least weekly using the applicable STARS reports; and
- the department utilized the appropriate STARS reports as bases for preparing the Schedules of Expenditures of Federal Awards and reports submitted to the federal government.

We interviewed key personnel to gain an understanding of the department’s procedures and controls concerning Policy 20. Based on our interviews, reviews, and testwork, the department was in compliance with the Department of Finance and Administration Policy 20. The department had fully utilized the STARS Grant Module to record the receipt and expenditure of all federal funds and made drawdowns in a timely manner. The department also used the appropriate STARS reports as the basis for preparing the Schedule of Expenditures of Federal Awards and reports submitted to the federal government.

**DEPARTMENT OF FINANCE AND ADMINISTRATION POLICY 22,
SUBRECIPIENT MONITORING**

Department of Finance and Administration Policy 22, “Subrecipient Monitoring,” establishes guidelines for uniform monitoring of subrecipients that receive state and/or federal funds from state agencies. Our objectives were to determine whether

- the department submitted the required monitoring plans and monitoring reports to the Department of Finance and Administration in a timely manner,
- the department identified its subrecipients and included them in the monitoring plans, and
- the department assessed the risk of each subrecipient in accordance with the guidelines established by the Department of Finance and Administration.

We interviewed key personnel to gain an understanding of the department’s procedures and controls concerning Policy 22. As a result of our interviews, we concluded that

- the department had not submitted monitoring plans and reports to the Department of Finance and Administration,
- the department had not identified its subrecipients, and
- the department had not assessed the risk of each subrecipient.

These matters are discussed in finding 8.

8. The Department of Economic and Community Development did not comply with the Department of Finance and Administration's Policy 22, Subrecipient Monitoring

Finding

The department did not identify and report its subrecipients to the Department of Finance and Administration in the form of an annual monitoring plan as required by Policy 22. Policy 22 establishes guidelines for uniform monitoring of subrecipients that receive state and/or federal funds from state departments, agencies, and commissions. The department has classified these grants as vendor agreements; however, the agreements more closely fit the attributes of a subrecipient arrangement as defined in Office of Management and Budget Circular A-133. The policy requires the Department of Economic and Community Development to submit an annual monitoring plan to the Division of Resource Development and Support in the Department of Finance and Administration for review, comment, and approval by September 30 of each year. This plan should identify all subrecipients to be monitored, describe the risk criteria utilized to select subrecipients for monitoring purposes, identify full-time equivalents dedicated to monitoring activities, and include a sample monitoring guide. The department has not prepared and submitted the required plan to identify its subrecipients and document other plan requirements for the audit period.

In addition, the Department of Economic and Community Development is required to submit an annual report summarizing its monitoring activities to the Resource Development and Support Division by October 31 of each year. This report was not submitted.

Not submitting the required monitoring plan and annual report could result in inadequate monitoring of subrecipients.

Recommendation

The Commissioner should ensure that the required annual monitoring plan is submitted by September 30 of each year and that the plan includes all the required information. Also, the Commissioner should ensure that the annual report summarizing the department's monitoring activities is submitted by October 31 of each year.

Management's Comment

We concur with the finding. The department was unsure as to the application of Policy 22 regarding grants. With the clarification of the Policy 22 application, we will adhere to the policy.

OBSERVATIONS AND COMMENTS

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Section 4-21-901, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30 each year. The Department of Economic and Community Development filed its compliance reports and implementation plans on June 29, 2001, and May 28, 2002.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds. The Human Rights Commission is the coordinating state agency for the monitoring and enforcement of Title VI. A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury.

APPENDIX

ALLOTMENT CODES

Department of Economic and Community Development divisions and allotment codes:

- 330.01 Administrative Services
- 330.02 Industrial Development
- 330.03 Small & Minority-Owned Telecommunications Program
- 330.04 Regional Grants Management
- 330.05 Business Services
- 330.06 TIIP-95 County Jobs Program
- 330.07 Community Development
- 330.08 Energy
- 330.09 Industrial Training Service
- 330.10 Small Business Energy Loan Program
- 330.11 Local Government Energy Loan Program
- 330.13 Skills Fund