

# AUDIT REPORT

Tennessee Arts Commission

September 2010



STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY

Department of Audit  
Division of State Audit



**Arthur A. Hayes, Jr., CPA, JD, CFE**  
Director

**Kandi B. Thomas, CPA, CFE**  
Assistant Director

**Ronald E. Anderson, CPA, CFE**  
**Aaron Jewell, CPA, CFE**  
Audit Managers

**Rebecca Troyani, CPA, CFE**  
In-Charge Auditor

**James Ligon**  
**Kendra Roberts**  
**Benjamin Rogers**  
Staff Auditors

**Amy Brack**  
Editor

Comptroller of the Treasury, Division of State Audit  
1500 James K. Polk Building, Nashville, TN 37243-1402  
(615) 401-7897

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

SUITE 1500  
JAMES K. POLK STATE OFFICE BUILDING  
NASHVILLE, TENNESSEE 37243-1402  
PHONE (615) 401-7897  
FAX (615) 532-2765

September 14, 2010

The Honorable Phil Bredesen, Governor

and

Members of the General Assembly

State Capitol

Nashville, Tennessee 37243

and

Mr. Rich Boyd, Executive Director

Tennessee Arts Commission

401 Charlotte Avenue

Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a financial and compliance audit of selected programs and activities of the Tennessee Arts Commission for the period June 1, 2005, through May 31, 2008.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Management of the Tennessee Arts Commission is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

Our audit resulted in no findings.

We have reported other less significant matters involving the commission's internal control and instances of noncompliance to the Tennessee Arts Commission's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA  
Director

AAH/aj  
08/040

State of Tennessee

# **A u d i t   H i g h l i g h t s**

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit  
**Tennessee Arts Commission**  
September 2010

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## **AUDIT SCOPE**

We have audited the Tennessee Arts Commission for the period June 1, 2005, through May 31, 2008. Our audit scope included a review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements in the areas of artifacts inventory, equipment, revenue, expenditures, payroll and personnel, vehicle registration revenue, and the Financial Integrity Act. The audit was conducted in accordance with generally accepted government auditing standards.

## **AUDIT FINDINGS**

The audit report contains no findings.

# Financial and Compliance Audit Tennessee Arts Commission

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# **Financial and Compliance Audit Tennessee Arts Commission**

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## **INTRODUCTION**

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### **POST-AUDIT AUTHORITY**

This is the report on the financial and compliance audit of the Tennessee Arts Commission. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which requires 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.

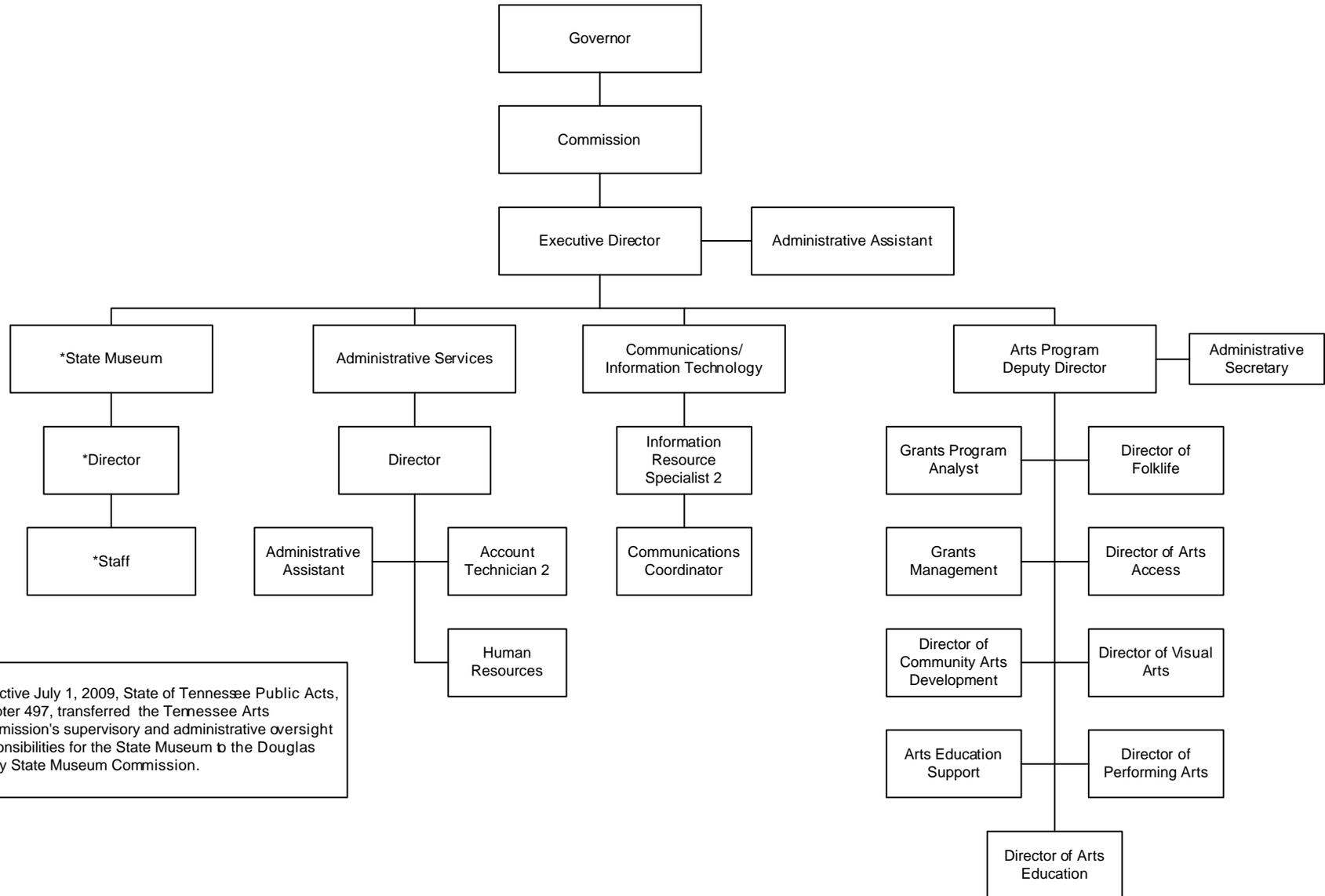
### **BACKGROUND**

The Tennessee Arts Commission was created by the General Assembly in 1967 and is governed by 15 board members appointed by the Governor with the mission of ensuring that the citizens of the State of Tennessee have access to and participate in the arts. In addition to its responsibility to the arts and artists in Tennessee, until June 30, 2009, the Tennessee Arts Commission also had supervisory and administrative responsibility for the Tennessee State Museum. However, effective July 1, 2009, State of Tennessee Public Acts, Chapter 497, was enacted, which states, “The duties and functions of the Tennessee arts commission relative to the operation of the state museum are transferred to the Douglas Henry state museum commission.”

The Tennessee Arts Commission’s governing policies ensure that cultural agencies are present and their activities are utilized throughout the state, arts organizations are well-supported, artists work in a supportive environment, the people of Tennessee value the arts, the arts are vital to education and learning in Tennessee, public policy is favorable toward Tennessee’s arts industry, and the people of Tennessee value their material and cultural history.

An organization chart of the Tennessee Arts Commission is on the following page.

# Tennessee Arts Commission Organization Chart



\*Effective July 1, 2009, State of Tennessee Public Acts, Chapter 497, transferred the Tennessee Arts Commission's supervisory and administrative oversight responsibilities for the State Museum to the Douglas Henry State Museum Commission.

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## AUDIT SCOPE

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We have audited the Tennessee Arts Commission for the period June 1, 2005, through May 31, 2008. Our audit scope included a review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements in the areas of artifacts inventory, equipment, revenue, expenditures, payroll and personnel, vehicle registration revenue, and the Financial Integrity Act. The audit was conducted in accordance with generally accepted government auditing standards.

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## PRIOR AUDIT FINDINGS

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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 Tennessee Arts Commission filed its report with the Department of Audit on December 28, 2006. A follow-up of all prior audit findings was conducted as part of the current audit.

## RESOLVED AUDIT FINDINGS

The current audit disclosed that the Tennessee Arts Commission has substantially corrected previous audit findings concerning risks associated with

- controlling and safeguarding museum artifacts;
- controlling and safeguarding equipment;
- inadequate accounting controls related to segregation of duties, system access, and inadequate documentation for transactions;
- the Tennessee State Museum's failure to follow purchasing procedures;
- monitoring of subrecipient contracts;
- noncompliance with Department of Finance and Administration's Policy 20;
- inadequate internal controls over funds from the sale of specialty vehicle registration plates;
- lack of guidance governing conflict-of-interest responsibilities;
- noncompliance with the Financial Integrity Act;

- failure to recover revenue collected by the Tennessee Arts Foundation on behalf of the Tennessee Arts Commission; and
- museum staff's circumvention of purchasing policies and procedures.

We also concluded that the previous audit finding concerning noncompliance with the state law governing donations collected in donation boxes in the Tennessee State Museum is inconsequential to the commission's operations, and therefore we did not repeat the finding.

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## **OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS**

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### **ARTIFACTS INVENTORY**

The objectives of our review of the Tennessee Arts Commission's artifacts inventory were to obtain an understanding of artifacts inventory controls and procedures and to determine whether

- the artifacts inventory listing represented a complete and valid listing of the artifacts on hand;
- artifacts purchased during the audit period were properly added to the artifacts inventory listing;
- the artifacts inventory was adequately safeguarded;
- lost or stolen artifacts, if any, were properly reported to the Comptroller's office and deleted from the artifacts inventory listing; and
- an annual artifacts inventory was taken in accordance with established procedures during the audit period.

We interviewed key personnel and reviewed supporting documentation to gain an understanding of the commission's procedures and controls over the artifacts inventory. We selected a nonstatistical sample of artifacts from the artifacts inventory listing. We located the items and compared the artifacts with the description, object identification information, location, and condition reported on the artifact inventory listing. To determine completeness of the artifact inventory listing, we haphazardly selected artifacts from the A, B, and D levels of the James K. Polk Building, the War Memorial Building, and the ground floor of the Citizens Plaza Building. For the items selected, we agreed each artifact's description, object identification number, location, and condition to the information reported on the artifact inventory listing. We selected a sample of disbursements for artifacts purchased during the audit period and located these artifacts and compared the description, object identification number, condition, and location with the inventory listing. We made inquiries and performed walkthrough procedures to determine if the artifacts inventory was adequately safeguarded. We asked management if any artifacts had

been lost or stolen and whether losses were properly reported to the Comptroller's office and deleted from the inventory listing. We reviewed the museum's annual physical inventory procedures and verified management's compliance with the inventory procedures during our discussions with management and walkthrough procedures.

Based on our interviews, observations, and review of documentation, we gained an understanding of the commission's procedures and controls over the artifacts inventory, and we determined that

- the artifacts inventory listing represented a complete and valid listing of the artifacts on hand;
- artifacts purchased during the audit period were properly added to the artifacts inventory listing;
- the artifacts inventory was adequately safeguarded;
- there were no lost or stolen artifacts; and
- an annual artifacts inventory was taken in accordance with established procedures during the audit period.

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## **EQUIPMENT**

The objectives of our review of the Tennessee Arts Commission's equipment were to obtain an understanding of equipment controls and procedures and to determine whether

- equipment items were adequately safeguarded;
- lost or stolen equipment that was reported to the Comptroller's office was deleted from the commission's equipment listing;
- the equipment listing represented a complete and valid listing of the assets physically on hand;
- equipment purchases were appropriately added to the equipment listing;
- equipment locations recorded in Property of the State of Tennessee (POST) were valid locations for the commission; and
- only active employees had access to POST, their level of access to POST was reasonable, and their POST access did not result in an inadequate segregation of duties considering employees' responsibilities.

We interviewed key personnel and reviewed supporting documentation to gain an understanding of the commission's procedures and controls over equipment. We made inquiries and performed walkthrough procedures to determine if equipment items were adequately safeguarded. We reviewed the equipment listing to determine if lost or stolen equipment reported to the Comptroller's office was deleted from the equipment listing. We selected a nonstatistical sample of items from the equipment listing to locate the items and compare the

description, tag number, serial number, and location of the item with information on the equipment listing. In addition, we selected a nonstatistical sample of equipment items located on the ground floor of the Citizens Plaza Building and levels A and B of the James K. Polk Building and for each item compared the equipment tag number, description, serial number, and location to the information reported on the equipment listing. For all disbursements recorded as equipment purchases during the audit period, we ascertained if the items were added to the active equipment inventory in POST. We reviewed the location codes on the equipment listing to determine if the locations listed were valid locations for the commission. We reviewed a listing of employees with access to POST to ensure that only active employees had access to POST, their level of access to POST was reasonable, and their POST access did not result in an inadequate segregation of duties considering the employees' responsibilities.

Based on our interviews, observations, and review of documentation, we gained an understanding of the commission's procedures and controls over equipment, and we determined that

- equipment items were adequately safeguarded;
- lost or stolen equipment that was reported to the Comptroller's office was deleted from the commission's equipment listing;
- the equipment listing represented a complete and valid listing of the assets physically on hand;
- equipment purchases were appropriately added to the equipment listing;
- equipment locations recorded in POST were valid locations for the commission; and
- only active employees had access to POST, their level of access to POST was reasonable, and their POST access did not result in an inadequate segregation of duties considering the employees' responsibilities.

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## **REVENUE**

The objectives of our review of the Tennessee Arts Commission's revenue were to obtain an understanding of revenue controls and procedures and to determine whether

- physical controls over cash at the museum were adequate;
- museum staff had reasonable donation box collection procedures; and
- the museum's petty cash fund was authorized by the Department of Finance and Administration, and the amount authorized reconciled to petty cash on hand.

We interviewed key personnel to gain an understanding of the commission's procedures and controls over revenue. We interviewed key museum personnel, reviewed procedures, and observed procedures to determine the adequacy of physical controls over cash collected at the museum. We reviewed the results of a recent internal monitoring review of museum donation collection procedures to determine the reasonableness of the procedures. We obtained

information from the Department of Finance and Administration regarding the authorized petty cash fund for the museum and reconciled the amount authorized with the cash on hand.

Based on our interviews, review of controls, and testwork, we determined that

- physical controls over cash at the museum were adequate;
- the museum's procedures for donation box collections were reasonable; and
- the museum's petty cash fund was authorized by the Department of Finance and Administration, and the amount authorized reconciled to petty cash on hand.

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## EXPENDITURES

The objectives of our review of the commission's expenditures were to determine whether

- only active employees had access to the State of Tennessee Accounting and Reporting System (STARS) and the Tennessee On-Line Purchasing System (TOPS);
- the annual monitoring plan required by Department of Finance and Administration (F&A) Policy 22, *Subrecipient Contract Monitoring*, was submitted and monitoring was adequate;
- voucher registers were properly approved;
- there was a state payment card application and a cardholder agreement on file for the employee with the payment card that was active (as of January 15, 2008), the employee attended a cardholder training class before being issued the card, and the employee's job duties required access to a payment card; and
- payment card transactions were supported by receipts, transaction logs contained the required cardholder and approver signatures, purchased items were allowable, and sales tax was not paid.

To gain an understanding of the commission's policies and procedures over expenditures, we interviewed key personnel and performed walkthroughs with management of the commission's controls over expenditures.

We obtained a listing of employees with active access to STARS and TOPS and tested to determine if the employees were active employees. We reviewed the annual monitoring plan to determine if it was submitted in accordance with Policy 22, and we selected a nonstatistical sample of contracts listed in the monitoring plan to determine if the monitoring was adequate. We scanned voucher registers to determine if they were properly approved.

We obtained the state payment card application and cardholder agreement from the statewide payment card coordinator in the Department of Finance and Administration for the

employee with the payment card that was active as of January 15, 2008. We asked the statewide payment card coordinator for the date the employee attended the payment card training class and compared that date to the date the card was activated. We documented the employee's job responsibilities and determined if the responsibilities required a payment card. We tested support for all payment card transactions from June 1, 2005, through January 31, 2008, to determine if transactions were supported by receipts, transaction logs contained the required cardholder and approver signatures, purchased items were allowable, and sales tax was not paid.

Based on our interviews, reviews, and testwork, we determined that

- only active employees had access to STARS and TOPS;
- the annual monitoring plan required by F&A Policy 22 was submitted and monitoring was adequate;
- voucher registers were properly approved;
- there was a state payment card application and a cardholder agreement on file for the employee with the payment card that was active (as of January 15, 2008), the employee attended a cardholder training class before being issued the card, and the employee's job duties required access to a payment card; and
- payment card transactions were supported by receipts, transaction logs contained the required cardholder and approver signatures, items that were purchased were allowable, and sales tax was not paid.

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## **PAYROLL AND PERSONNEL**

The objectives of our review of the commission's payroll and personnel controls were to determine whether

- payroll and personnel policies and procedures were adequate;
- personnel files were adequately maintained;
- only active employees had access to the State Employment and Information System (SEIS) and the level of access was appropriate for their job duties; and
- overtime paid was not excessive.

We interviewed key personnel to gain an understanding of the commission's procedures and controls over payroll and personnel. To determine that personnel files were adequately maintained, we performed a walkthrough of personnel files. To find out if only active employees had SEIS access and the level of access was appropriate for their job duties, we examined a listing of employees with SEIS access. To determine that overtime paid was not excessive, we obtained a listing of overtime expenditure transactions recorded in STARS and determined the total paid.

Based on our interviews, walkthrough, and review of documentation, we determined that

- the commission’s payroll and personnel policies and procedures were adequate;
- personnel files were adequately maintained;
- only active employees had SEIS access and the level of access was appropriate for their job duties; and
- the amount paid for overtime was not excessive.

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## **VEHICLE REGISTRATION REVENUE**

The objective of our review of the commission’s vehicle registration revenue was to determine if there was a reasonable process to account for disbursements of vehicle registration revenue. Section 55-4-215, *Tennessee Code Annotated*, prescribes that “the revenues allocated to the Tennessee arts commission . . . shall be distributed by the arts commission in the form of grants to arts organizations or events which meet criteria established by the arts commission for receiving grants, within the following parameters: (1) One third (1/3) of the funds shall be distributed to qualifying arts organizations or events in urban counties; and (2) Two thirds (2/3) of the funds shall be distributed to qualifying arts organizations or events in rural counties.”

We interviewed key personnel and reviewed commission policy to obtain an understanding of the commission’s process to record vehicle registration revenue disbursements. Based on our interviews and review of supporting documents, we determined that the commission had a reasonable process to account for disbursements of vehicle registration revenue.

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## **FINANCIAL INTEGRITY ACT**

For the audit period, 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. In addition, the head of each executive agency is required to conduct an evaluation of the agency’s internal accounting and administrative control and submit a report by December 31, 1999, and December 31 of every fourth year thereafter.

Our objective was to determine whether the Tennessee Arts Commission’s June 30, 2005; June 30, 2006; and June 30, 2007, responsibility letters were filed in compliance with Section 9-18-104, *Tennessee Code Annotated*.

We reviewed the June 30, 2005; June 30, 2006; and June 30, 2007, responsibility letters submitted to the Comptroller of the Treasury and the Department of Finance and Administration

to determine adherence to the submission deadline, and the responsibility letters were filed in compliance with Section 9-18-104, *Tennessee Code Annotated*.

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## **OBSERVATIONS AND COMMENTS**

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### **MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT**

Auditors and management are required to assess the risk of fraud in the operations of the entity. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the entity.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the entity. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic. The assessment and the controls should be reviewed and approved by the head of the entity.

## **FRAUD CONSIDERATIONS**

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*, promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

## **TITLE VI OF THE CIVIL RIGHTS ACT OF 1964**

During the audit period, Section 4-21-901, *Tennessee Code Annotated*, required 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 Tennessee Arts Commission filed its compliance reports and implementation plans on June 30, 2005; June 29, 2006; and June 28, 2007.

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 Tennessee Title VI Compliance Commission is responsible for monitoring and enforcement of Title VI. A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans has been presented in the special report, *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury. However, on June 23, 2009, Public Chapter 437, House Bill 129, amended *Tennessee Code Annotated* to require the annual reports to be submitted to the Human Rights Commission "by October 1, 2010, and each October 1 thereafter" and requires the commission to "publish a cumulative report of its findings and recommendations concerning compliance. . . ."

## STATE MUSEUM REVIEW

A separate review is being conducted related to certain activities and operations of the museum. The issues noted during that review are not included in this report and will be reported separately.

## ISSUE FOR LEGISLATIVE CONSIDERATION

Section 55-4-215, *Tennessee Code Annotated*, designates the Tennessee Arts Commission as a recipient of a portion of the revenues generated from the sale or renewal of specialty earmarked motor vehicle registration plates. The statute provides that the revenues allocated to the Tennessee Arts Commission will be distributed by the Arts Commission in the form of grants to art organizations or events.

The Tennessee Arts Commission has established criteria to select qualifying arts organizations or arts events as grant recipients. The arts organizations and arts events must submit grant applications to the commission. The applications are reviewed by staff, advisory panels, and the allocations committee. Based on these reviews, grant funding recommendations are made to the commission. The commission ultimately approves the grant awards.

Based on discussions with Tennessee Arts Commission management, we determined that management does not distribute all of the vehicle registration plate revenue it has received each year, which has allowed the revenue to build a significant reserve balance. According to fiscal year 2008 year-end reserve letters, the Tennessee Arts Commission collected \$4,528,700 in revenue generated from the sale or renewal of specialty earmarked motor vehicle registration plates and disbursed \$4,877,241 in grant expenditures for the fiscal year ended June 30, 2008. At the end of every fiscal year, management compares total yearly spending with collections. When spending exceeds collections, the balance of the reserve fund is reduced. When collections exceed spending, the balance of the reserve fund is increased. The resulting balance is carried forward to the next year. At the end of fiscal year 2008, the balance of the reserve fund was reduced by the excess of spending over collections of \$348,541. The reserve fund balance at June 30, 2008, was \$5,271,703. This balance represents the cumulative total of the excess of funds received over the amount spent since the inception of the fund.

We noted that the September 2005 commission meeting minutes reported that the Arts Commission's Executive Director desired to spend down the reserve to approximately \$2 million. However, based on our discussion with the Executive Director, he stated that no official action has been taken because he believes that it is not prudent to spend down every penny of its specialty license plate revenue. He stated it would not be wise to reduce the reserve fund dramatically by awarding large grants but rather to consistently review available funding against organizational needs.

When *Tennessee Code Annotated* mandates that revenues such as vehicle registration revenues are collected for the purpose of funding grants to arts organizations or events,

Tennessee citizens can reasonably expect the Tennessee Arts Commission, as the oversight agency, to spend these funds for grants to arts organizations or events. The General Assembly may wish to consider amending Section 55-4-215, *Tennessee Code Annotated*, to require the Tennessee Arts Commission to hold public hearings to allow for legislative and public input on the use of the license plate revenue and to report annually on the status of the funding it has received from license plate revenue. The General Assembly may also wish to consider giving guidance to the Tennessee Arts Commission on how to spend the more than \$5 million in license plate revenue that the commission has accumulated over the years.

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## APPENDIX

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### ALLOTMENT CODES

Tennessee Arts Commission division and allotment codes:

316.25	Tennessee Arts Commission
316.27	Tennessee State Museum