# Department of Economic and Community Development
# Office of Business Enterprise

## April 2005

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**John G. Morgan**
**Comptroller**

April 28, 2005

The Honorable John S. Wilder
Speaker of the Senate
The Honorable Jimmy Naifeh
Speaker of the House of Representatives
The Honorable Thelma M. Harper, Chair
Senate Committee on Government Operations
The Honorable Mike Kernell, Chair
House Committee on Government Operations
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the performance audit of the Department of Economic and Community Development and the Office of Business Enterprise. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated*, the Tennessee Governmental Entity Review Law.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the department and office should be continued, restructured, or terminated.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/dww
04/055

State of Tennessee

# Audit Highlights

Comptroller of the Treasury | Division of State Audit

Performance Audit

**Department of Economic and Community Development**

**Office of Business Enterprise**

April 2005

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## AUDIT OBJECTIVES

The objectives of the audit were to determine the duties and responsibilities of the Department of Economic and Community Development and the Office of Business Enterprise, to assess the operations of the department and office, and to make recommendations that could result in more efficient and effective operation of the department and office.

## FINDINGS

**The Department Should Improve Its Performance Measures and Ensure It Has Adequate Economic Information to Help It Determine Whether It Is Meeting Its Goals and Statutory Mandate**

The department's performance measures focus on output rather than outcomes in terms of the results or effects of its programs. Until recently, the department had not comprehensively identified the major economic areas of the state or their associated needs. The department cannot determine whether its programs are improving economic conditions in the state, at least indirectly, without collecting and tracking data on multiple economic indicators (page 10).

**The FastTrack Infrastructure Development Program Has No Real Grant Limits**

Because the funding requirements for infrastructure grants have changed in the yearly appropriations act, there is not a true limit on the amount the department may award to a local government (page 13).

**The Department Does Not Collect Adequate Data to Determine the Extent of Effectiveness of the FastTrack Training Assistance Program**

The department does not follow up to ensure that companies are hiring at least as many people as agreed upon, collect information on the wage levels of those who are hired, or evaluate the program to assess its impact and determine its effectiveness. As a result, it is unclear how successful the program is in encouraging new job hires (page 14).

**The Department Did Not Gather All Necessary Information to Properly Implement and Monitor the FastTrack Infrastructure Development Program**

The department had not collected program outcome information, such as the number of new hires, from either the companies or communities receiving infrastructure grants. Thus, it is unclear whether the program has been successful in encouraging job creation and retention or

encouraging businesses to locate or expand in the state (page 19).

**The Department Had Not Enforced Local Government Compliance With the Requirement for Joint Economic and Community Development Boards in Order to Receive State Grants**

Although joint economic and community development boards have been a requirement for all state grants since 1998, the department had not enforced this requirement when awarding infrastructure grants. The boards' purpose is to foster communication about economic development between and among governmental entities, industry, and private citizens (page 23).

**The Business Enterprise Resource Office Had Not Developed a System to Measure Its Performance**

The office's mission is to expand economic opportunities for small, rural, and minority- and women-owned businesses by providing technical, financial, and management assistance. Without a performance measurement system, the department cannot determine whether the office is accomplishing its goals and objectives (page 24).

## OBSERVATIONS AND COMMENTS

The audit also discusses the following issues: the Three-Star Pilot Program, Community Development Block Grant processing time, and department monitoring of Community Development Block Grants (page 6).

## ISSUES FOR LEGISLATIVE CONSIDERATION

The General Assembly may wish to consider (1) placing all statutes pertaining to the FastTrack Infrastructure Development Program in *Tennessee Code Annotated* instead of the yearly appropriations act so that program requirements remain consistent over time, and giving the responsibility to the State Funding Board for making recommendations to the General Assembly on increasing grant limits, as needed; and (2) mandating funding limits that apply to an entire project instead of to a contract, specifying State Funding Board approval for any exceptions (page 27).

# Performance Audit
# Department of Economic and Community Development
# Office of Business Enterprise

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# Performance Audit
# Department of Economic and Community Development
# Office of Business Enterprise

## INTRODUCTION

### PURPOSE AND AUTHORITY FOR THE AUDIT

This performance audit of the Department of Economic and Community Development and the Office of Business Enterprise (known as the Business Enterprise Resource Office) was conducted pursuant to the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-226, the department and office are scheduled to terminate on June 30, 2005. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the department and office and to report the results to the Joint Government Operations Committee of the General Assembly. This performance audit is intended to aid the committee in determining whether the department and office should be continued, restructured, or terminated.

### OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to determine the authority and responsibility mandated to the department by the General Assembly;

2. to determine whether the department has a clear focus on how its economic development activities affect the economic conditions in the state and whether it is using its limited funds in the most effective and efficient manner possible to achieve economic developments;

3. to determine whether the department has a strategic plan to guide the department's efforts to create better paying, higher skilled jobs for Tennesseans;

4. to determine whether both FastTrack programs, the FastTrack Infrastructure Development Program and the FastTrack Job Training Assistance Program, have been effective or successful in helping businesses locate/expand in the state and in the creation and retention of jobs;

5. to ascertain the status of the Three-Star Program;

6. to evaluate the department's management of Community Development Block Grant (CDBG) applications;

7. to determine whether the Business Enterprise Resource Office (BERO) has a strategic plan to effectively promote disadvantaged businesses;

8. to determine whether the department adheres to Title VI requirements; and

9. to recommend possible alternatives for legislative or administrative action that may result in more efficient and effective operation of the department.

## SCOPE AND METHODOLOGY OF THE AUDIT

We reviewed the department's activities and procedures, focusing on procedures in effect during fiscal years 2003 and 2004. The audit was conducted in accordance with the standards applicable to performance audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The methods used included

1. review of applicable legislation, executive orders, and department rules, policies, and procedures;

2. examination of the department's records, reports, and information summaries;

3. examination of prior performance audit and financial and compliance audit reports on the department, as well as such reports from other states;

4. analysis of information obtained from other states, the federal government, and state and national organizations; and

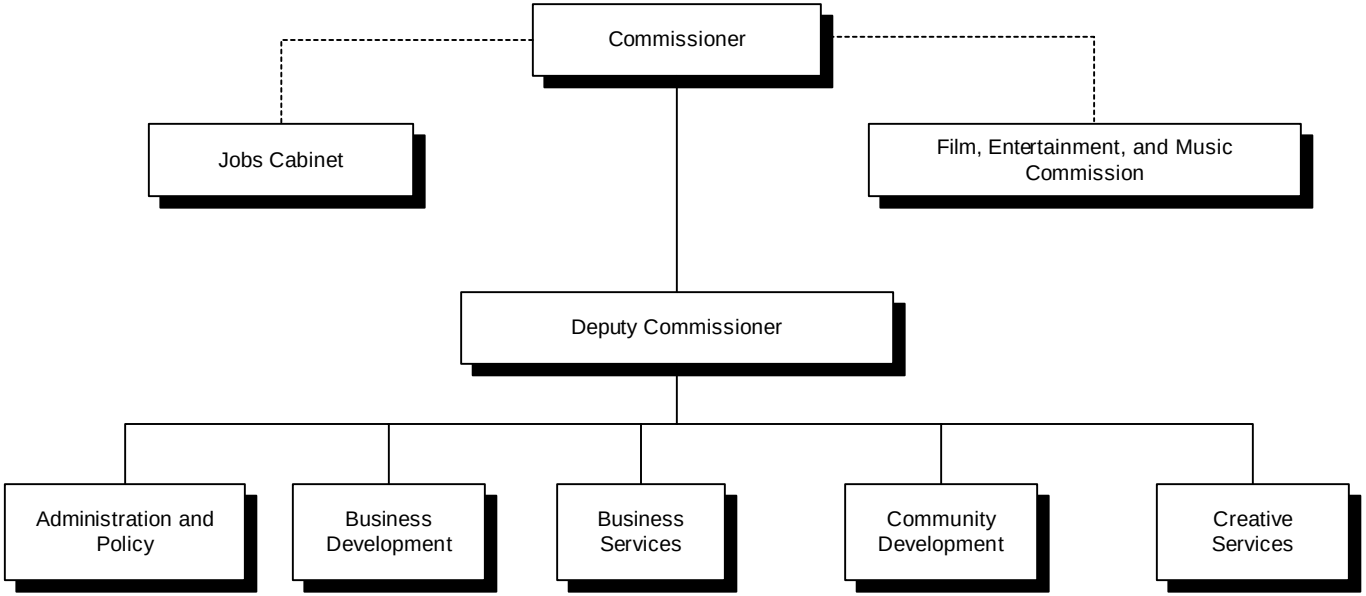
5. interviews with department staff and federal government staff who interact with the Department of Economic and Community Development.

## ORGANIZATION AND RESPONSIBILITIES

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. The department had 206 positions, as of August 2004. The department is organized into five major areas: Administration and Policy, Business Development, Business Services, Community Development, and Creative Services. (See organization chart on the following page.)

- Administration and Policy handles the daily operations and procedures of the department. Administration and Policy provides services that include budget, fiscal, personnel, legal, information systems, research, and policy.

# Department of Economic and Community Development
# Organization Chart



- Business Development encompasses three divisions. Recruitment works with companies and site selectors to assist them in locating or expanding in the state. Recruitment specialists are assigned to either international or domestic recruitment. In addition, the recruitment specialists work within specific industry clusters and assist in the preparation of client proposals. Jobs Development specialists assist existing industries with training, infrastructure needs, and other services and are assigned to specific regions of the state. They also work with local economic development professionals, chambers of commerce, community leaders, and elected officials to encourage job investment in their assigned territory. The Office of Special Projects is responsible for the provision of engineering, environmental, and technical graphics expertise as well as data on large industrial sites. Its scope of responsibilities includes site and infrastructure analysis and environmental permitting issues.

- Business Services supports two major sectors of business and industry in Tennessee. The division consists of two offices—the Business Enterprise Resource Office (BERO) and the FastTrack Job Training Office. BERO serves small, minority- and women-owned businesses by providing technical and management information assistance. BERO also works closely with the Governor's Office of Diversity Business Enterprise assisting small and minority businesses with procurement opportunities. The FastTrack Job Training Office is the workforce training resource of the department. The office supports new and existing industries with training needs as an incentive for those businesses that meet certain criteria.

- Community Development works with communities to help attract new business development, improve the quality of life, and ensure they develop and maintain the leadership, organizations, and infrastructure essential for economic growth. Community Development consists of four programs: Community Economic Development, which consists of the Tennessee Three-Star Program assisting those communities that have prepared for economic success and the Main Street Program providing communities a format for the revitalization of their downtown districts, thus increasing the potential for job growth, community livability, and increased local tax revenue; the Local Planning section, which works with municipal and county planning commissions; Program Management, which administers state and federal government grant and loan funds; and the Energy section, which implements energy-saving education programs and administers federal energy grant and loan programs.

- Creative Services is divided into two sections. The first section serves as an in-house resource for the department and other agencies of state government by providing inexpensive, high-quality creative and graphic services and strategic communications consulting. The second section serves as a liaison between the department, ECD partners, the media, and the public, and is primarily responsible for developing communications strategies to keep those groups informed about ECD programs and services. This section creates department-wide messages, provides consultation on all communication issues, handles the development and distribution

of news releases, and coordinates news conferences and announcements for the department as well as other external and internal communication concerns.

## REVENUES AND EXPENDITURES

The Department of Economic and Community Development had a budget of $78,984,800 for fiscal year 2004. During fiscal year 2003, the department had revenues and expenditures of $69,389,200. The department revenues were derived from state appropriations (44.2%), federal funding (40.9%), and other sources (14.8%). The major categories of expenditures were as follows:

**Categories of Expenditure for Fiscal Year 2003**

| Category of Expenditure | Amount | Percent of Total Department Expenditures |
|---|---|---|
| Administrative Services | $4,321,500 | 6.2% |
| Industrial Development | $6,302,100 | 9.1% |
| Business Services | $1,461,700 | 2.1% |
| Small and Minority Owned Telecommunications Program | $289,400 | 0.4% |
| FastTrack Job Training Assistance Program and Job Skills | $2,279,500 | 3.3% |
| Job Skills Fund | $7,042,500 | 10.1% |
| Regional Grants Management | $28,239,400 | 40.7% |
| FastTrack Infrastructure Development Program | $13,644,400 | 19.7% |
| Community Development | $4,184,200 | 6.0% |
| Energy Division | $1,624,500 | 2.3% |

## OBSERVATIONS AND COMMENTS

The issues discussed below did not warrant findings but are included in this report because of their effect on the operations of the Department of Economic and Community Development and the citizens of Tennessee.

### THREE-STAR PILOT PROGRAM

The Three-Star Pilot Program is designed as a roadmap to assist local communities in their effort to achieve success in community and economic development. The pilot program is part of an effort to revise the original Three-Star Program to make it more dynamic and more flexible by shifting its focus away from just manufacturing development.

To attain certification under the revised program, the department has identified basic criteria which are prerequisites for certification and serve as the program's foundation. Participating communities are required to

- have a joint economic and community development board;
- have a resolution from the local legislative body confirming compliance with federal Title VI regulations;
- develop a five-year strategic economic development plan, which is updated annually;
- have a resolution from the local legislative body adopting the strategic development plan;
- have a resolution from the local legislative body to participate in the program, with a contact person designated; and
- clearly identify areas of responsibility for each active local or regional economic development organization.

A community becomes a certified Three-Star Pilot Program community by satisfying the basic criteria and accumulating points for either Level I, II, or III certification. Points are assigned to various program elements, some of which are required and some of which are optional. There are three major components of the program: Community Development, which includes community involvement, community livability, and community pride; Economic Development, which includes business development, job skills development, and visitor development; and Visionary Development, which includes participation of city governments and regional partnerships. The department annually certifies those communities meeting program requirements.

Incentives to participate in the program include matching grants for participating communities from the department for community marketing and promotional materials, points on Community Development Block Grant (CDBG) applications, increased loan limits for CDBG loans, energy loan incentives, and a reduction in the amount of local match money required for CDBG and FastTrack Infrastructure Development Program grants and loans. (See Table 1.)

**Table 1**
**Incentives for Participation in the Three-Star Pilot Program**

| | **Level I Certification** | **Level II Certification** | **Level III Certification** |
|---|---|---|---|
| Matching Grants | $1,000 | $1,500 | $2,000 |
| CDBG Points Added: | | | |
| City Program | 2 | 2 | 2 |
| County Program | 5 | 5 | 5 |
| Reduction in Percent of Local Match Required (CDBG and FIDP) | | | |
| City Program | -1 | -2 | -3 |
| County Program | -3 | -4 | -5 |
| CDBG Loan Limits | | | |
| City Program | $550,000 | $575,000 | $600,000 |
| County Program | $600,000 | $625,000 | $650,000 |
| Energy | $500 Energy Education Grant<br>Low Interest Loans (2%) | $2,000 Change a Light Grant to upgrade lighting in schools<br>Low Interest Loans (2%) | |

Eight pilot counties were chosen to participate in the revised Three-Star Pilot Program, which started in January 2004: Bedford, Fayette, Morgan, Rhea, Sequatchie, Wayne, Weakley, and Unicoi. (As of April 2004, there were 70 counties participating in the program's old version.) Officials from the pilot counties stated that the pilot program has been an impetus for counties to begin critical planning for the future and has facilitated cooperation and support between the local elected officials and other community leaders. As of January 2005, 69 cities and counties had submitted a letter of intent to participate in the program.

As of April 2004, the department was not tracking, nor did it appear to have plans to track, any outcome data such as unemployment rates, sales tax revenue, poverty level, per capita income, education, or capital investment to measure the effectiveness of the revised Three-Star Program. Tracking such key economic indicators at least annually would help the department chart community and economic development progress.

## COMMUNITY DEVELOPMENT BLOCK GRANT PROCESSING TIME

The Community Development Block Grant (CDBG) program is a federally funded program administered through each state's department involved in economic and community development whose goal is improving the economic development of local communities. Each CDBG grant and loan, which must be applied for by a local government even if it involves a private business, must meet one of the following three "national objectives":

- principally benefit low- and moderate-income (LMI) persons,
- eliminate or prevent slums and blight, and
- address imminent health and safety problems.

The department's CDBG program does not serve large metropolitan areas. There are 13 "entitlement programs" which receive money directly from the U.S. Department of Housing and Urban Development (HUD) instead of the department. These entitlement areas are Bristol, Chattanooga, Clarksville, Davidson County, Jackson, Johnson City, Kingsport, Knox County, Knoxville, Memphis, Murfreesboro, Oak Ridge, and Shelby County.

The program has two components: (1) community development and (2) economic development. The majority of projects are community development projects. These projects, also called "regular round" projects, involve grants that are funded by money the department receives from HUD. The department received $31.3 million in federal fiscal year 2004. Community development projects have a quality-of-life rather than an economic development objective. These projects are in four categories: water, wastewater, housing rehabilitation, and community livability. Community livability projects aim to improve health and safety conditions in the community (e.g., health centers, fire trucks). Local governments apply once a year for the grants. Their applications are evaluated by department staff using a scoring system developed by the Program Management Section.

There are two categories of economic development projects: those funded by grants for industrial infrastructure and those funded by loans for industrial buildings and equipment. The department provides grants to communities to help them locate or expand businesses in their areas. These grants are similar to the state-funded FastTrack program. The businesses have to be "bird in hand" (i.e., these grants cannot be used on businesses that do not yet exist). The low-interest loans to companies for buildings and equipment have to be applied for through the local communities.

The economic development component is not funded by the federal funds but through a revolving loan fund with a portfolio of $10.4 million, as of June 2004. However, the federal government provided the original funding, and loans are made under federal rules and regulations. Communities can apply for economic development grants and loans throughout the year on a first-come, first-served basis. The Loan and Grant Committee, headed by the Commissioner, approves economic development grants and loans.

We reviewed ten randomly selected community development projects and all six economic development projects funded in fiscal year 2002 to determine the time between when the department receives the application and the department releases the funds. The time between application receipt to application approval for both community development and economic development cases averaged 257 days for community development cases, 233 days for economic development cases, and 248 days for all cases. (See Table 2.) The department does not release CDBG funds to applicants until all contract requirements (e.g., environmental assessments) have been satisfied. The time from when an application was received by the department until the department released the funds averaged 515 days for community development cases, 314 days for economic development cases, and 434 days for all cases. The length of time depends on the number of applications the department receives, completeness of the applications, time taken by the applicant to complete requirements, such as environmental reviews, and approvals by the Governor's office and the Department of Finance and Administration.

**Table 2**
**Community Development Block Grant Projects**
**Average Processing Times**

| | Community Development Cases | Economic Development Cases | All CDBG Cases |
|---|---|---|---|
| Average Application Processing Time (Days) * | 257 | 233 | 248 |
| Processing Time 90 days or less (Percent) | 0% | 17% | 6% |
| Average Processing Time Between Approval and Funds Release Dates (Days) ** | 256 | 81 | 186 |
| Average Processing Time Between Application and Funds Release Dates (Days) | 515 | 314 | 434 |

* The time between ECD receiving the application and issuing an approval letter.
** ECD releases CDBG funds once contract conditions (e.g., environmental) are met by applicants.

## MONITORING OF COMMUNITY DEVELOPMENT BLOCK GRANTS

The federal Housing and Community Development Act of 1974 requires states to conduct necessary reviews and audits to determine that local governments receiving Community Development Block Grant (CDBG) funds have carried out activities in accordance with the law's primary objective and those of other applicable laws. A Department of Housing and Urban Development (HUD) guide for state programs states that experience indicates that "for the CDBG program on-site reviews are an essential part" of a monitoring system. The department has developed such a system, including monitoring during the project and "closeout visits" after project completion to determine whether all requirements of CDBG contract grant or loan requirements have been met.

Of the 16 (ten community development and six economic development) fiscal year 2002 CDBG projects reviewed, nine had been completed as of June 2004. Of these nine projects, four

had closeout visits documented in their case files. According to the department, closeout visits, while a component of the monitoring system in place, are not mandatory. Department staff indicated that project administrators are on-site at least monthly, and have the option of giving projects closeout visits. Performing or witnessing such final inspections helps ensure that local government recipients have followed contract requirements. Monitoring and closeout visits help ensure that contractors have completed projects in a manner that fulfills their intended purpose. Since the department does not always perform closeout visits, regular monitoring (and documenting the results) is essential.

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## FINDINGS AND RECOMMENDATIONS

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### 1. The department should improve its performance measures and ensure it has adequate economic information to help it determine whether it is meeting its goals and statutory mandate

#### Finding

The department stated in its strategic plan (issued in September 2004) that it is concerned with promoting the location and expansion of new industries in the state, aiding existing businesses in their efforts to expand and create jobs, and forming strategic partnerships inside and outside state government with the ultimate end of creating better paying, higher skilled jobs for Tennesseans. Section 4-14-105, *Tennessee Code Annotated*, requires the department to "promote in a sound manner the location of additional industries and businesses in the state, to utilize the state's resources to the best advantage and to increase employment opportunities for all elements of the state's population."

The department's performance measures listed in its strategic plan focus on output rather than outcomes in terms of the results or effects of its programs. For example, the plan has a performance measure regarding the number of new contacts relating to potential investment prospects (1,500 annual contacts for fiscal years 2005 and 2006) but no measures to determine what percentage of these contacts actually result in investments and the dollar amounts of these investments.

Until recently, the department had not comprehensively identified the major economic areas of the state or their associated needs. Although the department collected data on the number of new job commitments by companies, by county on a quarterly basis, the department did not collect data on or track changes regarding all new jobs created or other economic indicators across the state such as the unemployment rate, poverty level, average per capita income, educational level, small-business development, technology development and resources, or high-growth industries.

The department obtained this type of information in August 2004. The department contracted with the University of Tennessee's Center for Business and Economic Research to

produce a report to identify the economic regions of Tennessee and provide a comprehensive profile of each region and how it compares with other regions. The department contracted for the report in order to obtain an understanding of Tennessee's regions so that it would be possible to undertake informed economic development planning for the state. The center issued the report in August 2004. The report provides an economic and demographic description of the state divided into 10 regions for this purpose. The report does not recommend any particular actions regarding economic or community development.

The department needs to collect this economic information regularly. Failure to collect and track data on multiple economic indicators, on a county or regional level, will diminish the department's ability to determine, at least indirectly, whether economic conditions are being positively affected by department programs and efforts.

In June 2004, another department contractor, Lockwood Greene, completed an analysis of the department's organizational structure and strategic goals. The analysis included a review of the department's current organizational structure and economic development strategies; a "best practices" analysis of economic development organizations in other states; and a search for existing research and surveys on the organization of state departments of economic and community development. As a result of this report, in June 2004, the department revised its organizational structure in line with the report's recommendations.

## Recommendation

The department should include in a statewide economic development plan performance measures relating to desirable outcomes, and deadlines for achieving these outcomes. The performance measures should address, at the least, existing industry expansion, business recruitment, workforce development (including education and training needs), and infrastructure improvements. The department should include in its plan other state departments, economic development districts, local economic and community development organizations, local governments, representatives from the private sector, and other key stakeholders. The department's programs should help meet and promote the goals of the plan.

The department should routinely collect outcome data on multiple economic indicators relating to the effectiveness of its programs. The department should analyze this data to determine if and how these programs have improved economic conditions in specific regions, especially disadvantaged ones, and the state as a whole. Results from this analysis should be used as a tool to help the department focus on programs that appear to be effective, change or terminate those programs that do not appear to be effective, and determine whether the goals of the statewide economic development plan are being met.

## Management's Comment

We concur in part. Prior to the current administration, research-based performance measurements had not been developed, were not used, nor had systems been developed to

provide, collect, or track this type of information. In fact, the current administration was challenged, upon its arrival, to develop systems to identify and collect meaningful economic and community development information, apply research-based performance measures to the department's activities, and utilize the resulting information to influence and inform the department's activities. Further, with an emphasis on accountability, the current administration has not only improved its fiscal services and research capabilities, but has also developed an internal audit function.

While we agree that our performance measures should always be subject to evaluation, the department is effectively promoting the location and expansion of new industries in the state, aiding existing businesses in their efforts to expand and create jobs, and forming strategic partnerships inside and outside state government with the ultimate end of creating better paying, higher skilled jobs for Tennesseans, therefore meeting both its statutory mandate and its goals.

Beginning in FY 2006, the department will operate under the Governmental Accountability Act (performance-based budgeting). To prepare for this, a team was formed within the department, in October 2004, to scrutinize the department's current performance measures and assess, evaluate, and identify any areas for improvement. However, the challenge in evaluating economic development activities is determining cause. Not only are economic conditions not directly within the department's control, but the department is only one of several players setting priorities and working to improve the state's economic competitiveness. As a result, the department has sought to create performance measures which reflect and measure its activities.

In order to maximize its resources, the department commissioned the University of Tennessee's Center for Business and Economic Research (CBER) report to aid in its efforts to engage in a strong community-based approach to economic development, in keeping with the Governor's vision and the national trend towards regionalism, allowing the department to undertake informed economic development planning for the state. In addition, the Lockwood Greene report was commissioned to assess the structure and operations of the department in order to improve the effectiveness and efficiency of the department and create more economic opportunities for the people of Tennessee. The report made a series of suggestions which the department has implemented, as possible, to pursue best practices in economic development as well as improve effectiveness and efficiency. With the restructuring of the Research Division, the information provided by CBER and Lockwood Greene will be updated on a regular basis, allowing the department to continue focusing its efforts as strategically as possible.

## 2. The FastTrack Infrastructure Development Program has no real grant limits

### Finding

Because the funding requirements for the FastTrack grants can be, and have been, changed in the yearly appropriation acts, there is not a true limit on the amount the department may award to a project. The Tennessee Infrastructure Improvement Program (renamed the FastTrack Infrastructure Development Program, or FIDP, in December 2003) was created in the 1988 general appropriations act and has been renewed subsequently in each fiscal year's general appropriations act. In each act, the General Assembly has set minimum requirements for an industrial training and industrial infrastructure program. The department must use money appropriated to the program for grants and loans to local governments and businesses to create and/or retain jobs.

Grant requirements have not been consistent, changing frequently since the 1988 general appropriations act. From fiscal years 1989 to 1996, grants were limited to a maximum amount of $1,000,000. From 1997 to 1999, grants were limited to a period of one year and $750,000. In fiscal year 2000, the maximum grant was limited to $750,000; however, for extraordinary development projects of major employment and investment significance, additional funding could be provided with the approval of the State Funding Board. The term "project" was not defined in the appropriation acts. For 2001 grants, the general appropriations act was revised to change the $750,000 limit per grant to a limit of $750,000 per contract. Since this allows the department to give multiple grants to the same project, there is no real funding limit per project. The department's guidelines are more restrictive; they state that the combination of training, site preparation, and infrastructure costs for a project cannot exceed $750,000.

The department's December 2003 financial and compliance audit found that without obtaining State Funding Board approval, the department had circumvented the $750,000 limit for a $2,845,000 FIDP project by awarding four contracts to the Town of Smyrna for infrastructure improvements related to the expansion of the Nissan North America plant. We reviewed FIDP projects approved from fiscal year 2000 – 2004. We found that the department committed amounts over $750,000 per project to five projects using multiple contracts and did not seek approval from the State Funding Board. (See Table 3.) For two 2004 projects, the department did seek and receive approval from the State Funding Board.

**Table 3**
**Projects With Commitments Greater Than $750,000: Fiscal Years 2000 – 2004**

| *Location* | *Company Name* | *Commitment* | *Commitment Date* |
|---|---|---|---|
| Athens | Denso | $975,000 | 2001 |
| Gallatin | GAP | $781,577 | 1999, 2000 |
| Crossville | Graniti Fiandre | $1,100,937 | 2001, 2002 |
| Smyrna * | Nissan North America | $2,845,000 | 2000, 2001 |
| Oak Ridge | Theragenics | $1,250,000 | 2000, 2001 |

* *Discussed in the December 2003 financial and compliance audit.*

In addition, Boeing had a commitment of $1,089,705 in 2004 for two projects in Oak Ridge. One project involved a centrifuge ($630,070 committed) while another project involved commercial activities ($459,635 committed). Since the term "project" is not defined by statute, it is unclear whether the $750,000 limit was exceeded since both projects were in the same location.

### Recommendation

The General Assembly may wish to consider placing all statutes pertaining to the FastTrack Infrastructure Development Program in *Tennessee Code Annotated* instead of the yearly appropriations act so that program requirements remain consistent over time, and giving the responsibility to the State Funding Board for making recommendations to the General Assembly on increasing grant limits, as needed. The General Assembly may wish to consider mandating funding limits that apply to an entire project instead of to a contract, specifying State Funding Board approval for any exceptions. The term "project" should be defined in statute.

### Management's Comment

We concur in part. Consistent with the requirements of the annual appropriations act, the department has consistently obtained approval from the State Funding Board for the extraordinary economic development projects of major employment and investment significance receiving more than $750,000 in funding. The department has established protocols to ensure that State Funding Board approval is obtained for all such projects exceeding $750,000.

With regard to the audit's recommendation regarding placing the program's requirements within *Tennessee Code Annotated*, we will propose legislation to the General Assembly this session to ensure consistent application of the program guidelines.

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## 3. The department does not collect adequate data to determine the extent of effectiveness of the FastTrack Training Assistance Program

### Finding

It does not appear that companies receiving assistance through the FastTrack Job Training Assistance Program (formerly Industrial Training Service) are hiring as many people as promised, nor does there appear to be a connection between the amount of assistance given to a company and the number of jobs created or the wage levels of the jobs created. As a result, it is unclear whether the program is successful in encouraging new investment for facilities, equipment, and new job hires.

Eligibility and reimbursement rate guidelines are flexible and often overridden without explanation, and do not limit the amount of assistance awarded. Although grant budgets may be changed, there are no guidelines for how grant budgets can be changed, what items may be

subject to change, under what circumstances, or who needs to approve any changes. The department does not follow up to ensure that companies are hiring at least as many people as agreed upon, collect information regarding the wage levels of those who are hired, or evaluate the program to assess its impact and determine its effectiveness. Further, the department lacks adequate internal controls over its reimbursement process, resulting in payments not justified by the project's contract.

The General Assembly created the training program in 1972 to provide training services for new industries locating in Tennessee and for existing industries creating new jobs for Tennessee through capital expansion. The Department of Education administered the program until 1978, when it was transferred to the Department of Economic and Community Development.

The program is marketed to companies by the Existing Industries Section field personnel, the Marketing Section, corporate site locators, or the communities themselves. Department staff, called "consultants," work with companies to develop a grant budget that is agreed upon by both the department and the company. Department staff present the project to the Grant and Loan Committee, which consists of the Commissioner, the Deputy Commissioner, and all four of the Assistant Commissioners. Once the budget is approved by the committee, the department draws up a contract for the current fiscal year, which includes the grant budget and the total amount the department has committed to the project. Then representatives of the company and the department sign the contract.

Eighty-four FastTrack Job Training Assistance Program contracts were written by the Department of Economic and Community Development in fiscal year 2003, obligating over $3.5 million. Ten contracts (11.9% of the contracts for fiscal year 2003) were randomly chosen for review, accounting for $351,539 of the obligated funds. The department dispersed $216,180 (61.5%) of the money obligated by these contracts.

In our review, the committee approved all projects before the contract was signed. All contracts were written for amounts that were less than or equal to the total amount committed to the project by the committee. Contracts were signed, on average, two months after the committee approved them. However, the department regularly "backdates" the beginning date of the contract to enable companies to incur expenses before the contract has been signed. On average, contract periods preceded the actual contract dates by four months and preceded loan committee approvals by two months. (For example, a project approved in March by the loan committee with a contract signed in May would cover a contract period from January to June.) Backdating contracts to precede the loan committee approval raises the concern that contracts may intentionally be written to cover expenses already incurred.

In addition, the department reimbursed companies without adequate documentation. Auditors identified payments not justified by contract in six (60%) of the files reviewed totaling approximately $29,000. For example, the department paid $5,625 to American Yeast for training its staff in the areas of "Maintenance," "Packaging," "Process Operation," and "Quality" even though the same staff had already had received such training reimbursed through its contract with the department.

Hiring by FastTrack Grant Recipients

Because management does not compile information on the number of people hired versus the number promised in the contract, we reviewed 10 projects to determine if the companies hired as many people as promised. Only three of the ten companies reviewed hired at least as many employees as promised in the contract between the department and the company. For the remaining 70% of the contracts reviewed, the companies did not hire as many employees as promised.

**Table 4**
**Hires Promised Versus Reported Hires**
**10 Projects Reviewed**

| | Hires Promised | Reported Hires |
|---|---|---|
| Total Hires | 835 | 407 |
| Highest for a single company | 165 | 191 |
| Lowest for a single company | 25 | 5 |
| Average for the projects reviewed | 84 | 45 |

While there was a wide variety in the amount spent per hire, there did not appear to be a connection between the amount of assistance given to a company and the number of jobs created or the wage level of the jobs created. On average, the department spent $664 per hire, with a high of $2,016 and a low of $210. Based on our review, assistance received through the training assistance program did not appear to increase for companies creating more jobs or creating higher paying jobs. In addition, nine (90%) of the contracts reviewed were with companies that had average company wages that were lower than the local county average. On average, for all contracts reviewed, the average county wage was $13.60, while the average company wage was $11.58 (a difference of $2.02).

The department does not penalize companies for not hiring the number of employees as promised or compile information on the wages of those hired. The department relies on data self-reported by companies. Department management told auditors during the file review that the department "trusts" the companies to reliably and accurately report this information. It is one thing to "trust" the companies, but in this case, it really did not matter what the companies reported. This data had no impact on the department's administration of the contracts.

Program Guidelines

Program guidelines regarding program eligibility and reimbursement rates are flexible and often overridden. The department has no guidelines with regard to the total amount of assistance awarded. Department personnel stated that the factors considered include the level of capital investment the company states it is going to make, the number of new hires, and the location in which the company is interested. Priority is placed on special-enhancement counties and rural counties. Special-enhancement counties are those counties which are among the worst ten in three-year employment, per capita income, or poverty rates. However, it is unclear to what

extent these factors are considered, what impact these factors have on funding decisions, or whether funding is tied to these factors.

For a brief period, the department had guidelines, approved in July 1996, which based the level of training assistance on the number of new employees and the average starting wage. Eligible training activities included pre-employment training, job-specific training, and workforce development. However, department management reported that the guidelines were used for, at most, 90 days and then retired because companies were not receiving as much money as they wanted.

Expenses approved in the grant budgets per worker hired varied widely from contract to contract. While some of the variance in training costs per worker hired can undoubtedly be explained by the individualized nature of the training needed by companies, there does not appear to be a uniform set of criteria used to determine the actual need for or appropriateness of training and travel. There was no documentation or explanation of how grant budgets were set, what was included in them, and the levels of funding for various items. Travel expenses were not well justified, with no obvious benefit, other than to the company, or explanation given. The formula used to determine training (number of groups x number of hours x $15/hour) is confusing and is used inconsistently. Contracts contained no explanation as to the definition of what constitutes a group—whether it was a class or a certain number of trainees—and appeared subject to arbitrary interpretation.

Grant budgets can be, and were, changed on a regular basis by the consultants. Amounts originally allocated may be redistributed, per the consultant's approval, from other areas of the budget to fund shortfalls or to cover expenses that were not specified in the original grant budget. While flexibility is important, there are no guidelines as to how grant budgets can be changed, what items may be subject to change, under what circumstances, or who needs to approve any changes.

A 1997 report issued by the Comptroller of the Treasury's Office of Research, *The Tennessee Industrial Infrastructure Program and the Industrial Training Service*, also indicated that the department had problems linking training expenditures to improvements in economic development. The report concluded that the department lacked an overall strategic plan for statewide economic development in awarding training contracts, instead responding to companies in a piecemeal manner.

In addition, the report found that the department did not have sufficient methods of accountability and evaluation to ascertain the impact of its training efforts. Although the department did maintain records on the number of jobs created, it relied on self-reported numbers provided by the grant recipients. In addition, grant recipient companies completed surveys about grants. Although the department recorded this information, it did not analyze it and used the information only anecdotally in subsequent grant decisions. The number of jobs created was not verified by any state agency, although the Department of Employment Security possessed the capability to provide such verification. The Department of Economic and Community Development had not established any measures making companies accountable to the state if they did not meet their promised goals.

## Recommendation

The Department of Economic and Community Development should take steps to ensure that companies are hiring at least as many people as agreed to in grant budgets, including verifying employment figures with the Department of Labor and Workforce Development. The department should implement effective internal controls to prevent companies from intentionally misrepresenting the number of hires they make. The department should consider adding contract provisions that require repayment of part of the grant if the company does not meet hiring goals without sufficient justification. The department should establish guidelines regarding the amount of training assistance available to a company based on objective criteria, such as the number of new employees and the average starting wage. The department should consider structuring the guidelines in such a way that the amount of assistance available increases as the number of jobs created increases and/or the wage levels of the jobs created increase. Included in the guidelines should be criteria to help determine the actual need for and appropriateness of training and travel to be included in the grant budget. Further, the department should clearly establish and specify the process by which grant budgets can be modified, what items or areas may be subject to modification, under what circumstances, and who needs to approve any changes.

The department should ensure that internal controls over the reimbursement process are adequate to ensure that companies are reimbursed appropriately. The department should periodically evaluate the program to assess its impact and determine its effectiveness in encouraging capital investment and new hires.

## Management's Comment

We concur in part. Prior to the current administration, the FastTrack Job Training Assistance Program made little use of performance measures or guidelines, and there was little emphasis placed on ensuring program effectiveness or accountability. In an effort to validate the program's effectiveness and ensure accountability, the department has been working on the establishment and implementation of program guidelines which will address the following: program eligibility, criteria considered when determining assistance amounts, appropriate training and travel, the process by which training budgets may be set and modified, reimbursement, and collection of job creation numbers. In addition, the department has been examining methods by which to generate the necessary reports, which will allow the program's success to tracked and validated. However, while the department has not, in the past, collected sufficient data to validate the extent of the program's effectiveness, the FastTrack Job Training Assistance Program has been and will continue to be an integral, successful, and effective part of the department's incentive package for recruiting new and expanding industries, encouraging new investment, and creating jobs.

## 4. The department did not gather all necessary information to properly implement and monitor the FastTrack Infrastructure Development Program

### Finding

The Tennessee Infrastructure Improvement Program, renamed the FastTrack Infrastructure Development Program (FIDP) in December 2003, was created by the General Assembly in the 1988 general appropriations bill, to provide grants and loans to local government and businesses for industrial training and industrial infrastructure for the purpose of job creation and/or retention. Industrial infrastructure funds may be used for infrastructure improvement activities normally provided by local governments and their implementing agencies (for example, regional economic development agencies) to businesses which are locating, expanding, or operating in Tennessee. Funds are limited to situations where there is a commitment by a private-sector business to locate or expand in the state and create or retain jobs for Tennesseans. The program can fund the following improvements.

- Water systems: source development, intake structures, treatment plants, storage tanks, transmission lines, and other improvements normally associated with the provision of public water service.

- Wastewater systems: collector lines, treatment plants, and other improvements normally associated with the provision of public wastewater service.

- Transportation systems: access roads, rail sidings, port facilities, airport improvements, and other improvements normally associated with the provision of public transportation service.

- Site improvements: limited to extraordinary situations where physical conditions of the site must be altered before construction can occur, normally not involving improvements to land owned or to be purchased by the company.

- Other physical infrastructure improvements: limited to improvements that are required for the location or expansion of private business, however, not allowed on land owned or to be purchased by the company.

The maximum grant for any project in a community is $750,000. This includes training, site preparation, and all infrastructure improvements. (See Finding 2 for a discussion of grant limits.)

The department had not, at the time of fieldwork, collected program-outcome information, such as the number of new hires, from either the companies or communities receiving FastTrack Infrastructure Development Program funds; thus, it is unclear whether the program has been successful in encouraging job creation and retention or encouraging businesses to locate or expand in the state. The department did not have policies in place to ensure that employment commitments made by companies receiving FIDP assistance were met. The department did not always obtain required application information. In addition, the department

has not documented why it has approved Proceed at Own Risk letters for some projects (see page 21 for a description of Proceed at Own Risk letters).

Employment and Investment Information

The department markets the FIDP program through the Commissioner's Office, the Program Management Section, its regional offices, its website, local economic development organizations, area development districts, industrial development boards, legislators, and engineering firms. Once the application is received, it is examined for completeness, and, if requested, a Proceed at Own Risk letter is issued to the local government cooperating with the business. The project is then presented to the Loan and Grant Committee, where it is either approved or disapproved.

If the committee approves the project, a contract is completed and applicant signatures are obtained. Any construction change orders associated with the project must be reviewed and approved by the department. The department makes payments based on invoices the grantee submits in accordance with the line-item budget in the contract.

The department committed $19,258,440.57 to the FIDP program in fiscal year 2003. We reviewed eight project files accounting for 11.3% of the total FIDP commitment ($2,176,509.04) that fiscal year. We were unable to determine the number of jobs created by the projects reviewed. Further, the department does not have any policies requiring staff to ensure contract commitments are met, including monitoring to see that companies have provided required hiring figures and verifying those figures. Lack of complete employment information and related policies hinders the department from ensuring these commitments are met.

Application Approval Process and Reimbursements

We reviewed the eight project files to ascertain whether the application process was uniform and consistent, project files met application requirements, and appropriate documentation was submitted for all reimbursements. The department did not consistently obtain all application information or document why that information was not obtained. (See Table 5.) While appropriate documentation (e.g., receipts) was submitted for all reimbursements, we noted that budgets may be amended at any time as long as they do not exceed the grant amount. Authority for approving changes to budgets resides in a single staff member, an account manager. Without additional approvals over the budget amendment process, there is a risk that the grants funds could be used for purposes not intended by the Loan and Grant Committee.

**Table 5**
**Project Files Meeting Application Requirements**

| Application Requirements | Files Meeting Requirement | Files Not Meeting Requirement |
|---|---|---|
| Submit detailed explanation of the plan for administration | 3 | 5 |
| Resolution by municipal or county legislative body | 7 | 1 |
| Letter of intent including necessary information: projected start-up date, investment, type and number of jobs to be created, average hourly wage, and commitment to provide a specific number of jobs within 3 years | 6 | 2 |
| Business plan | 6 | 2 |
| Business history and future plans | 6 | 2 |
| Key personnel of business | 5 | 3 |
| Appropriate financing details | 3 | 5 |
| Marketing plan | 7 | 1 |

Proceed at Own Risk Letters

The department had issued Proceed at Own Risk letters for four of the projects we reviewed. According to the department, the letters are useful in helping local governments attract and retain industry. The purpose of these letters is to give the grantee permission to incur expenses up to the commitment amount for potential reimbursement by the department prior to the formal grant award. However, of the four projects that were issued Proceed at Own Risk letters, two were issued letters prior to the department receiving their applications. While one project's letter was issued less than one month before the application was received, the other project's letter was issued more than 11 months before the application was received. It was unclear on what basis the commitments for these two projects were made or whether the letters had the approval of the Loan and Grant Committee. The department does not have written procedures detailing the purpose of the letters, who should approve them, when they should be issued or the conditions under which they may be issued.

While the department does not consider a Proceed at Own Risk letter an obligation to the grantee or a legally binding document, the department does use the date of the notice as a start date after which expenses can be reimbursed, ignoring the start date of the contract period noted in the contract. Not only is the appropriateness of approving expenses incurred prior to the contract terms questionable, but such a letter does not indicate either approval of the project or what conditions the prospective grantee must meet to qualify for reimbursements (e.g., specific allowable expenses).

## Recommendation

The department should collect (and verify) on a frequent basis employment information from both the communities and companies receiving FIDP assistance to help the department ascertain the program's effectiveness and ensure that companies meet their employment commitments. The department should apply project approval process guidelines uniformly and consistently, ensuring that applicants supply all necessary information. The department should develop procedures specifying how and when grant budgets can be amended and what approvals are required.

The department should review its use of Proceed at Own Risk letters, including potentially revising its project-approval process to allow for speedier grant awards. The department should develop clear, written policies and procedures relative to these letters. The policies should require that such letters clearly define the conditions which must be met for a grantee to qualify for reimbursements and that such letters are not construed as project approval. The department should also examine its practice of approving expenses incurred prior to the beginning of the contract.

## Management's Comment

We concur in part. Due to turnover in the Program Management Division, employment data was not collected in fiscal year 2003, as noted in the audit. However, employment data has been and is collected, with the exception of 2003, on an annual basis by the department, with analysis performed to determine whether companies are meeting their job creation targets. This analysis clearly shows that the FastTrack Infrastructure Development Program has been not only successful but is also a critical part of the department's incentive package for recruiting new and expanding industry, encouraging new investment, and creating jobs.

A standard checklist is used for the FIDP application process, although the companies and communities who apply to the program may vary widely from a small business to a multi-national corporation. If elements of an application are missing, these elements will be requested from the community and the company. Some of the elements listed on the application checklist may be flexible. For example, the department does not normally request a marketing plan from a major corporation or a detailed administration plan from a development district that has been involved with the FIDP program since its inception.

Proceed at Own Risk letters are provided to communities that request them. Since 2003, communities have been required to submit an official request for the letter which specifically outlines what the letter covers. The use of these letters has been invaluable for communities, although the use of such will continue to be evaluated.

Revisions to the grant budget which involve the reallocation of money from one line item to another are handled by the Accounting Manager. Any change orders, which could potentially affect the scope of the project, must be reviewed and approved by the Accounting Manager and the Loan Program Manager and/or the Director of Program Management.

## 5. The department had not enforced local government compliance with the requirement for joint economic and community development boards in order to receive state grants

### Finding

Although joint economic and community development boards have been a requirement for all state grants since 1998, the department had not enforced compliance with this requirement when awarding Tennessee Industrial Infrastructure Program (TIIP) grants at the time of fieldwork. This state-funded program was renamed the FastTrack Infrastructure Development Program in December 2003.

Section 6-58-114, *Tennessee Code Annotated*, requires the establishment in each county of a joint economic and community development board, the purpose of which is "to foster communication relative to economic and community development between and among governmental entities, industry, and private citizens." Cities and counties, when applying for state grants, are required to certify their compliance with Section 6-58-114.

The department had not documented compliance with the joint economic and community development board requirement in any of the ten fiscal year 2003 TIIP projects we reviewed. Although it was the policy of the department up to September 1, 2003, to accept a letter from the municipal or county mayor of the local government applying for grants certifying compliance, there were no such letters in the files of any of the projects reviewed. In August 2003, the department sent a letter to all local governments, stating that the department would not approve grants without proof of compliance with the requirements of Section 6-58-114, *Tennessee Code Annotated*, beginning September 1, 2003. The law establishes requirements for board composition, frequency of meetings of the board and its executive committee, and keeping of minutes.

### Recommendation

The department should not approve any state grants to local governments that have not adequately documented compliance with Section 6-58-114, *Tennessee Code Annotated*, including the establishment of joint economic and community development boards with appropriate membership, which meet at least the minimum required times per year. The department should require more than a letter as proof that these boards have been established (e.g., information including the names and phone numbers of board members and other contacts, their home and business addresses, and the phone numbers and locations of the boards' offices).

### Management's Comment

We concur. The department does not award state grants to communities that do not comply with the joint economic and community development board requirement. As of July 1, 2004, no state grant or loan application is considered complete, and will not be processed further,

without documentation of, at least, four board meetings and eight executive committee meetings within the past twelve months.

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## 6. The Business Enterprise Resource Office had not developed a system to measure its performance

### Finding

The Business Enterprise Resource Office's (BERO) mission is to expand economic opportunities for small, rural, and minority- and women-owned businesses by providing technical, financial, and management assistance. BERO was formerly the Office of Business Enterprise, which was established in 1977. BERO provides information to these businesses on procurement opportunities, loan programs, and management programs with Tennessee private industry and federal government entities to help them succeed and grow in the state. BERO also assists the Governor's Office of Diversity Business Enterprise, which is administratively attached to the Department of General Services, in its mission to expand opportunities for these businesses to compete successfully for the state's expenditures for goods and services. The Office of Diversity Business Enterprise was created by Executive Order in December 2003.

BERO has identified several goals and objectives to further the economic development and growth of these businesses in its *Work Plan*, issued in May 2004. Goals include

- developing staff roles and responsibilities, including increasing BERO staff from one to five people;

- advising and assisting the Office of Diversity Business Enterprise in selecting and training staff as the General Services Commissioner deems appropriate to identify new growth opportunities for small, rural, and women- and minority-owned businesses, if needed;

- continuing the position of the Director of the Office of Minority Business Enterprise and training incoming Small Business Consultants in the areas of minority businesses enterprise issues, needs, and other business-related matters affecting the goals of minority business owners;

- establishing a Tennessee Supplier Development Program to identify new growth opportunities for small, rural, and women- and minority-owned businesses, including creating procurement partnerships beneficial to these businesses and corporations and state agencies; and

- establishing an Advisory Council for Small and Minority Businesses with members from the small, rural, and minority- and women-owned business community and from government agencies and large corporations with significant procurement requirements.

Objectives include

- providing technical, financial, and management assistance to small, rural, and minority- and women-owned businesses referred to BERO by the Governor's Office of Diversity Business Enterprise and to those who call BERO directly and who do not seek procurement opportunities with the state system;

- serving as an information resource for small, rural, and minority- and women-owned businesses, with regard to private industry and government entity procurement and business opportunities.

- assisting the Office of Diversity Business Enterprise in coordinating and developing training and awareness sessions for small, rural, and minority- and women-owned businesses;

- creating partnerships between private industry, government entities, and small, rural, and minority- and women-owned businesses that will prove mutually beneficial;

- in cooperation with the Office of Diversity Business Enterprise, providing technical assistance to state agencies and guiding them toward full implementation of policies to include small, rural, and minority- and women-owned businesses in the state's competitive bid process;

- disseminating bid information to small, rural, and minority- and women-owned businesses, making them aware of opportunities available with private industry and government entities;

- assisting small, rural, and minority- and women-owned businesses in finding the private industry or government entity most likely to purchase their goods and/or services; and

- working in cooperation with the Office of Diversity Business Enterprise to foster a positive environment in which small, rural, and minority- and women-owned businesses can network and nurture relationships and partnerships with private industry and government entities.

However, at the time of audit fieldwork, BERO was unable to measure its performance in achieving these goals and objectives as it had not developed performance measures and a related tracking system. As a result, we were unable to determine whether BERO has been successful in the expansion of economic opportunities for small, rural, and minority- and women-owned businesses. Department management stated that understaffing and lack of cooperation with other state agencies are major obstacles in BERO being able to carry out its role of helping disadvantaged businesses. Consequently, these businesses have had problems dealing with government "red tape" and locating contracting opportunities.

## Recommendation

In light of the major obstacles to success noted by the Business Enterprise Office, it is critical that measures are implemented immediately to evaluate the program's success. The office should develop relevant performance measures to enable it to determine its progress in achieving its goals and objectives, and its overall mission. The office should gather and analyze outcome data related to these measures at least annually to determine progress. The department should ensure that the office has adequate resources to carry out its mission, including partnering with other state agencies to help disadvantaged businesses.

## Management's Comment

We concur in part. At the time of audit, BERO, formerly the Office of Minority Business Enterprise, was being redeveloped to offer enhanced services to assist in the promotion of small, minority, and women-owned businesses. Project New Day, effective July 1, 2004, launched the new and redeveloped BERO Office. BERO, with a current staff of six, has in place both the resources and staff to meet its goals and objectives. As of August 2004, BERO had established performance measures as well as a tracking system. The tracking system, BERO Exit, allows BERO to track the assistance it provides. Additional interactions are planned to allow BERO to track demographic and geographic data in addition to the activity data already being collected.

## RECOMMENDATIONS

### LEGISLATIVE

This performance audit identified the following area in which the General Assembly may wish to consider statutory changes to improve the efficiency and effectiveness of the Department of Economic and Community Development.

1. The General Assembly may wish to consider placing all statutes pertaining to the FastTrack Infrastructure Development Program in *Tennessee Code Annotated* instead of the yearly appropriations act so that program requirements remain consistent over time, and giving the responsibility to the State Funding Board for making recommendations to the General Assembly on increasing grant limits, as needed. The General Assembly may wish to consider mandating funding limits that apply to an entire project instead of to a contract, specifying State Funding Board approval for any exceptions. The term "project" should be defined in statute.

### ADMINISTRATIVE

The following areas should be addressed to improve the efficiency and effectiveness of the Department of Economic and Community Development's operations.

1. The department should include in a statewide economic development plan performance measures relating to desirable outcomes, and deadlines for achieving these outcomes. The performance measures should address, at the least, existing industry expansion, business recruitment, workforce development (including education and training needs), and infrastructure improvements. The department should include in its plan other state departments, economic development districts, local economic and community development organizations, local governments, representatives from the private sector, and other key stakeholders. The department's programs should help meet and promote the goals of the plan.

2. The department should routinely collect outcome data on multiple economic indicators relating to the effectiveness of its programs. The department should analyze this data to determine if and how these programs have improved economic conditions in specific regions, especially disadvantaged ones, and the state as a whole. Results from this analysis should be used as a tool to help the department focus on programs that appear to be effective, change or terminate those programs that do not appear to be effective, and determine whether the goals of the statewide economic development plan are being met.

3. The department should take steps to ensure that companies are hiring at least as many people as agreed to in grant budgets, including verifying employment figures with the

Department of Labor and Workforce Development. The department should implement effective internal controls to prevent companies from intentionally misrepresenting the number of hires they make. The department should consider adding contract provisions that require repayment of part of the grant if the company does not meet hiring goals without sufficient justification. The department should establish guidelines regarding the amount of training assistance available to a company based on objective criteria, such as the number of new employees and the average starting wage. The department should consider structuring the guidelines in such a way that the amount of assistance available increases as the number of jobs created increases and/or the wage levels of the jobs created increase. Included in the guidelines should be criteria to help determine the actual need for and appropriateness of training and travel to be included in the grant budget. Further, the department should clearly establish and specify the process by which grant budgets can be modified, what items or areas may be subject to modification, under what circumstances, and who needs to approve any changes.

4. The department should ensure that internal controls over the reimbursement process are adequate to ensure that companies are reimbursed appropriately. The department should periodically evaluate the program to assess its impact and determine its effectiveness in encouraging capital investment and new hires.

5. The department should collect (and verify) on a frequent basis employment information from both the communities and companies receiving FastTrack Infrastructure Development Program assistance to help the department ascertain the program's effectiveness and ensure that companies meet their employment commitments. The department should apply project approval process guidelines uniformly and consistently, ensuring that applicants supply all necessary information. The department should develop procedures specifying how and when grant budgets can be amended and what approvals are required.

6. The department should review its use of Proceed at Own Risk letters, including potentially revising its project-approval process to allow for speedier grant awards. The department should develop clear, written policies and procedures relative to these letters. The policies should require that such letters clearly define the conditions which must be met for a grantee to qualify for reimbursements and that such letters are not construed as project approval. The department should also examine its practice of approving expenses incurred prior to the beginning of the contract.

7. The department should not approve any state grants to local governments that have not adequately documented compliance with Section 6-58-114, *Tennessee Code Annotated*, including the establishment of joint economic and community development boards with appropriate membership, which meet at least the minimum required times per year. The department should require more than a letter as proof that these boards have been established (e.g., information including the names and phone numbers of board members and other contacts, their home and business addresses, and the phone numbers and locations of the boards' offices).

8. The Business Enterprise Resource Office should develop relevant performance measures to enable it to determine its progress in achieving its goals and objectives, and its overall mission. The office should gather and analyze outcome data related to these measures at least annually to determine progress. The department should ensure that the office has adequate resources to carry out its mission, including partnering with other state agencies to help disadvantaged businesses.

## Appendix
## Title VI Information

Title VI of the Civil Rights Act of 1964 requires that "No person in the United States shall, on the grounds of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subject to discrimination under any program or activity receiving federal financial assistance." In response to a request from members of the Government Operations Committee, we compiled information concerning federal financial assistance received by the Tennessee Department of Economic and Community Development and the department's efforts to comply with Title VI requirements. The results of the information gathered are summarized below.

According to *The Budget: Fiscal Year 2003-04*, the Department of Economic and Community Development was the recipient of $38,230,400 in federal assistance during fiscal year 2002. The vast majority of this assistance went to grants to local governments in the form of Community Development Block Grants (CDBGs). Listed below are the department's major programs that must meet Title VI requirements.

**Programs Subject to Title VI Compliance**

| Program/Activity | Funding Source | Amount | Minority Applicant/ Beneficiaries | Non-Minority Applicant/ Beneficiaries | Total Beneficiaries |
|---|---|---|---|---|---|
| CDBG: | U. S. Department of Housing and Urban Development (HUD) | FY 2001: $31,505,000 | 15,293 | 186,208 | 201,501 |
| Emergency Services (Equipment) Health (Clinics, Departments ) Housing (Acquisition/ Relocation, Clearance, Rehabilitation ) Sewer/Water System (Line Extension, Storage, Treatment) | | FY 2002: $31,570,000 | 27,578 | 135,852 | 163,430 |

| | | | | | |
|---|---|---|---|---|---|
| Clean Cities Program (Alternative Fuels)<br>Energy Star Program (program to increase consumer awareness of energy efficient products) | **U.S. Dept. of Energy** | FY 2003: $194,625 (Clean Cities only)<br>FY 2004: $145,669 (Both Clean Cities and Energy Star) | Energy Division uses 1998 population estimates from U.S. Census Bureau | Energy Division uses 1998 population estimates from U.S. Census Bureau | |
| Million Solar Roofs (promotes use of solar energy) | **U.S. Dept. of Energy** | FY 2003: $50,000<br>FY 2004: $130,000 | Energy Division uses 1998 population estimates from U.S. Census Bureau | Energy Division uses 1998 population estimates from U.S. Census Bureau | |
| Job Skills Training | State of Tennessee | FY 2003: $11,900,324<br>FY 2004: $2,097,001 | 2,099<br>1,095 | 6,808<br>3,307 | 8,907<br>4,402 |
| Industrial Training Services<br>(Fast Track Job Training Assistance Program) | State of Tennessee | FY 2003: $3,648,164<br>FY 2004: $12,644,172 | 2,929<br>2,769 | 6,783<br>8,703 | 9,712<br>11,472 |

Source: Department of Economic and Community Development.

According to the *Department of Economic and Community Development Title VI Compliance Plan 2004 – 2005*, issued in July 2004, the department's official policy is that all of its programs be administered to comply with Title VI. The plan further states that this policy has been and will continue to be communicated to the department's employees through Title VI training programs and policies, and through language contained in all contracts and grant agreements. The ultimate responsibility for ensuring that the department complies with requirements of Title VI rests with the Commissioner, who is accountable for the administration of the department's personnel and programs. However, the day-to-day responsibility rests with the assistant commissioners, program

directors, and the local governments, agencies, and organizations which receive assistance from the department.

The department has a Title VI coordinator. His major job responsibilities are as follows:

- coordinating all activities pertaining to Title VI of the Civil Rights Act of 1964 for the Department of Economic Community Development;
- providing training to all managers and professional staff covering the federal and state requirements of Title VI;
- conducting pre-award and post-award reviews of subrecipients to determine compliance with Title VI;
- collecting and analyzing racial and ethnic data provided by subrecipients;
- preparing and coordinating education and outreach programs to inform protected beneficiaries of their rights under Title VI; and
- preparing and coordinating the development of the department's Title VI implementation plan.

Although the coordinator does not have any additional staff members assigned to him, the department has formed a Title VI Review Committee to assist with some of the department's Title VI functions. The committee includes department staff of programs that administer federal and state funds.

Title VI Monitoring and Tracking

The Office of Program Management utilizes a system of frequent and random pre- and post-award Title VI reviews of its Housing and Urban Development (HUD) grantees. In fiscal year 2003, the department conducted 123 pre- and 65 post-award reviews, while in 2004 it conducted 139 pre- and 91 post-award reviews. The department found that all were in compliance with Title VI. We reviewed 16 pre-award and four post-award audit files and found that the department appears to have adequate measures in place to ensure its recipients comply with Title VI. The office also reviews Equal Employment Opportunity Commission-related records. In addition, the office prepares and submits to HUD a State Grant Performance/Evaluation Report, which denotes grant award amounts, activities, location, as well as a breakdown (by ethnicity) of its applicants/beneficiaries being served.

The Energy Division uses a Title VI Compliance Review Form for its Title VI monitoring and tracking for its recipients (e.g., Board of Regents universities and non-profit organizations). This division also tracks the number of minorities benefiting from

each program in counties with minority populations of at least five percent. The FastTrack Job Training Assistance Program uses a form that collects data to support Title VI compliance, which a company submits when it seeks partial or full reimbursement for the contracted training activities, as specified in its training assistance contract with the department.

Complaint Process

According to the *Department of Economic and Community Development Title VI Compliance Plan 2004 – 2005*, a complaint alleging discrimination may be filed with the Title VI coordinator. All entities receiving assistance from the department are required to have information available for public review on the procedures for filing a complaint. The Title VI coordinator has the responsibility of receiving, logging, acknowledging, and investigating complaints and reporting the findings. The coordinator will notify the Commissioner and the appropriate program director when a complaint is received. After receiving a complaint or identifying potential discriminating activity, the department will take the steps described below.

- Within 30 calendar days of receiving the complaint, the Title VI coordinator will conduct a fact-finding investigation. The coordinator will meet with the complainant or the staff member who identified the alleged discriminatory activity to determine the nature of the complaint and whether Title VI requirements were violated. The coordinator will meet with the director in whose area the alleged violation occurred to get the director's perspective on the complaint. The coordinator will notify the members of the Title VI Review Committee.

- If the coordinator determines that discrimination has not occurred, the complainant, the Commissioner, and the program director will be informed. The complainant will then have a right to appeal the decision.

- If the investigation indicates that discrimination did in fact occur, it will be discussed with the program director. The Title VI coordinator will discuss ways to resolve the complaint and seek voluntary corrective action.

- The complainant, applicant, or program director may appeal any rulings made by the coordinator to the Title VI review committee within 10 calendar days of the receipt of the written findings. The request can include relevant documentation and sworn testimony, if any, from the appealing party together with any testimony by witnesses having first-hand knowledge of the Title VI violations. The testimony may be in the form of an affidavit and will describe in detail the circumstances and events which would lead a reasonable person to believe that a Title VI violation has occurred. The Title VI committee will have broad latitude to review an appealed case and make a finding. The committee may discuss the complaint with the complainant, the alleged offender, the Title VI coordinator, or other parties to determine the facts. The

committee will make a finding on the appeal within 15 calendar days of receipt of the request for appeal.

- If the discriminatory activity cannot be resolved by the committee, a written report on the situation will be prepared and forwarded to the Tennessee Title VI Compliance Commission. If a complaint involves one of the department's federally funded programs, the federal agency sponsoring the program will also be notified. Information will also be provided to the parties involved on the procedures for appealing to the federal level.

- If either the Tennessee Title VI Compliance Commission or the federal agency determines that discrimination has in fact occurred, the offending party will be denied further services or benefits of the department's programs until the discriminatory activities have been terminated.

According to department management and the Title VI coordinator, as of May 2004, the department has not had any Title VI related complaints filed during the past two years. The coordinator stated that, after department review, any Title VI complaints are forwarded to the Tennessee Title VI Compliance Commission, which was established under Executive Order No. 34, issued in August 2002. The commission's director stated that, as of July 2004, there had been no Title VI complaints against the department filed with his agency in the last two years.

**Staff of the Department of Economic and Community Development**
**By Title, Gender, and Ethnicity**
**As of December 2004**

| | ***Gender*** | | | ***Ethnicity*** | | | | |
|---|---|---|---|---|---|---|---|---|
| ***Title*** | ***Male*** | ***Female*** | | ***Black*** | ***White*** | ***Asian*** | ***Hispanic*** | ***Other*** |
| Accounting Manager | 0 | 1 | | 0 | 1 | 0 | 0 | 0 |
| Accounting Technician | 0 | 2 | | 0 | 2 | 0 | 0 | 0 |
| Accountant 2 and 3 | 1 | 2 | | 1 | 2 | 0 | 0 | 0 |
| Assistant Commissioner 2 | 3 | 1 | | 1 | 3 | 0 | 0 | 0 |
| Administrative Assistant 1, 2, and 3 | 2 | 7 | | 2 | 7 | 0 | 0 | 0 |
| Administrative Service Assistant 2, 3 and 4 | 1 | 10 | | 2 | 9 | 0 | 0 | 0 |
| Administrative Secretary | 0 | 7 | | 1 | 6 | 0 | 0 | 0 |
| Affirmative Action Officer 1 | 1 | 0 | | 1 | 0 | 0 | 0 | 0 |
| Auditor 3 | 1 | 1 | | 0 | 2 | 0 | 0 | 0 |
| Business Development Consultant 2, 3, and 4 | 7 | 6 | | 1 | 12 | 0 | 0 | 0 |
| Business Enterprise Resource Director | 0 | 1 | | 0 | 1 | 0 | 0 | 0 |
| Business Enterprise Resource Consultant | 1 | 1 | | 2 | 0 | 0 | 0 | 0 |
| Cartographer 2 | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| Community Development Consultant 2 and 3 | 2 | 4 | | 0 | 6 | 0 | 0 | 0 |
| Community Development Director | 0 | 1 | | 0 | 1 | 0 | 0 | 0 |
| Community Planning Director | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| Community Planning Regional Director | 7 | 0 | | 0 | 7 | 0 | 0 | 0 |
| Community Principal Planner | 31 | 11 | | 5 | 36 | 0 | 1 | 0 |
| Commissioner 4 | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| Creative Services Coordinator | 0 | 1 | | 1 | 0 | 0 | 0 | 0 |
| Creative Services Director | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| Deputy Commissioner 2 | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| ECD Communications Office | 0 | 1 | | 1 | 0 | 0 | 0 | 0 |

| | ***Gender*** | | | ***Ethnicity*** | | | | |
|---|---|---|---|---|---|---|---|---|
| ***Title*** | ***Male*** | ***Female*** | | ***Black*** | ***White*** | ***Asian*** | ***Hispanic*** | ***Other*** |
| Economic Research Analyst | 1 | 1 | | 0 | 1 | 1 | 0 | 0 |
| Economic Research Director | 0 | 1 | | 0 | 1 | 0 | 0 | 0 |
| Executive Administrative Assistant 2 and 3 | 4 | 1 | | 0 | 5 | 0 | 0 | 0 |
| Executive Director-Tenn. Film Entertainment Comm. | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| Existing Industry Consultant 2 and 3 | 3 | 2 | | 0 | 5 | 0 | 0 | 0 |
| Fiscal Director 1 and 2 | 1 | 1 | | 0 | 2 | 0 | 0 | 0 |
| General Counsel 1 | 0 | 1 | | 1 | 0 | 0 | 0 | 0 |
| Geologist 4 | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| Geographic Information Systems Technician 2 | 5 | 1 | | 2 | 4 | 0 | 0 | 0 |
| Geographic Information Systems Technician Supervisor 1 | 2 | 1 | | 0 | 3 | 0 | 0 | 0 |
| Grants Analyst 2 and 3 | 2 | 4 | | 1 | 5 | 0 | 0 | 0 |
| Grants Director | 1 | 1 | | 0 | 2 | 0 | 0 | 0 |
| Grants Program Manager | 3 | 2 | | 1 | 4 | 0 | 0 | 0 |
| Industrial Training Consultant 3 and 4 | 2 | 1 | | 0 | 3 | 0 | 0 | 0 |
| Industrial Training Director | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| Industrial Training Manager | 0 | 1 | | 0 | 1 | 0 | 0 | 0 |
| Information Resource Specialist 3 and 4 | 3 | 2 | | 0 | 5 | 0 | 0 | 0 |
| Information Representative | 0 | 2 | | 1 | 1 | 0 | 0 | 0 |
| Information Systems Director 2 | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| International Investment Director | 2 | 0 | | 0 | 2 | 0 | 0 | 0 |
| International Marketing Director | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| Job Development Regional Director | 1 | 1 | | 0 | 2 | 0 | 0 | 0 |
| Librarian 2 | 0 | 1 | | 0 | 1 | 0 | 0 | 0 |
| Loan Officer 2 | 2 | 1 | | 1 | 2 | 0 | 0 | 0 |
| Loan Program Manager | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |

| | ***Gender*** | | | ***Ethnicity*** | | | | |
|---|---|---|---|---|---|---|---|---|
| ***Title*** | ***Male*** | ***Female*** | | ***Black*** | ***White*** | ***Asian*** | ***Hispanic*** | ***Other*** |
| Location Coordinator 2 | 2 | 0 | | 0 | 2 | 0 | 0 | 0 |
| Manufacturing Extension Program Director | 1 | 1 | | 1 | 0 | 0 | 1 | 0 |
| Music Media Coordinator | 0 | 2 | | 0 | 2 | 0 | 0 | 0 |
| Personnel Director 1 | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| Secretary | 0 | 3 | | 0 | 3 | 0 | 0 | 0 |
| Small Business Enterprise Director | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| Statistical Analyst 3 | 0 | 1 | | 0 | 1 | 0 | 0 | 0 |
| Statistical Research Specialist | 1 | 0 | | 0 | 0 | 0 | 1 | 0 |
| Web Developer 2 | 1 | 0 | | 0 | 1 | 0 | 0 | 0 |
| **Total** | 107 | 89 | | 26 | 166 | 1 | 3 | 0 |