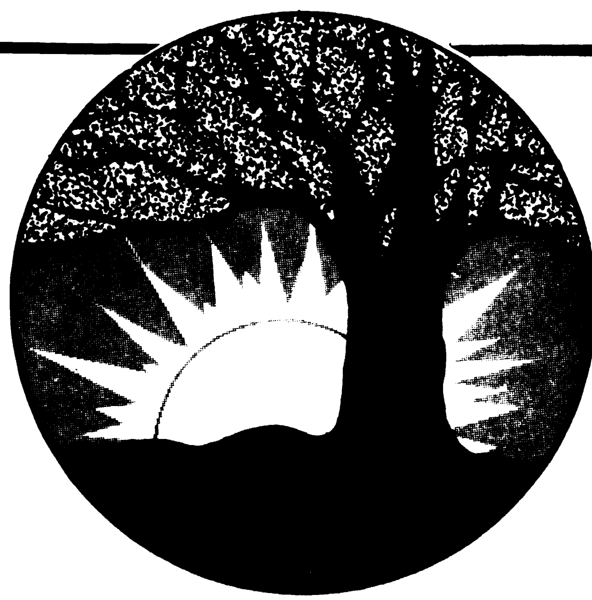
PERFORMANCE AUDIT

Department of Economic and Community Development
October 2012



Justin P. Wilson
Comptroller of the Treasury

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October 9, 2012

The Honorable Ron Ramsey
Speaker of the Senate
The Honorable Beth Harwell
Speaker of the House of Representatives
The Honorable Mike Bell, Chair
Senate Committee on Government Operations
The Honorable Jim Cobb, Chair
House Committee on Government Operations
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Commissioner William Hagerty
11th Fl. William Snodgrass/TN Tower Bldg.
312 Rosa L. Parks Avenue
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a performance audit of selected programs and activities of the Department of Economic and Community Development for the period July 1, 2007, through June 30, 2012. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated*, the Tennessee Governmental Entity Review Law.

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

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

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the Department of Economic and Community Development should be continued, restructured, or terminated.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/mpc
12/060

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Performance Audit

Department of Economic and Community Development

October 2012

AUDIT SCOPE

We have audited the Department of Economic and Community Development for the period July 1, 2007, through June 30, 2012. Our audit scope included a review of prior audit findings, business processes, internal controls, and compliance with laws, regulations, and provisions of contracts or grant agreements for each of the following: the TNInvestco program, contracts, receivables collection and write-off procedures, the FastTrack program, work-force reduction, performance measures, Title VI, and conflict-of-interest forms. The audit was conducted in accordance with generally accepted government auditing standards.

AUDIT FINDINGS

Finding 1 The Department of Economic and Community Development failed to establish the proper organizational structure or develop adequate internal controls over the Tennessee Small Business Investment Company Credit Program, resulting in serious and pervasive noncompliance with program requirements and increasing the risk of fraud, waste, and abuse (page 7).

Finding 2 Management has not ensured contracts were approved prior to allowing contractors to begin services, increasing the risk that the state may be liable for unauthorized services (page 24).

Finding 3 Management of the Department of Economic and Community Development has allowed grant and loan recipients to violate state contracts and federal requirements by not ensuring contractors submitted the required financial statements (page 27).

Finding 4 Staff of the Department of Economic and Community Development did not always follow loan receivable collection policies and did not pursue collection of all amounts due to the State of Tennessee (page 30).

Finding 5 The Department of Economic and Community Development did not ensure board and committee members signed annual conflict-of-interest forms, and department management did not identify the risks associated with board and committee members in the department's risk assessment * (page 38).

OBSERVATIONS AND COMMENTS

The audit report also discusses the following issues (page 41):

Observation 1 Updating Section 4-14-109b, *Tennessee Code Annotated*, to reflect changes made to other code sections

Observation 2 Repealing Rule 0500-5-2, Enterprise Demonstration Project, created and funded by the General Assembly in 1998, which is no longer active

* This finding is repeated from the prior audit performed in 2009.

Performance Audit
Department of Economic and Community Development

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Performance Audit
Department of Economic and Community Development

INTRODUCTION

PURPOSE AND AUTHORITY FOR THE AUDIT

This performance audit of the Department of Economic and Community Development, scheduled to terminate June 30, 2013, was conducted pursuant to the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the agency and to report to the Joint Government Operations Committee of the General Assembly. This audit is intended to aid the committee in determining whether the Department of Economic and Community Development should be continued, restructured, or terminated.

This performance audit was also conducted at the request of current management. In January 2011 the current Commissioner assumed responsibilities for the Department of Economic and Community Development and started the process of evaluating how efficiently the department was meeting its mission based on the department's organizational and internal control structure. Within the first six months of his administration, the Commissioner identified weaknesses in both the organizational structure and internal controls and requested an audit of the department.

ORGANIZATION AND STATUTORY RESPONSIBILITIES

Section 4-3-701, *Tennessee Code Annotated*, created the Department of Economic and Community Development, which is statutorily responsible for coordinating development services to communities, businesses, and industries in the state. The department's stated philosophy is to invest in Tennessee's greatest resources—the state's communities and people—through assistance in community-based infrastructure and training investments. The department's top priorities are to

- prepare local communities for economic development opportunities;
- train Tennessee's workers;
- recruit new industries; and
- assist existing firms.

The department says its ultimate goal is for Tennessee to become number one in the Southeast for high-quality jobs. The department has four key strategies for obtaining this goal:

- prioritizing key groups of businesses and existing businesses;
- establishing regional “jobs base camps”;
- investing in innovation; and
- reducing business regulation.

The department is statutorily supervised by a Commissioner appointed by the Governor. A Chief of Staff and Assistant Commissioners oversee the department’s day-to-day activities and directly supervise its administrative function.

In addition to its Nashville headquarters, the department has jobs base camps in each of nine regions throughout the state. A key function of the nine jobs base camps is to reach out to rural counties to incorporate them into broader regional economic development strategies that leverage existing resources and maximize the assets of rural communities. There are also international outreach offices located in Toronto, Canada; Düsseldorf, Germany; Yokohama, Japan; and Beijing, China.

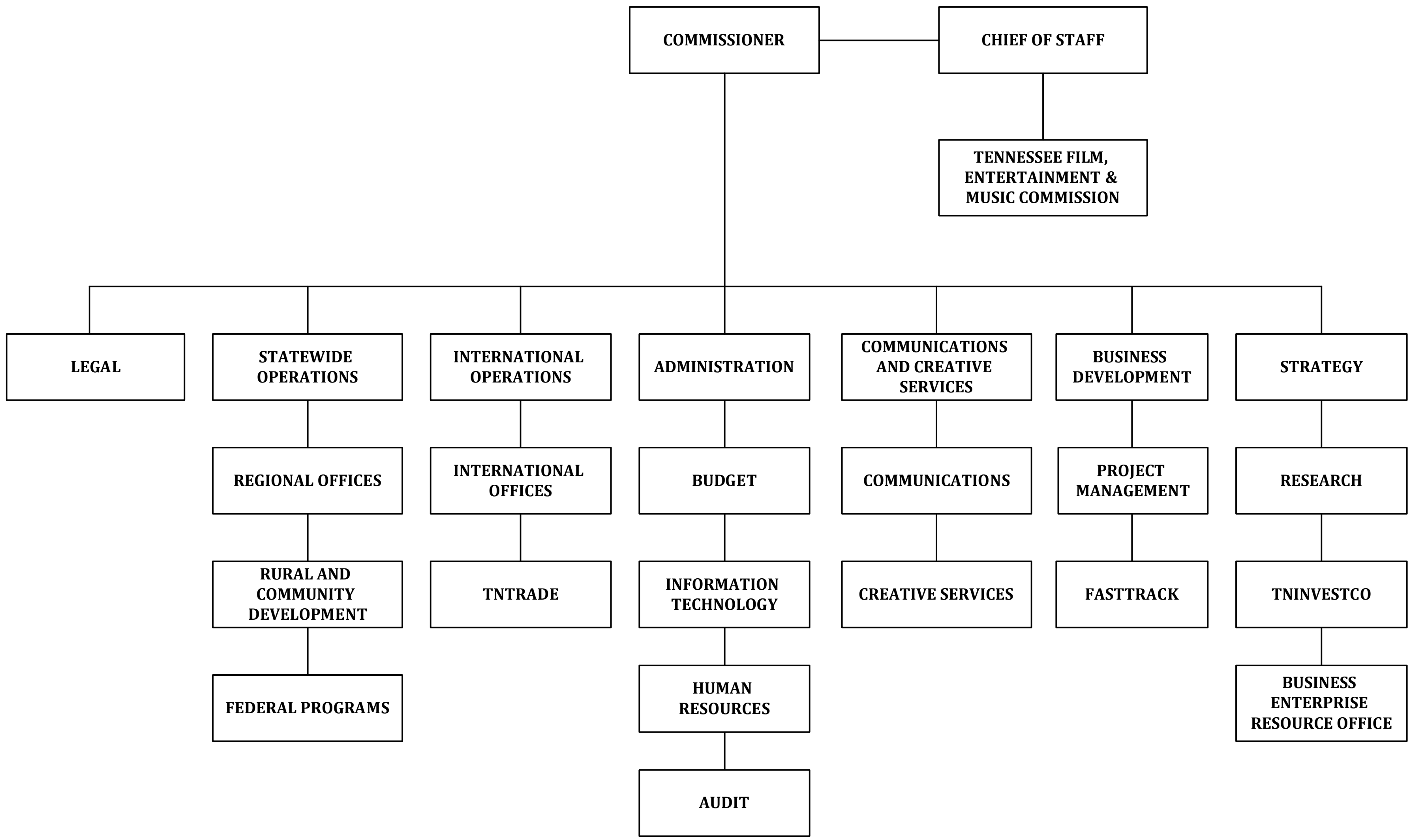
The department’s Administrative Services provides administrative and support services to the department and is responsible for the daily operations and procedures of the department. Its functions include policy development, legal services, public communications, graphic and media services, research, personnel, information technology, internal audit and consulting, fiscal services, and budgeting. The rest of the department is functionally organized in two primary components: Community Development and Business Development.

The Community Development group awards and manages state and federal grants to support existing and new businesses, and to make local areas attractive for business. Community Development staff are divided into two major groups: (1) traditional community development programs and (2) grants and loans. Traditional community development programs focus on improving communities’ “livability” and ability to attract and keep businesses. Grants and Loans Management, the department’s primary grant and loan management unit, awards, accounts for, and monitors multiple state and federal economic development grants and loans. Previously, these awards focused on community development. However, several other department grant and loan functions, including business development and energy efficiency, have moved into this unit to consolidate and ensure loan and grant management expertise.

The Business Development group helps to create new or maintain existing high-paying jobs by recruiting new industries and businesses to the state, working with existing industries to remain or expand in Tennessee, and developing international trade relationships.

An organization chart of the department is on the following page.

TENNESSEE DEPARTMENT OF ECONOMIC AND COMMUNITY DEVELOPMENT
ORGANIZATIONAL STRUCTURE
AUGUST 2012



AUDIT SCOPE

We audited the Department of Economic and Community Development for the period July 1, 2007, through June 30, 2012. Our audit scope included a review of prior audit findings, business processes, internal controls, and compliance with laws, regulations, and provisions of contracts or grant agreements for each of the following areas: the TNInvestco program, contracts, receivables collection and write-off procedures, the FastTrack program, work-force reduction, performance measures, Title VI compliance, and conflict-of-interest forms. The audit was conducted in accordance with generally accepted government auditing standards.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Economic and Community Development filed its report with the Department of Audit on September 11, 2009. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the Department of Economic and Community Development has corrected the previous audit findings concerning the grant and loan recipient monitoring process, improving performance measures, and updating the department's statutes, rules, and regulations.

REPEATED AUDIT FINDING

The prior audit report also contained a finding concerning department-administered boards and encouraging members to disclose conflict of interests. This finding has not been resolved and is repeated as Finding 5.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

BUSINESS PROCESSES AND INTERNAL CONTROLS

TNINVESTCO PROGRAM

In 2009, the General Assembly passed the Tennessee Small Business Investment Company Credit Act (the Act) codified as Section 4-28-101 to 4-28-114, *Tennessee Code Annotated*. This legislation was designed to increase the flow of capital to innovative new companies in Tennessee in the early stages of business development.

The objectives of our review of the TNInvestco program were to

- gain an understanding of the relevant sections of *Tennessee Code Annotated* and the related requirements;
- gain an understanding of controls over the TNInvestco program;
- determine that TNInvestcos only invested in qualified businesses as defined in Section 4-28-102, *Tennessee Code Annotated*;
- determine that TNInvestcos made qualified distributions in compliance with Section 4-28-102(12), *Tennessee Code Annotated*;
- determine that each TNInvestco's seed or early stage investments met the requirements of Section 4-28-102(15), *Tennessee Code Annotated*;
- determine that TNInvestcos continue to maintain the certification requirements as outlined in Section 4-28-106, *Tennessee Code Annotated*;
- determine that the TNInvestcos complied with Section 4-28-106(b), *Tennessee Code Annotated*, by submitting a Qualified Business Form, and that the manager of the Department of Economic and Community Development (ECD) approved the Form;
- determine that the TNInvestcos complied with Section 4-28-110, *Tennessee Code Annotated*, and submitted a designated capital report, remaining designated capital report, and a key person letter stating the contact person for the TNInvestco;
- determine that the TNInvestcos complied with Section 4-28-110(a)(5), *Tennessee Code Annotated*, and submitted audited financial statements and an agreed upon procedures report, or equivalent;
- determine if ECD received the annual certification fee from the TNInvestcos as required by Section 4-28-110(b), *Tennessee Code Annotated*;
- determine if ECD performed annual reviews of the TNInvestcos as required by Section 4-28-111, *Tennessee Code Annotated*;

- determine if ECD complied with Section 4-28-112, *Tennessee Code Annotated,* by submitting its TNInvestco annual report to the Governor;
- determine if the TNInvestcos complied with Section 4-28-113, *Tennessee Code Annotated,* by submitting an investment strategy “scorecard”;
- determine that ECD performed reconciliations between the Local Government Investment Pool (LGIP) master account and supporting revenue and expenditure documents; and
- obtain the department’s risk assessment and ensure that management identified appropriate risks and controls for the TNInvestco program.

We reviewed relevant sections of *Tennessee Code Annotated* to gain an understanding of all of the requirements included. We performed interviews of key personnel, performed walkthroughs of procedures, reviewed supporting documentation, and performed testwork to gain an understanding of internal controls and to determine ECD’s and the TNInvestcos’ compliance with the Act. We obtained and reviewed ECD management’s risk assessment.

Based on our interviews, reviews, and testwork, we

- gained an understanding of *Tennessee Code Annotated* and its requirements and the controls related to the TNInvestco program;
- determined the TNInvestcos invested in qualified businesses and made qualified distributions, and that the TNInvestcos’ investments in seed or early-stage companies met the requirements of the Act;
- determined the TNInvestcos maintained certification required by the Act and submitted the required Qualified Business Form and ECD approved the form; however, the department did not adequately document the process used, as discussed in the finding below;
- determined the TNInvestcos submitted required designated capital reports, remaining designated capital reports, and key person letters;
- determined that one of 10 of the TNInvestcos failed to submit audited financial statements as required, and nine failed to submit agreed upon procedures reports, or equivalent, as discussed further in the finding below;
- determined that ECD management and staff did not
    1. establish the proper organizational structure at the inception of the program or establish an adequate internal control structure,
    2. have adequate internal controls over collection of TNInvestcos’ annual certification fees,
    3. adequately perform annual reviews of the TNInvestcos,
    4. submit the required annual report to the Governor,

5. ensure that the TNInvestcos submitted fully completed investment strategy "scorecards,"
6. perform reconciliations between the LGIP master account and supporting documentation, and
7. identify all risks and controls in its risk assessment, all of which is discussed further in the finding below.

Finding

1. **The Department of Economic and Community Development failed to establish the proper organizational structure or develop adequate internal controls over the Tennessee Small Business Investment Company Credit Program, resulting in serious and pervasive noncompliance with program requirements and increasing the risk of fraud, waste, and abuse**

Background

On July 9, 2009, the Governor signed into law the Tennessee Small Business Investment Company (TNInvestco) Credit Act (the Act), which was codified as Section 4-28-101 to Section 4-28-114, *Tennessee Code Annotated*. To fulfill the objectives of the Act, the Department of Economic and Community Development (ECD) established the TNInvestco program to accomplish the following goals: to develop the entrepreneurial infrastructure across the state, to attract new capital to Tennessee, to diversify the state's economy, and to create jobs through the development of independent undertakings such as innovative start-ups which result in the formation of new companies.

In 2009 the state initially offered $120 million in gross premium tax credits to insurance companies and in 2010, the state offered an additional $80 million of future premium tax credits under the program for a total of $200 million in future premium tax credits. Proceeds from the sale of these discounted tax credits totaled $149,220,016 and the tax credits were redeemable beginning June 2012. The proceeds from the sale were deposited into ten Local Government Investment Pool (LGIP) escrow accounts, administered by the Department of the Treasury, and are designated and available to the ten companies that the state has certified as TNInvestco companies. These ten TNInvestcos were chosen by the former Commissioner of ECD and the former Commissioner of Revenue based on a scoring matrix used to rate each applicant based on data provided through applications and interviews.

ECD is responsible for monitoring compliance with the TNInvestco program; however, the current Commissioner of ECD recused himself due to a business interest in one of the TNInvestco companies. A senior staff person at ECD was designated to act on the Commissioner's behalf and is responsible for managing the TNInvestco program as prescribed by the Act. The delegation of duties letter states, "the designee will provide an update on any actions taken or decisions made to the Commissioner so that he may carry out any other necessary duties under the statute."

As of January 1, 2012, the TNInvestco companies have invested $55,269,630 in 76 seed or early-stage businesses. The Act requires ECD and the TNInvestco companies to comply with the following 14 administrative, reporting, and/or filing requirements.

ECD is required to:

1) send written notice to each TNInvestco stating whether it has been approved as a qualified TNInvestco,
2) perform an annual review of each TNInvestco,
3) provide an annual report to the Governor and Legislature,
4) notify the TNInvestcos to confirm the TNInvestco has satisfied required benchmarks, and
5) notify the TNInvestcos whether a proposed investment in the seed or early-stage companies has been approved by ECD.

The TNInvestcos are required to:

6) provide ECD with a report on designated capital,
7) provide ECD with a report on the remaining designated capital,
8) provide ECD with a one-time-only key person letter,
9) pay to ECD an annual certification fee,
10) provide ECD with an investment strategy scorecard,
11) provide ECD with an agreed upon procedures report within 180 days of the close of the TNInvestco's year-end,
12) provide ECD with audited financial statements within 180 days of the close of the TNInvestco's year-end,
13) notify ECD when required investment benchmarks have been met, and
14) request from ECD a written determination that a proposed investment will meet the requirements of a qualified investment.

To determine whether ECD and the TNInvestco companies complied with the statutory requirements listed above, we reviewed related ECD and TNInvestcos' files, including correspondence between the TNInvestcos and ECD, and interviewed key ECD personnel and TNInvestco companies' personnel. We also reviewed information from the Enterprise computer application designed by ECD to allow the TNInvestcos to submit electronic documentation of proposed investments, supporting documentation for qualified disbursements, and drawdown requests from each TNInvestco's escrow account.

Results

Based on our review, we found deficiencies in 6 of 14 statutorily required administrative, reporting, and/or filing requirements (43%). We also found that the prior administration, which was responsible for establishing and monitoring the program from inception on July 9, 2009, until the current administration took office in January 2011, failed to establish the proper organizational structure or develop adequate internal controls to ensure proper program accounting and compliance with the Act. Even though the current administration inherited the TNInvestco program, in the year and a half management has carried out the functions, management has not appropriately evaluated the program to ensure optimum organizational efficiency and that proper internal controls were in place and operating to ensure management's compliance with *Tennessee Code Annotated*. As a result, the following weaknesses have continued during the current administration.

<u>Noncompliance With the Act</u>

The current Director of Strategy and Innovation, in the role of program oversight, failed to ensure the TNInvestcos and ECD staff have complied with the Act's requirements.

Incomplete Statutorily Required Scorecards

The Act requires the Commissioner of ECD and the Commissioner of Revenue, consulting with the state treasurer and the TNInvestco, to create an investment strategy "scorecard" for each TNInvestco. Each scorecard is a summary of how that TNInvestco will make investment decisions and provides a measurement of how well those investment decisions are executed. Management of ECD uses the scorecards as a means to evaluate the performance of the TNInvestcos' investment strategy. Section 4-28-113(a), *Tennessee Code Annotated*, requires each scorecard to "contain not more than six (6) objective metrics or measures used to reflect the investment strategy."

We found that ECD's Director of Strategy and Innovation allowed seven of ten TNInvestcos tested (70%) to submit scorecards without any objective metrics or measures. Therefore, we question how the Director of Strategy and Innovation could evaluate the TNInvestcos' investment strategies, monitor the use of investment proceeds, or determine whether the TNInvestcos have met required benchmarks.

Inadequate Annual Reviews

The Act requires ECD program management to conduct an annual review of each qualified TNInvestco to determine if each TNInvestco is investing in qualified businesses and that all investments have been made in accordance with the Act. We found that ECD's reviews consisted of a brief memo with a one paragraph conclusion for each TNInvestco. However, the Director of Strategy and Innovation could not provide supporting documentation of the conclusions, or even the rationale for the conclusions he presented in the annual review. The Director of Strategy and Innovation did state his process for performing the annual review included comparing the scorecards to the TNInvestcos' investments. However, as noted above, most of the scorecards were inadequate.

Management's review based on scorecards with inadequate information is at best inconclusive and therefore cannot satisfactorily assess investments and determine whether the TNInvestcos are abiding by the requirements of the program without the required objective metrics. In addition, without an effective, well-documented process to review the TNInvestcos' investment strategies, management cannot substantiate the conclusions reached or even that a review was performed.

Inadequate Agreed Upon Procedures Reports and Late Audited Financial Statements

To ensure that management of ECD has appropriate information to evaluate each TNInvestco's internal controls and compliance with the Act's requirements, the Act requires that "Each qualified TNInvestco shall report the following to the department of economic and community development: An agreed upon procedures report, or equivalent, regarding the operations of the qualified TNInvestco."

According to the Statements on Standards for Attestation Engagements (SSAE) No. 10 AT §201.03, "an agreed-upon procedures engagement is one in which a practitioner is engaged by a client to issue a report of findings based on specific procedures performed on subject matter. The client engages the practitioner to assist specified parties in evaluating subject matter or an assertion as a result of a need or needs of the specified parties."

We tested the TNInvestcos' 2010 audited financial statements and accompanying reports and found that none of the ten TNInvestcos met the Act's requirements. We believe the intent of the Act was to have a formal agreed upon procedures report performed by a certified public accounting firm to assess the TNInvestco companies and to provide another level of assurance for controls and compliance. ECD's current Director of Strategy and Innovation failed to ensure the TNInvestcos complied with the agreed upon procedures requirement stated in the Act.

In addition, the Act states the TNInvestco must submit audited financial statements within 180 days of the TNInvestcos' fiscal year-end. Therefore, with a December 31 year-end, the 2011 audited financial statements and accompanying reports were due June 30, 2012. As of July 18, 2012, one of ten TNInvestcos (10%) had still not submitted the required audited financial statements and accompanying reports. We tested the other nine reports and found eight of the nine (89%) did not meet the Act's agreed upon procedures requirement. One TNInvestco submitted a document titled "Report of Independent Auditors on Other Financial Information," which satisfied the elements of an agreed upon procedures report. The Office of the Comptroller of the Treasury is working with private accounting firms and ECD management to bring the remaining TNInvestcos into compliance.

Annual Report of the Program Not Completed

The Director of Strategy and Innovation of ECD is statutorily required to complete an annual report for the Governor and Legislators. The annual report, prepared by the Director of Strategy and Innovation, is to include

- the amount of designated capital each TNInvestco has invested in each qualified business;
- the business location and classification;
- the number of jobs created and retained;
- the cumulative amount of designated capital invested;
- the cumulative amount of "subsequent capital" each TNInvestco created, defined as capital invested by sources other than the TNInvestco at either the same time or subsequent to investments made by the TNInvestco in qualified businesses;
- the total amount of tax credits applied; and
- whether the TNInvestco continues to meet certification requirements.

The Director of Strategy and Innovation disclosed on May 14, 2012, that ECD did not complete the required annual report to the Governor and Legislators. According to ECD's guidelines, the report should have been completed by March 15, 2012, and was 97 days late as of June 20, 2012. The Director of Strategy and Innovation stated the reason for the delayed report was transition in staff and not receiving all of the information needed from the TNInvestcos to complete the annual report.

Management of ECD has a responsibility to taxpayers and government leaders to provide the required information timely. The Governor and Legislators may use the annual report as an informative tool which tells the number of new businesses created, the resulting number of jobs created and retained, and the number of jobs held by minorities. While we agree ECD has experienced significant personnel transitions and reorganization, all the data for the annual report should have already been collected. ECD management, and specifically the Director of Strategy and Innovation, must effectively manage its staff and responsibilities so that expected or unexpected personnel transitions do not impact management's ability to fulfill its mission.

Risks Not Included in Annual Risk Assessment

We reviewed management's risk assessment to determine if management had appropriately identified risks of noncompliance, fraud, waste, and abuse for the TNInvestco program. We found that management had failed to identify the risks or mitigating controls associated with the TNInvestco program.

As with any new program, management and staff must properly design the program and develop the processes, including adequate internal controls to ensure proper financial reporting and compliance. We recognize ECD has experienced turnover in personnel for this program. Since the program's inception there have been four different individuals successively acting as administrators of the TNInvestco program. Also, while we recognize that the Act is broad as it relates to certain areas of the program requirements, we believe ECD and the TNInvestcos have not exercised due diligence in developing program controls or its organizational structure to ensure proper accounting and compliance with the Act's requirements. In fact, the issues we found are serious and pervasive.

<u>Prior and Current Management Failed to Structure the TNInvestco Program to Achieve Adequate Segregation of Cash Receipting and Expenditure Approval Functions</u>

Based on our review of the TNInvestco processes, we found that neither prior nor current ECD management established proper program roles and responsibilities for the day-to-day activities and oversight of the TNInvestco program. Specifically, ECD management did not adequately ensure staff duties related to cash receipting and disbursements from the LGIP and general administrative accounts related to the TNInvestco program were adequately segregated. The former Internal Audit Director received the annual certification fee payments and also approved disbursements for management fees, professional services, start-up costs, and qualified investments. The Internal Audit Director's performance of these functions impaired his independence and his ability to perform audits of the TNInvestco program. We also noted that when the Internal Audit Director left ECD employment, the Director of Strategy and Innovation, who assumed responsibilities for the TNInvestco program, continued to perform those same duties without proper segregation of duties or compensating controls.

<u>Management of the Department Failed to Develop Adequate Internal Controls</u>

Based on our reviews, we found that ECD management failed to

- develop adequate policies and procedures for fee collection;
- document changes in procedures for how TNInvestcos submit required documentation;
- perform reconciliations of LGIP master account, general administrative account, certification fees, and sales transactions; and
- maintain documentation of LGIP deposits.

Inadequate Policies and Procedures for Receipt of Certification Fees

The Act requires all TNInvestcos to pay a $5,000 annual certification fee to ECD on or before April 1. Based on our review of supporting documentation, we found that ECD has no policy or procedure to ensure each TNInvestco pays the annual certification fee or to track whether ECD receives each fee. Based on our testwork of certification fees, we found that ECD management did not know that two of ten TNInvestcos' certification fee checks for $5,000 each

(20%) had not been deposited until we brought the matter to the department's attention on May 8, 2012. These checks, dated March 29, 2012, had been sent by the TNInvestcos and were located on the former Internal Audit Director's desk among a stack of papers. The checks were not deposited until May 8, 2012, and May 10, 2012.

According to ECD's risk assessment, there is a control in place regarding the risk of funds not deposited immediately. However, this control is not specific to the TNInvestco program and does not mitigate the risk. The fiscal services department makes daily deposits; however, certification fee checks were not mailed directly to the fiscal services department. The TNInvestcos are currently instructed to mail their annual certification fee checks to the Director of Strategy and Innovation, who then takes the checks to the fiscal services department for deposit. ECD management has not adequately identified in its risk assessment risks or controls associated with cash receipting in the TNInvestco program.

Failure to Document Changes in Procedures

The ECD Director of Strategy and Innovation is responsible for reviewing investment proposals submitted by the TNInvestcos. Based on our review of the department's process for preparing its annual report to the Governor, we found that ECD had not received from the TNInvestcos 10 of 28 of the required paper investment documents (36%) titled "The TNInvestco Qualified Investment Form." These missing documents, which spanned the period from September 2010 through September 2011, were the responsibility of the prior three directors of the program. The current Director of Strategy and Innovation, who started on March 5, 2012, agreed it was his job to review documentation of any proposed investments. After he researched these missing documents, the Director of Strategy and Innovation later informed us that one of the previous directors had changed the procedure to allow the TNInvestcos to complete the requirement by certifying the investment information electronically. However, until we inquired about the missing paper documents, the current Director of Strategy and Innovation was not aware of the policy change. After learning of the policy change, he could not provide evidence of when and how the policy change was implemented by the department and communicated to the TNInvestcos. Therefore, we could not determine if all investment proposals (whether paper or electronic) had been reviewed by the department. The Director of Strategy and Innovation stated he had reviewed the electronically submitted investment data that the department had received since he started and would continue to review the data in this format.

Well-documented policy changes help ensure staff are consistently and accurately accounting for program data. ECD's failure to document the change in policy could have resulted in the Director of Strategy and Innovation's inability to effectively perform critical program monitoring.

Failure to Perform Reconciliations

Revenue from sales of premium tax credits were deposited into LGIP accounts, and expenses of each TNInvestco were paid from the same accounts. To ensure proper accountability for program revenue and expenses, the Director of Strategy and Innovation and the Director of Fiscal Services should perform the following reconciliations:

- LGIP master account to the premium credit agreements and to revenue;
- certification fee collection to deposits in the general administrative account; and
- revenue from sales transactions to LGIP deposits.

Based on our review, we found that neither the Director of Strategy and Innovation nor the Director of Fiscal Services could provide documentation showing these reconciliations were performed. Management's reconciliations would provide reasonable assurance that the accounting records for the TNInvestco program were accurate and revenue was properly deposited.

The Division of Accounts in the Department of Finance and Administration (F&A) assumed responsibility for administering ECD's Fiscal Services Department on March 5, 2012. The F&A Director of Fiscal Services immediately tried to substantiate the amount of funds in the LGIP master account. ECD's Director of Strategy and Innovation stated that the amount of money ECD received from the sale of the tax premium credits was "roughly $140 million," but the Director of Strategy and Innovation could not provide the tax premium credit agreements to the F&A Director of Fiscal Services. These agreements would confirm the fiscal office properly recorded all revenue. We obtained from the Director of Internal Audit copies of the tax premium credit agreements and traced revenue collections to deposits in the master LGIP account to verify the deposit of all of the money.

When management and staff perform adequate and prompt reconciliations of revenue collections to deposits and to recording of the transactions, the potential of errors, waste, and abuse is reduced. If reconciliations had been performed, the Director of Strategy and Innovation would likely have identified the two missing certification fee checks mentioned above and would have secured proper documentation to support the sale of a business interest as discussed below.

Lack of Supporting Documentation for LGIP Account Deposits

Based on our review of supporting documentation, the Director of Strategy and Innovation could not provide documentation to support all deposits made into the TNInvestco LGIP accounts. We found a deposit totaling $1,719,616, made on November 29, 2011, that could not be traced to the tax agreements. The Director of Strategy and Innovation stated the amount was likely proceeds from a TNInvestco sale of its interest in a business. (The profit from the public offering and sale of a startup company is paid to the state, and then evenly split between the state and the TNInvestco.) The Director of Strategy and Innovation did not have any documentation of the sale, the sales price of the transaction, or the receipt of the proceeds from the sale. The TNInvestco deposited the proceeds into the LGIP account but provided no documentation to ECD.

The Director of Strategy and Innovation contacted the TNInvestco to obtain the supporting documentation of the sale, but the documentation obtained did not include the sales price of the transaction. Because the Director of Strategy and Innovation did not know the sales price, ECD management could not be certain the state received the total amount due. We contacted the TNInvestco's lawyer and verified the amount in the LGIP master account was correct. Management of ECD cannot ensure complete and accurate accounting records, and receipt of all money due to the state, without adequate supporting documentation.

Recommendation

Due to the serious and pervasive nature of these problems noted during the audit and increased level for risks of noncompliance, fraud, waste, and abuse, it is imperative that the Director of Strategy and Innovation take steps to address these issues and ensure that these operations are in full compliance with applicable requirements and are subject to effective internal controls. In this regard, for example, the Director of Strategy and Innovation, should at a minimum, promptly implement procedures to segregate the cash receipting and disbursement process and establish detailed procedures regarding collections of annual statutory fee requirements.

The Director of Strategy and Innovation should

- segregate duties and provide compensating controls when duties cannot be segregated;
- document the procedures for seeking approval of a proposed investment (including any changes in procedures), thus establishing consistency in the process;
- perform timely reconciliations between the LGIP accounts and supporting documentation and the certification fees with the general administrative account to ensure accurate accounting information;
- obtain/retain supporting documentation of all monetary transactions;
- require the scorecards to contain objective metrics for program performance evaluations; and
- ensure a more thorough and timely annual review of the TNInvestcos is performed by comparing the scorecards' strategies to their investments.

The Director of Strategy and Innovation should ensure the TNInvestcos submit both agreed upon procedures reports in compliance with the Act and statutorily required audited financial statements within 180 days of the TNInvestcos' fiscal year-end. The Director of Strategy and Innovation should be fully knowledgeable of the statutory reporting requirements of the program and any related deadlines to ensure the TNInvestcos comply with those requirements, and also should ensure the annual report to the Governor and Legislature is completed and submitted by March 15. Finally, the Director of Strategy and Innovation should assign primary and secondary responsibilities to personnel to allow the department to run the program smoothly and effectively in times of transition.

The Commissioner should ensure that program management address risks and implement mitigating controls related to the TNInvestco program in the department's annual risk assessment.

Management's Comment

The department concurs in part to the above finding.

Purpose of Audit

In the summer of 2011, following the department's top-to-bottom review, the ECD management met with the Comptroller to request a review of the department. Information gathered during the Haslam Administration's top-to-bottom review of ECD indicated that the TNInvestco program suffered from inadequate management attention and structural shortcomings that had existed since its inception in 2009. The department sought the assistance of the Office of the Comptroller across various divisions in order to help it better address deficiencies in the department and the department is appreciative of the time and resources invested by the Comptroller's office in this task. While awaiting the results of the recently completed audit, the department notes that it has taken meaningful steps towards improving the administration of the TNInvestco program and mitigating risks to the department posed by the program.

Failure to Establish Proper Organizational Structure

The department concurs that, at its inception, an ineffective management structure was in place for the management of the TNInvestco program. The program was initially directed by the former ECD Commissioner's executive assistant and, in 2011, with the arrival of the current administration, the program was passed to an interim manager, who also served as the department's Director of Internal Audit. Following the completion of the top-to-bottom review in the second quarter of 2011, the department recognized that, in order to appropriately administer this complex program, a staff member who was able to devote more attention to it was needed. As a result, the department created a new position to manage the TNInvestco program, Director of Strategy and Innovation, which reported to the Chief of Staff. Two persons served as Director of Strategy and Innovation from the summer of 2011 through the time of this audit in spring 2012. It is the department's expectation that, absent further turnover, the structure is far more stable today than at the program's inception and during the period of the audit review.

In May 2012, a new Assistant Commissioner of Strategy was named and several functions, including ultimate oversight of the TNInvestco program, were moved from the Chief of Staff to the Assistant Commissioner of Strategy. The Director of Strategy and Innovation left ECD in July 2012 and the Assistant Commissioner of Strategy appointed a new administrator with familiarity with the program and a state audit background to this position and renamed the position TNInvestco Director. In August 2012, the department also enhanced oversight over the program by moving the secondary approval role for the program from the Assistant

Commissioner of Administration to the Assistant Commissioner of Strategy. This structural improvement should lead to substantially higher organizational strength managing the program moving forward.

<u>Noncompliance with the Act</u>

Incomplete Statutorily Required Scorecards

The department does not concur with this finding. TCA 4-28-113 requires that the department consult with the commissioner of revenue and the treasurer on the design of the scorecard. The department followed the appropriate process and consulted with the entities outlined in statue in the creation of the scorecards and has all appropriate documents on file. The department issued its scorecards with objective metrics. Initially, several TNInvestco companies did not fully respond to the scorecards. This was unsatisfactory to the department and the department compelled the TNInvestco companies to receive complete responses to all questions posed in the scorecard. All ten TNInvestco companies supplied completed scorecards, although not as in nearly a timely fashion as the department would have liked or demanded. The department notes that the Director of Strategy and Innovation questioned by the auditors did not actually conduct the scorecard reviews and believes that he did not supply the auditors with copies of the TNInvestco companies' fully completed scorecards. Those files are available for further inspection by the Comptroller's office.

Auditor Rebuttal: Incomplete Statutorily Required Scorecards

The department's management did not provide us with the final completed scorecards even though management apparently had the scorecards on file. We originally requested the TNInvestco scorecards in May 2012 and we were provided scorecards that were incomplete and insufficient to satisfy management's review process. We discussed the insufficiency of the scorecards on multiple occasions during our audit fieldwork with the Director of Strategy and Innovation and the General Counsel and again at our audit field exit conference. We also discussed the scorecard concerns with the newly appointed Assistant Commissioner of Strategy on June 13, 2012 during our field exit conference; however, management still did not inform us that it had requested and received completed scorecards from the TNInvestco companies or provide us with those scorecards until September 2012, two months after the end of our audit fieldwork. We have since reviewed the completed scorecards and verified with the TNInvestcos that the scorecards were resubmitted to the department in November 2011.

Management's Comment (Cont.)

Inadequate Annual Reviews

The department does not concur with this finding. The act requires that the commissioner of economic and community development consult with the commissioner of revenue and the state treasurer in conducting the annual review of each qualified TNInvestco. Letters spanning November 15, 2011 – February 14, 2012 between ECD, the department of revenue, and the state treasurer's office clearly document the process followed and the materials reviewed by all statutorily required parties in the department's conduct of the annual review.

Auditor Rebuttal: Inadequate Annual Reviews

Our finding was based on the fact that management provided us with incomplete scorecards and therefore, could not perform an adequate review of the TNInvestcos' investments using incomplete scorecards. The Director of Strategy and Innovation and the General Counsel described their annual review process which included comparing the scorecards to the TNInvestcos' investments. However, as noted in the finding, most of the scorecards that management provided to us during audit fieldwork were inadequate. We explicitly stated that without completed scorecards the review would not be effective. Without sufficient evidence of the department's process, including the final completed scorecards, we could not evaluate the process. Subsequent to our audit, management has made available the completed scorecards.

Management's Comment (Cont.)

Inadequate Agreed Upon Procedures Reports and Late Audited Financial Statements

The department concurs in part with this finding. In the second half of 2011, several meetings occurred between the Office of the Comptroller and the department related to improving upon the format and submission of the TNInvestco companies' audited financial statements and accompanying agreed upon procedures reports in order to increase transparency and accountability in the program (namely, that the TNInvestco companies submit GAAP based audited financial statements instead of the originally supplied tax based audited financial statements). These improvements were communicated to the TNInvestco companies' audit firms through the Comptroller's office of local government audit. All ten TNInvestco companies had signed contracts with the Comptroller's office to submit their 2011 audits according to these revised standards. Nine of the ten TNInvestco companies submitted their audited financial statements and accompanying report on internal controls prior to the June 30, 2012 deadline. The department agrees, and was aware, that one TNInvestco company was late in providing their 2011 audited financial statements. That report has since been submitted.

In July 2012, the Office of the Comptroller notified the Assistant Commissioner of Strategy of the additional requirement that the TNInvestco companies' CPAs opine on the schedule of jobs and follow on capital in the reports. This change was communicated in August 2012 to all of the TNInvestco companies. The department is confident that the 2012 audited financial statements, due June 30, 2013, and the accompanying agreed upon procedures report will accurately reflect all of the additional improvements suggested by the Comptroller's staff.

Auditor Rebuttal: Inadequate Agreed Upon Procedures Reports and Late Audited Financial Statements

The Office of the Comptroller has not notified the department of any additional requirements. In July 2012 the auditor met with the Assistant Commissioner of Strategy to clarify the requirements of the Act. It is the department's responsibility to determine the Act's requirements and to ensure that the TNInvestco companies submit the required documents. The Office of the Comptroller of the Treasury cannot and has not required additional requirements. This office is working with private accounting firms and ECD management to bring all TNInvestco companies into compliance with the Act.

Management's Comment (Cont.)

Annual Report of the Program Not Completed

The department concurs with this finding. The annual report was completed and delivered to all required parties on August 22, 2012.

Risks Not Included in Annual Risk Assessment

The department concurs with this finding. The department commits to updating the department's annual risk assessment to include the TNInvestco program. The Director of Internal Audit will review these updates and ensure that they include all recommendations made in this report prior to submitting the document at year end. It should be noted that at its inception the TNInvestco program was set up outside of the state's traditional accounting policies. Since 2011, the department has taken steps to bring the program into alignment with standard state reporting and monitoring systems and this has greatly facilitated the department's ability to implement risk management procedures.

<u>Prior and Current Management Failed to Structure the TNInvestco Program to Achieve Adequate Segregation of Cash Receipting and Expenditure Approval Functions</u>

The department agrees in part with this finding. At its inception, procedures related to the sale of securities were not in place and the department is working vigorously to define the process for the state's receipt of funds following an investment's liquidation.

As it relates to the receipt of certification fees; there exists a segregation of cash receipting and expenditure approval functions. Certification fees are deposited into the ECD general administrative account with receipt of deposited funds provided by the Fiscal Services Division (now part of the Department of Finance and Administration). The TNInvestco Director does not deposit funds into the ECD general administrative account and has no role in managing disbursements out of the ECD general administrative account related to the TNInvestco program (or any other program). For further clarification, the annual certification fees are not deposited into the LGIP account, where he acts as the Escrow Administrator to the TNInvestco companies' funds. Therefore there is segregation of cash receipting and expenditure approval functions.

The department has maintained compensating controls throughout the management of the program. The department's Assistant Commissioner for Administration served in a secondary approval capacity for approvals of all disbursements from the LGIP accounts from the program's inception through August 2012. The department's enterprise application system has a complete log showing that all transactions approved received a secondary approval. Secondary approval in this system can only occur through the password protected log-in of the approver.

The department documented all program roles and responsibilities related to the disbursement of TNInvestco funds in its internal agreed upon procedures report, dated December 2009, and subsequently revised in January 2011. This document further defines the roles of back up personnel for all aspects related to the disbursement of funds from the LGIP accounts. The department began significant revisions to the agreed upon procedures report in June 2012 to encompass changes related to anticipated personnel changes as well as process changes related to moving the accounts to the Edison system, which is a move advised by the department because a significant flaw in the program is that it has been administered outside of the state's traditional accounting systems since its inception. To minimize confusion, the department delayed the release of the update of this document to coincide with the migration of accounts to Edison. The department expects F&A to complete this by October 31, 2012 and the department will circulate its updated agreed upon procedures report at that time.

Auditor Rebuttal: Prior and Current Management Failed to Structure the TNInvestco Program to Achieve Adequate Segregation of Cash Receipting and Expenditure Approval Functions

The Director of Strategy and Innovation received the certification fees and was also responsible for approving expenditures. Our audit evidence confirms that the Assistant Commissioner for Administration's role as a secondary approver was not intended as a substantive reviewer for the TNInvestco program because she is not involved in the day to day program operations.

Management's Comment (Cont.)

<u>Management of the Department Failed to Develop Adequate Internal Controls</u>

Inadequate Policies and Procedures for Receipt of Certification Fees

The department concurs in part with this finding. The department maintains a standing procedure for collecting, documenting, and depositing programmatic fees received by the department. This was and continues to be handled by the Fiscal Services staff. It is important to recall that these checks are not deposited into the LGIP account and therefore a procedure unique to the LGIP account is not warranted related to certification fee deposit. The department will ensure these department-wide policies are also re-stated within the TNInvestco program management files. These policies and the updated risk assessment plan will be documented and filed on or before December 31, 2012, which is four months prior to the next payment date for certification fees.

Auditor Rebuttal: Inadequate Policies and Procedures for Receipt of Certification Fees

Management's comment did not address the issue noted in the finding. Because the TNInvestcos are instructed to mail the certification fees directly to the Director of Strategy and Innovation who then gives the checks to the Fiscal Services Staff, the current policies and procedures were not adequate to address the risk of checks mailed to locations outside of Fiscal Services.

Management's Comment (Cont.)

Failure to Document Changes in Procedures

The department concurs with this finding. It is important to note that throughout this administration all investments received the appropriate dual approval. The presence of both a paper and an online process, while duplicative, did in no way increase the chances of waste, fraud, and abuse in the program. In August 2012, the department circulated a draft of process changes seeking comments from the TNInvestco companies and shortly thereafter to the Comptroller's staff. In anticipation of this audit, the department refrained from issuing a final process improvement memo to the TNInvestco companies. The department expects to release that policy update to the TNInvestco companies and to post the updates to our website on or before October 31, 2012. The department will ensure that the Comptroller's suggestions made through this audit are included in that document's definitive release.

Failure to Perform Reconciliations

The department concurs in part with this finding. At the time the performance audit occurred, the Director of Strategy and Innovation was not performing reconciliations of the LGIP Master Account. Prior to his tenure, however, reconciliations of the LGIP accounts were occurring and they are occurring now. Programmatic reconciliations of the department's master administrative accounts occur regularly and are performed by the Division of Fiscal Services (now administered by F&A). Additional documentation further substantiating the receipt and transfer of the proceeds of the sale of premium tax credits include the department's receipt of designated capital letters, the dual-approval authority required to transfer funds from the master account to the individual LGIP accounts, and the department's provision of monthly LGIP statements to the TNInvestcos.

As noted above, certification fees are deposited into the department's general administrative accounts and reconciled to the appropriate program. This process is managed by the Division of Fiscal Services (now administered by F&A).

Revenue from sales transactions (liquidation events) must be certified prior to transferring funds from the master account to the individual fund account and from an individual fund account to the state's general fund (in the case of positive liquidations where the TNInvestco applies for a non-qualified distribution). The current TNInvestco Director and

Assistant Commissioner of Strategy commit to meeting with F&A to resolve the process for fund certification and to document that process on or before October 31, 2012.

Auditor Rebuttal: Failure to Perform Reconciliations

As noted in the finding, the Director of Strategy and Innovation did not provide any evidence that he performed any reconciliations of LGIP master account to the premium credit agreements and to revenue, certification fees to the general administrative account, or revenue from sales transactions to LGIP deposits. We also requested any reconciliations performed by the management or staff since the inception of the program; however, management did not provide us with any reconciliations.

Management's Comment (Cont.)

Lack of Supporting Documentation for LGIP Account Deposits

The department concurs with this finding. In August 2012, the department circulated a draft process improvement memo to the TNInvestco companies which included instructions to the TNInvestco companies on the steps to be followed in the liquidation of a security. While the Department had communicated in late 2011 with F&A regarding the establishment of a process to certify the receipt of funds following a sale, the department had not yet finalized or published the policies and procedures. In the transition from the interim TNInvestco Director to the Director of Strategy & Innovation, the work conducted by ECD regarding the formulation of a policy was not adequately communicated. The department appreciates the additional suggestions contained in this report and will update our guidance to the TNInvestco companies accordingly and document the procedure with F&A for certifying funds following a sale. The department commits to fully updating the policies related to the LGIP Account Deposits on or before October 31, 2012.

<u>Additional Items Not Covered in the Audit Report</u>

In addition to the measures described above, the department has also taken the following steps to mitigate risks to the department and improve the administration of the TNInvestco program during the period after which it requested the program audit:

1. Proactively forming a consistent distribution policy;
2. Correcting previously published timelines which created dates, such as the date of the publication of the annual report, which were inconsistent with statutorily defined timelines provided to the TNInvestco companies for the required inputs to that report;
3. Anticipating potential questions surrounding future pacing requirement calculations and providing illustrative examples to better articulate how TNInvestco companies can meet the statute's requirements;

4. Resolving inconsistencies related to calculating management fees in the program's future years;
5. Proactively seeking feedback related to crafting policies for the program's document retention policy;
6. Ensuring viability of the ECD enterprise application through updating the program to anticipate long-term use downstream access and data extraction needs; and
7. Proactively seeking feedback related to crafting policies for disposition of assets following the program's conclusion;
8. Creating a TNInvestco program ethics, waste, fraud & abuse policy, which is currently under review by the department's General Counsel and is expected to be presented to the TNInvestcos on or before October 31, 2012; and
9. Posting project investment letters quarterly, which provides the public and stakeholders greater visibility of the program than that required by statute.

CONTRACTS

The Department of Economic and Community Development has numerous contracts with businesses and communities throughout the state in an effort to bring businesses and jobs to the state. These contracts can be awarded through the FastTrack program, Community Development program, and Business Development program.

The objectives of our review of the contracting process were to

- gain an understanding of management's process to approve and award contracts to determine if the process is working as described;
- determine if contracts were approved before the contract start date;
- determine if contracts were entered into the state's accounting system, Edison;
- determine that the department obtained audited financial statements as required for contracts in the FastTrack and Community Development Block Grant (CDBG) programs; and
- determine if the department's risk assessment identified relevant contract risks and controls.

We interviewed key personnel and performed a walkthrough of the procedures in order to obtain an understanding of the department's contracting process and whether the process is working as described. We selected a sample of 25 contracts totaling $4,989,022 of 651 contracts totaling $406,101,022 to determine if management obtained all required approvals before the contract start date. We reviewed the department's contract listing to ensure all contracts were entered into the state's accounting system, Edison. We also interviewed key personnel to determine whether the department obtained audited financial statements from FastTrack and CDBG contractors. We obtained and reviewed the department's risk assessment to determine if the department identified relevant contract risks and controls.

Based on our interviews and walkthroughs, we determined that the department's contracting process was not consistent across divisions and that the process was not efficient in obtaining approvals in a timely manner. We also found that contracts were not approved before the start date of the contract. These issues are discussed in more detail in finding 2 below. We determined that all contracts were recorded in the Edison system. Based on our discussions with personnel, we determined that the department did not obtain audited financial statements from FastTrack and CDBG contractors as required by the contracts. This is discussed in more detail in finding 3. Based on our review of the department's risk assessment we determined that management had not identified all risks and mitigating controls associated with contracts as discussed in finding 2 below.

Finding

2. Management has not ensured contracts were approved prior to allowing contractors to begin services, increasing the risk that the state may be liable for unauthorized services

The Department of Economic and Community Development (ECD) did not obtain all required approvals for contracts before the contract start date but allowed contractors to begin work, which increased the risk that the state may be liable for services it would not have otherwise authorized.

Chapter 0620-3-3-.06(3) of the *Rules of the Department of Finance and Administration* (F&A) lists the parties that must approve a contract and states that "upon approval by the Commissioner of Finance and Administration, a contract shall be fully approved." Rule 0620-3-3.07(2) states, "A signed contract affixed with the signatures of all officials required for approval of the contract shall authorize a contractor or grantee to commence work on the subject scope of services."

Based on our review of a sample of 25 contracts, we determined whether the contract was approved before the start date of the contract and whether any payments were made before the contract was fully executed. We found 24 of 25 contracts examined (96%) were approved after the start date of the contract. The length of time between the start date and the final approval ranged from 17-290 days. If contracts are not fully executed before services are rendered or job costs are incurred, then the state could be obligated to pay for unauthorized expenditures. We found that even though ECD allowed work to begin on these contracts, ECD did not make any payments to the contractors until the contracts were approved.

The Comptroller Procurement Oversight Section of the Office of Management Services in the Office of the Comptroller of the Treasury tracked the status of the state's contracts for the period July 1, 2009, through February 28, 2011, to provide recommendations to F&A and other state officials to improve the Edison contracting process. The Comptroller Procurement Oversight section tracked and recorded the state departments and agencies who submitted their contracts for approval after the effective contract start dates and prepared a one-time report, the *Comptroller's Summary of Late Contracts*, so that F&A and state agencies could pursue appropriate corrective action. We reviewed the report and determined that for that period ECD submitted 433 ECD contracts to the Office of the Comptroller of the Treasury after the start date of the contracts, including the 24 we reviewed during this audit. The number of days late ranged from one to 1,275 days after the start date of the contract.

We also found that the method ECD management uses to establish contract start dates is not consistent across its programs. Apparently ECD management has failed to coordinate internally between program managers and contract staff when setting contract start dates. As a result, ECD management often sets the contract start date without allowing sufficient time for staff to prepare and obtain required approvals for the contract. Program staff often set contract start dates based on a press conference or public announcement without considering the time necessary for the contract unit staff to fully execute the contract. According to ECD program managers and contract staff, the average time to internally write a draft contract is five to seven working days, and then it is sent for all required approvals.

During our audit period, upon their own initiative members of top management evaluated the department's contracting process in an effort to improve the time it takes for contracts to move through the approval process, and they have adopted new procedures governing the contracting process. These new procedures have not been in place long enough to perform testwork and conclude on their effectiveness. Management is also still working with the state's Procurement Office to develop standard language for some of the department's contracts in an effort to increase the approval response time.

We also reviewed management's risk assessment to determine if management had appropriately identified risks of noncompliance, fraud, waste, and abuse in regard to contracts. We found that management had not identified the risks or mitigating controls associated with contracts.

If contracts are not properly approved before the contract start date and before services are rendered, the state could be obligated to pay for unauthorized services.

Recommendation

The Commissioner should continue to work with the Procurement Office to improve its contract approval process which includes adequate communication and coordination among ECD's offices. The Contract Director should perform regular monitoring of the contract process to ensure contracts are approved before work is authorized to begin. The Commissioner should ensure the risks noted in this finding are included in management's documented risk assessment.

Management's Comment

The department concurs. The department's own research during its top-to-bottom review concluded that 99% of the department's grant contracts during the last several years were executed subsequent to their start date. Upon identifying this deficiency, ECD senior staff began working with the Office of the Comptroller and the Central Procurement Office in late 2011 to develop new contracting procedures for each of the department's primary grant programs which will significantly reduce the number of grant contracts executed subsequent to their start date and decrease the state's potential liability for unauthorized services. The department would like to explicitly acknowledge its appreciation to both the Comptroller and the Central Procurement Office for their guidance and support as their help has allowed the department to take significant steps to transform the department's historic operating procedures. The new procedures, which were detailed in a memo sent to the Comptroller in July 2012, are currently in place and are summarized below:

Grant Program	New Procedure(s)	Effect(s) of New Procedure(s)
Community Development Block Grants ("CDBG")	Obtain delegated grant authority ("DGA") for CDBG contracts, which will permit the department to send contracts to recipients as soon as projects are announced	Virtually eliminate CDBG contracts that are executed subsequent to their start date
Film Incentive Grants	Begin sending grants to recipients as soon as projects are approved rather than after all expenses are incurred	Virtually eliminate film incentive contracts that are executed subsequent to their start date
FastTrack Job Training Assistance ("FJTAP") Grants	Make the start date of all FTJAP grants a specific date following the approval of each such grant and consider all grant contracts executed following this date null and void	Virtually eliminate FJTAP contracts that are executed subsequent to their start date
FastTrack Infrastructure Program ("FIDP") Grants	Obtain a DGA for FIDP contracts, which will permit ECD to send contracts to recipients as soon as grants are approved; in the event that the grant recipient cannot immediately execute the contract following the approval of an award, ECD shall send the recipient a permission to incur costs letter ("PIC letter") stating that ECD is not legally bound to reimburse any expenses until a grant contract has been fully executed	Reduce number of FIDP contracts that are executed subsequent to their start date; notify grantees that the state cannot be held liable for expenses incurred prior to the execution of an FIDP contract
FastTrack Economic Development Fund ("FEDP") Grants	Following approval of an award, ECD shall send the recipient a PIC letter stating that ECD is not legally bound to reimburse any expenses until a grant contract has been fully executed	Notify grantees that the state cannot be held liable for expenses incurred prior to the execution of an FEDP contract

In addition to introducing the new procedures above, the department re-organized the staff in order to enhance the department's legal capabilities related to contract processing. Today both the contracts director (now staffed by an attorney) and administrative assistant comprise the contracting unit. The contracting unit now reports to the general counsel. An additional attorney further augments the department's legal capacity.

Finding

3. <u>Management of the Department of Economic and Community Development has allowed grant and loan recipients to violate state contracts and federal requirements by not ensuring contractors submitted the required financial statements</u>

The Department of Economic and Community Development (ECD) awards grants and loans to qualified recipients through its FastTrack program, and through the federal Community Development Block Grant (CDBG) program. The CDBG program's purpose is to award federal and state dollars for state and community projects to expand existing, or attract new, companies. The department's FastTrack program's objective is to improve business infrastructure to encourage new jobs and business investment. Contracts used by both programs contain language that requires grantees to submit a report of activities funded, or audited financial statements, to the department following completion of the project. The following contract clause is in both CDBG and FastTrack contracts:

> D.16. <u>Annual Report and Audit</u>. The Grantee shall prepare and submit, within nine (9) months after the close of the reporting period, an annual report of its activities funded under this Grant Contract to the commissioner or head of the Granting agency, the Tennessee Comptroller of the Treasury, and the Commissioner of Finance and Administration. The annual report for any Grantee that receives five hundred thousand dollars ($500,000) or more in aggregate federal and state funding for all its programs shall include audited financial statements.

In addition, Office of Management and Budget (OMB) Circular A-133, Section 400(d) (applicable for federal funding), requires the pass-through entity (ECD) to monitor for compliance with audit requirements and states the pass-through entity should perform procedures to provide reasonable assurance that the subrecipient obtained required audits and takes appropriate corrective action on audit findings.

In accordance with the contract language and with OMB Circular A-133, recipients are required to submit a report of activities funded, or audited financial statements, to ECD after each project's completion. However, although ECD management maintains a listing of contracts, ECD does not track when contracts are completed so that staff can monitor contractors' submission of required state and federal reports. In fact, management was unaware of when the recipients of grants and loans were required to submit either a report of activities funded or audited financial statements. As a result, FastTrack and CDBG management of ECD made no effort to collect these reports within nine months of the contract completion date.

This issue was discussed with the Director of Internal Audit, Director of Fiscal Services, and Program Manager of ECD as part of the prior two single audits for the fiscal years ended June 30, 2010, and June 30, 2011. According to the current Internal Audit Director, there was a lack of communication between the former Internal Audit Director and the Contracts Director to set up a system to track when audited financial statements were due.

Management's lack of an effective tracking mechanism to identify when a report of activities funded or audited financial statements is due, and management's failure to pursue these reports, increases the risk of federal noncompliance and potential sanctions from the federal government including penalizing the department by withholding a percentage of the federal award or possibly terminating the award. Management's failure to follow state and federal requirements which govern the department's responsibility as a pass-through entity increases the risks of noncompliance, fraud, waste, and abuse within the programs.

Recommendation

The Commissioner of Economic and Community Development should require all employees who are responsible for managing grant and loan programs to ensure compliance with contracts and with federal regulations. Management should ensure that reports of activities funded or audit reports (as appropriate) are obtained from recipients of grants and loans through the FastTrack and CDBG programs. Management should ensure controls are established to mitigate risks of noncompliance, fraud, waste, and abuse within the loan and grant programs.

Management's Comment

The department concurs that the management of ECD's FastTrack Infrastructure Development Program (FIDP) and the Community Development Block Grant (CDBG) program have not consistently collected audited financial statements from grantees that received grants totaling $500,000 or more. Management of both the FIDP and the CDBG program have been instructed to begin collecting the required financial statements.

The department also notes that it expects to further enhance its grant tracking capabilities in early 2013 when it launches a new department-wide customer resource management database that will allow the department to track grants under all of its programs in one system. Included will be the ability for the department to note the contract complete date and ensure all necessary final reports are filed. The need for such a database was identified during the top-to-bottom review and this system has been under development since early 2012.

RECEIVABLES COLLECTION AND WRITE-OFF PROCEDURES

The Grants and Loan Division of ECD offers a variety of resources for community leaders to improve their infrastructure, foster economic growth in their area, and encourage sound environmental practices. The division administers state and federal government grant and loan funds and also collects payments on loan receivables.

The objectives of our review of the department's loan collection procedures were to

- gain an understanding of the internal controls and procedures for ECD's receivables collection and the write-off process for uncollectible receivables;
- determine the department's compliance with Section 4-4-120, *Tennessee Code Annotated*, and the Department of Finance and Administration's Policy 23, "Accounts Receivable – Recording, Collection, and Write-offs";
- compare the number of loans awarded, the percentage of loans in default, and the percentage of loans written off to determine reasonableness; and
- determine that the department has properly written off accounts receivables.

We interviewed key personnel, performed walkthroughs, and reviewed supporting documentation to gain an understanding of the department's internal controls and procedures for receivables collection and the write-off process of uncollectible receivables. We obtained a listing of loans receivable. We tested all loans receivable in default to determine compliance with the law and the Department of Finance and Administration's Policy 23. A chart of loan receivables outstanding is exhibited on the following page. We compared the listing of loans receivable obtained from the department's LoanBase system to the amount of loans in default and to the loans written off and compared with Edison. We obtained a listing of outstanding loans for fiscal years 2000 through 2010 and compared that listing to the write-off requests submitted. We reviewed all defaulted loan receivables to ensure loans were written off properly.

Based on our interviews, walkthroughs, and documentation reviewed, we gained an understanding of the internal controls as described by management and in policy and determined that management had not followed those controls. This is discussed in finding 4. Based on the testwork performed, we determined that the department has not complied with statute and with the Department of Finance and Administration's Policy 23, by failing to make collection calls and send the appropriate collection letters as noted in the finding below. We determined that the department's uncollectible receivables and write-offs were reasonable in comparison with the number of loan agreements.

Loan Receivables Outstanding
Fiscal Year 2011

Obtained from Auditor III, ECD

	Number of Loans			Dollar Value of Loans		
Loan type	Total	Delinquent	Percent Delinquent	Principal	Delinquent Principal	Percent Delinquent
CDBG	35	13	37.14%	$8,546,758	$800,211	9.36%
Energy-Small Business	40	1	2.50%	1,526,992	1,606	0.11%
Energy-Local Gov.	51	0	0.00%	6,655,908	0	0.00%
Micro-Loans	26	8	30.77%	116,828	13,154	11.26%
Totals	**152**	**22**	**14.47%**	**$16,846,487**	**$814,970**	**4.84%**

Finding

4. **Staff of the Department of Economic and Community Development did not always follow loan receivable collection policies and did not pursue collection of all amounts due to the State of Tennessee**

The Department of Economic and Community Development (ECD) provides loans to businesses and communities in Tennessee to improve infrastructure, foster economic growth, and encourage sound environmental practices. When a loan recipient defaults, ECD staff is responsible for subsequent loan collection efforts to recover any outstanding balance, and to pursue write-off of uncollectible amounts when necessary. ECD provides loans under the following programs:

- Community Development Block Grant (CDBG);
- Energy-Small Business Loan program;
- Energy-Local Government Loan program; and
- Bero-Micro Loan program.

We determined that ECD staff did not follow their own collection policies or Policy 23 of the Department of Finance and Administration (F&A), "Accounts Receivable – Recording, Collection, and Write-offs," when loan recipients defaulted on their loans. ECD staff did not make follow-up phone calls or send collection letters to the loan recipient and/or the loan guarantors as required by the policies.

According to F&A Policy 23, "state agencies should establish collection procedures that accommodate their business situation and collection capability. Collection efforts would include collection letters, phone calls, and collection agency services." In addition, ECD's own Collection Procedures state "that when a loan payment is 30 to 90 days past due the program management auditor will call the debtors and record notes of the call in the LoanBase system. If the loan payment is not received within 90 days, ECD staff sends letters to the debtors for five consecutive months. Each subsequent letter is more aggressive to facilitate the debtor's payment of the outstanding accounts receivable balance. If the account is still delinquent after five letters, the account is turned over to the Office of the Attorney General and Reporter for pursuit through legal collection efforts."

We tested the population of 22 defaulted loans from the various programs mentioned above that were in repayment status and were past due at least 30 days. We found ECD's collection staff did not make the required calls or send collection letters for 6 of the 22 loans tested (27%).

Specifically, we found the following:

- In July 2006, ECD made a $129,200 CDBG loan, which entered default status in January 2009 when the company went out of business. As of August 9, 2011, the company owed $114,565 on this loan. Based on our review of ECD's collection efforts, we found that from February 2009 to July 2010, ECD staff did not make any phone calls or send any collection letters to the loan recipient in an attempt to collect the outstanding loan balance. In July 2010, this company filed bankruptcy, and ECD lost the opportunity to recover any of the outstanding balance.

- In September 2005, ECD made a $5,475 Energy-Small Business loan to a business that defaulted in January 2011. The business, as of August 9, 2011, owed the state $1,606 in principal and $490 in late fees, for a total of $2,096. Since January 2011, ECD staff have not made any calls or sent collection letters to collect the outstanding loan balance. According to the current Statistical Analyst for ECD, the Statistical Analyst who was responsible for pursuing collections on this loan left the department in October 2010. At that time, ECD management assigned collection effort responsibility to the current Statistical Analyst for collections of Energy-Small Business loans; however, he also failed to follow the department's procedures or Policy 23 by calling or sending collection letters.

- In July 2003, ECD made a $735,000 CDBG loan to a municipal industrial board for the purpose of constructing a building. In September 2008, the loan recipient defaulted on the loan. The outstanding loan balance included $602,762 in principal and $16,280 in interest, for a total of $619,042 owed. The Auditor III responsible for collections of defaulted CDBG loans stated that since the loan was made through a municipal industrial board to a business, he determined that collection efforts would not be pursued in the same manner as they would have been for an individual owner. However, ECD's collection procedures do not make a distinction as to the type of loan recipients. In the absence of specific procedures for different recipients, ECD should have followed its normal collection procedures. The Auditor III documented his interactions with various companies that expressed interest in purchasing the building; however, the Auditor III made no effort to collect on the loan itself by making phone calls and sending collection letters to the industrial board as required by the collection policy.

- In April 2007, ECD made a $4,000 Bero-Micro loan. On August 22, 2007, the loan recipient defaulted with $3,484 in principal and $995 in interest for a total of $4,479 owed to the state. ECD staff made no phone calls between October 2007 and July 2010. The Bero Program manager sent two collection letters, one in December 2007 and another in April 2008 as the only collection attempts. ECD's collection policy, however, requires weekly phone calls to a debtor who has not paid in 90 days, in addition to the five collection letters sent from upper management of ECD. Further, ECD management did not turn the account over to the Office of the Attorney General and Reporter for legal assistance in the collection efforts until July 29, 2010.

- In December 2008, ECD made a $5,000 Bero-Micro loan. In March 2010, the loan recipient defaulted with $2,004 in principal and $30 in interest for a total of $2,034 still owed to the state. ECD staff could not provide any evidence that staff made the required phone calls since the default date, and only three collection letters sent, dated February 2011, April 2011, and June 2011.

- In November 1987, ECD made a $200,000 CDBG loan that went into default in April 1990. In June 2000, ECD staff applied the full amount of the loan payment to the loan's principal balance first rather than first to the outstanding interest balance as required by the loan agreement. Because of the staff's error in applying the loan payment, the state's financial records showed the loan balance as zero, instead of the accurate balances of $44,314 in principal and $7,016 in interest for a total of $51,330 still owed to the state. Since August 2002, ECD staff have made no phone calls or sent any letters to pursue collection efforts for this outstanding balance. On October 7, 2010, ECD submitted a write-off request for the remaining outstanding loan receivable of $51,330 to the Office of the Comptroller and to the Commissioner of Finance and Administration. The Comptroller denied this request because the department did not follow its collection policies.

When we discussed these weaknesses with ECD management, management directed the Internal Audit Director to update the loan collection procedures; however, these procedures have not been finalized.

Failure to consistently follow Department of Finance and Administration's Policy 23 and departmental policies regarding collection efforts on delinquent loans could result in excessive and unnecessary write-offs and the unnecessary loss of state/federal dollars in these loan programs. For fiscal year 2011, ECD had 22 delinquent loan receivables totaling $814,970 out of $16,846,487 total loan receivables.

Recommendation

The Commissioner of Economic and Community Development should ensure that the department's practices and revised internal policies related to the collection of delinquent loan receivables are appropriately aligned with the Department of Finance and Administration's Policy 23. Also, the Assistant Commissioner of Administration should ensure the policies are consistently enforced on all past-due loan receivables. The Commissioner of Economic and Community Development should ensure that loan and fiscal staff apply all loan repayments received in accordance with the loan agreement.

Management's Comment

The department concurs. The various divisions within the department have historically not followed the Finance & Administration's Policy 23 procedures consistently or vigorously. The department identified this issue in 2011 and sought to address this weakness in 2012 by establishing departmental loan collection procedures that require the active pursuit of all amounts due and include enlisting the assistance of the office of the Attorney General as necessary. New loan collection procedures that are consistent with Policy 23 are now in place for each of the department's divisions.

FASTTRACK

The Department of Economic and Community Development provides grants and loans to businesses through its FastTrack program. Management of the FastTrack program makes two types of awards to businesses, awards from the FastTrack Job Training Program (FJTAP) and awards from the FastTrack Infrastructure Development Program (FIDP), both of which are state funded. FJTAP offers reimbursement-based grants to businesses to cover training costs of employees in new or significantly altered businesses. The FIDP supports new businesses' basic location needs, such as rail lines, water service, and site work.

The objectives of our review of the FastTrack program were to

- gain an understanding of the internal controls used in issuing awards for the program;
- determine compliance with Section 4-3-716, *Tennessee Code Annotated*, requiring that no more than 5% of the funds appropriated by the General Assembly be used for administrative and marketing expenditures and program evaluation;

- determine compliance with Section 4-3-716, Tennessee Code Annotated, requiring that over commitments of funds not exceed 30% of appropriations available for new grants;
- determine whether the department retained a complete listing of program loans and grants to ensure over commitments were in compliance with statute;
- determine the accuracy and reliability of project estimates in FIDP and FJTAP to ensure the maximum projects were funded; and
- follow up on the prior audit finding related to the grant and loan recipient monitoring process.

We interviewed key personnel and performed a walkthrough to obtain an understanding of the FastTrack program and the controls in place. We obtained the appropriation totals and the expenditure total amounts for the program administration, marketing, and program evaluation expenses for fiscal years 2008 through 2010 to determine compliance with the 5% requirement. We selected a sample of 25 monthly Department of Finance and Administration memos and supporting documentation for the period July 1, 2007, through April 1, 2011, to determine compliance with the 30% rule in Section 4-3-716, *Tennessee Code Annotated*. These memos document a running balance of the amount of current commitments and current appropriations. We obtained a listing of FastTrack loans and grants. We selected and tested a random sample of 25 completed FIDP and FJTAP projects, compared the estimated original cost to the actual cost of the completed project, and analyzed any unrealistic differences. Once funding is allocated to a project, ECD management cannot reallocate the funds under any circumstances to another project, so accurate estimates are essential to maximize the department's efforts to bring businesses and jobs to the state. We interviewed key personnel and reviewed project files to determine if the department had implemented recommendations from the prior audit finding to monitor grant and loan recipients.

Based on interviews and walkthroughs, we gained an understanding of the program and found no problems with the department's internal controls as described. We found that the program administration, marketing, and program evaluation expenses did not exceed 5% of funds appropriated. Based on the sample tested and the supporting documentation reviewed, we determined the department did not overcommit funds for projects by more than 30% of the total current appropriations. Based on the listing obtained, we determined that the department has retained a listing of program loans and grants. Based on the testwork performed, we found the department's project estimates in FIDP and FJTAP were accurate and reliable. Based on interviews and testwork performed, we found the department was monitoring its grant and loan recipient process so the prior audit finding has been resolved.

WORKFORCE REDUCTION

In April 2011 the Governor and the Commissioner of the Department of Economic and Community Development announced a new strategy in an effort to bring more jobs to the state with the Jobs4TN program. In an effort to develop and meet the objectives of this strategy, the commissioner developed additional strategies within the department. One of these strategies included reorganizing the department, changing the departmental strategies and objectives, and reducing the department's workforce.

The objective of our review was to

- determine the impact of consolidating three field offices into one and reducing staff by 40% on the department's ability to recruit businesses and promote jobs.

We interviewed key personnel and performed walkthroughs to determine how the 40% reduction in staff affected the department's ability and procedures to recruit businesses and the advances of jobs in the state.

Based on interviews and walkthroughs performed, we determined that the reduction in staff was mainly due to the three field offices consolidation. The three field offices' main objective had been helping communities with local planning in bringing businesses and jobs to the communities; however, with the new Jobs4TN program the objectives have changed and that service is no longer provided to the local communities. Therefore, even with the 40% reduction in staff, the department has still carried out its mission by realigning staff and procedures.

COMPLIANCE

PERFORMANCE MEASURES

Executive agencies are required by the Governmental Accountability Act of 2002 and Section 9-4-5606(b), *Tennessee Code Annotated,* to annually submit a strategic plan for delivering services and the proposed program performance measures and standards to assist the General Assembly in making meaningful decisions about the allocation of the state's resources in meeting vital needs.

The objectives of our review of the department's performance measures process were to

- follow up on the prior audit finding related to performance measures;
- review the most recent Agency Strategic Plan submitted, note any changes in services since the previous plan, and determine any problems or inconsistencies between the Agency Strategic Plan and the organization of the department and its mission; and

- determine the department's methods for preparing and reviewing performance measures.

We interviewed key personnel and reviewed documentation to follow up on the prior audit finding. We reviewed the Agency Strategic Plans for 2011 Volume 1 and Volume 2 to determine problems and inconsistencies with the organization of the department. We also interviewed key personnel to determine how the performance measures were determined and reviewed.

Based on our interviews and supporting documentation reviewed, we determined that the department has implemented recommendations and improved its performance measures with the use of its internal performance measurement questionnaire used to evaluate data validity. The prior audit finding on performance measures has been resolved. Based on review of the Agency Strategic Plans and supporting documentation, and interviews conducted, we did not note any changes in services since the previous plan and did not note any problems or inconsistencies with the department's plan, the organization of the department, and its mission. We also were able to determine the department appropriately identified and added new measures when applicable and appropriately reviewed and reported on measures based on valid data. See Appendix 2 on page 46 for the department's performance measures for each division.

TITLE VI

Title VI of the Civil Rights Act of 1964 states that "no person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal financial assistance."

The objectives of our review of Title VI were to determine if the department

- prepared a Title VI plan;
- had procedures for handling Title VI complaints and if the department received any Title VI related complaints during the past two years;
- monitored Title VI compliance of subrecipients; and
- educated or informed employees and subrecipients regarding the requirements of Title VI.

We obtained and reviewed the Title VI Implementation Plan for the Department of Economic and Community Development. We reviewed the plan, interviewed key personnel, and reviewed supporting documentation to determine if the department had procedures for handling Title VI complaints and if any complaints had been filed, if the department monitored the Title VI compliance of subrecipients, and if the department educated or informed employees and subrecipients regarding the requirements of Title VI.

Based on our interviews and reviews, we found that the department

- prepared a Title VI plan;
- had procedures for handling Title VI complaints but did not receive any complaints during the last two years;
- monitored Title VI compliance of subrecipients; and
- educated and informed employees and subrecipients regarding the requirements of Title VI.

The Human Rights Commission is charged with the responsibility of verifying that all state governmental entities that are recipients of federal financial assistance comply with the requirements of Title VI of the Civil Rights Act of 1964 pursuant to the State of Tennessee Public Acts, 2009 Public Chapter No. 437. For the *Tennessee Title VI Compliance Program Annual Report* prepared by the Human Rights Commission, which covers the period July 1, 2009, through June 30, 2011, the Department of Economic and Community Development was issued the following findings:

- no Limited English Proficiency (LEP) policy and/or procedure for employees and
- responsible officials section not signed by the Department Head.

See Appendix 1, page 42 for the department's staff ethnicity and gender demographics as well as the ethnicity and gender demographics for subrecipients.

FOLLOW-UP OF OTHER PRIOR AUDIT FINDINGS

(All other prior audit findings were followed up in the applicable section of this report.)

Prior Audit Finding Entitled "Current procedures do not encourage members of ECD-administered boards to disclose conflicts of interest"

To follow up on the finding, we obtained and reviewed conflict-of-interest forms and interviewed key personnel to determine if procedures had changed. We determined the department did revise its conflict-of-interest form to encourage members to disclose conflicts of interest. However, during our review of the conflict-of-interest forms, we found that not all board members had a completed conflict-of-interest form filed with the department; therefore, this finding was repeated.

Finding

5. <u>The Department of Economic and Community Development did not ensure board and committee members signed annual conflict-of-interest forms, and department management did not identify the risks associated with board and committee members in the department's risk assessment</u>

As noted in the prior audit released in March 2009, the Department of Economic and Community Development has not required board and committee members to sign annual conflict-of-interest forms. According to the prior audit, the conflict-of-interest policy in the Department of Economic and Community Development (ECD) did not require board and committee members to sign annual conflict-of-interest forms. The policy required only new board members to sign conflict-of-interest forms when they were appointed. The conflict-of-interest form certified that the board members had received, read, and intended to abide by Executive Order No. 3, which set out multiple ethics and conflict-of-interest policies; however, the forms were not constructed in a way that members could fully disclose all conflicts.

In response to the prior audit finding and recommendation, ECD's management stated, "…the department will take the steps to ensure members of the ECD-administered boards update the conflict-of-interest forms annually … the department will provide opportunity on the form to enable board members and staff to document any potential conflicts of interests that may exist."

According to Sections 4-3-727, 4-14-109, and 4-14-305, *Tennessee Code Annotated*, ECD is required to administer the following four boards:

- the Tennessee Board for Economic Growth,
- the Tennessee Technology Development Corporation Board of Directors (TTDC),
- the Building Finance Committee, and
- the Local Government Planning Advisory Committee.

Since the prior audit, ECD has updated the conflict-of-interest form by providing space for possible conflicts to be added; however, ECD did not ensure all board and committee members signed the conflict-of-interest form annually. We reviewed conflict-of-interest forms for three of the aforementioned ECD-administered boards and one additional committee, the Loan and Grant Committee, which consists of ECD's Commissioner and Assistant Commissioners. The Tennessee Board for Economic Growth was statutorily deleted in 2009; therefore, the Tennessee Board for Economic Growth was not included in our review or investigated further.

Our testwork revealed that ECD staff did not ensure board and committee members of three of the four boards administered by the department (75%) signed conflict-of-interest forms annually. The results of our review are summarized below:

Tennessee Technology Development Corporation Board of Directors

The statutory function of the Tennessee Technology Development Corporation (TTDC), as stated in Section 4-14-305, *Tennessee Code Annotated*, is to assist, support, and improve technology transfer, research, statewide innovation capacity, and other economic and technology-related issues. The TTDC Board of Directors is required to sign the TTDC conflict-of-interest forms annually. However, not all the board members have updated their conflict-of-interest forms. Section 4-14-303 states the board should have 22 members; however, currently the board only has 19 members. We found that 7 of the 19 members (37%) have not signed conflict-of-interest forms.

Building Finance Committee

The Building Finance Committee's statutory function, per Section 4-14-109, *Tennessee Code Annotated*, is to review applications and issue certificates of public purpose and necessity for municipal provision of industrial buildings if counties and municipalities want to issue debt obligations. The Building Finance Committee members are required to declare a conflict of interest at the beginning of each meeting; however, the members do not sign the conflict-of-interest forms annually. Currently, only one of seven (14.3%) members has a signed conflict-of-interest form for fiscal year 2011.

Local Government Planning Advisory Committee

The Local Government Planning Advisory Committee's statutory function, according to Section 4-3-727, *Tennessee Code Annotated*, is to advise the department's Commissioner on local planning assistance and oversee regional planning commissioners. The seven members of the committee are required by Executive Order No. 3 to sign conflict-of-interest forms annually. Currently, five members serve on the committee. None of the five members (0%) have signed a conflict-of-interest form for fiscal year 2012.

The Department's Loan and Grant Committee

The Loan and Grant Committee has eight voting members consisting of the Commissioner, the five Assistant Commissioners, the Chief of Staff, and the Legal Counsel of ECD. The purpose of the Committee is to make the final decision regarding funding for economic development projects for programs such as Community Development Block Grants, FastTrack Infrastructure Development, FastTrack Job Training, and Energy Loans. As employees of the department, the committee members sign conflict-of-interest forms annually. We reviewed the Loan and Grant Committee members' conflict-of-interest forms and found that all members had conflict-of-interest forms on file as required.

Personal or private financial considerations on the part of board or committee members should not be allowed to enter the decision-making process. Failure to disclose conflicts of interest could result in unintentional bias, improper use of resources, and the appearance of impropriety.

We also reviewed management's risk assessment to determine if management had appropriately identified risks of noncompliance, fraud, waste, and abuse in regard to reporting conflicts of interest by board and committee members. We found that management had not identified the risks or mitigating controls associated with the area of conflicts of interest.

Recommendation

The Commissioner should require all the board and committee members to sign conflict of interest forms annually, and the Commissioner should enforce this requirement. The Commissioner should take steps to ensure that management of the department assesses the risks and mitigating controls associated with conflicts of interest regarding board and committee members and document that assessment.

Management's Comment

The department concurs. The department takes conflict-of-interest issues very seriously and all of the members of the Tennessee Technology Development Corporation Board of Directors and the Local Government Planning Advisory Committee have now signed conflict-of-interest forms that cover the current fiscal year. The members of the Building Finance Committee, however, have not yet signed such statements for the current fiscal year and the department intends to require each of the members of this committee to sign such a form immediately. The department notes that it failed to collect annual conflict-of-interest forms from these committee members in the past because (i) each appointees must sign such form when appointed; and (ii) members are formally asked on the record at the beginning of each committee meeting whether they have a conflict of interest related to any application coming before the committee.

While the department's Risk Assessment for FY 2012 identified the risks and mitigating controls associated with staff conflicts of interest, it did not address the risks and mitigating controls for the conflicts of interest of members of the boards and committees the department administers. The Management Risk Assessment for FY 2013 due to be submitted to the Office of the Comptroller by December 31, 2012 will address this risk.

Prior Audit Finding Entitled "The department's statutes, and rules and regulations need to be updated"

We interviewed key personnel and supporting documentation to determine if the department had implemented recommendations and updated the identified statutes, and rules and regulations from the prior audit finding. Based on interviews and documentation reviewed, we determined that the department updated all statutes, and rules and regulations discussed in the prior finding except for Rule 0500-5-2 addressing the Enterprise Demonstration Project as discussed in the Observation and Comments section in observation 2. We determined that it was not necessary to repeat the prior audit finding based on the department's progress with implementing the prior audit finding recommendations.

OBSERVATIONS AND COMMENTS

The topics discussed below did not warrant a finding but are included in this report because of their effect on the operations of the department and on the citizens of Tennessee.

Observation 1 – Updating Section 4-14-109(b), *Tennessee Code Annotated,* to reflect changes made to other code sections

We reviewed the statutes related to the Department of Economic and Community Development and the various boards and committees attached to the department to obtain an understanding of the department's responsibilities.

Based on this review, we found that Section 4-14-109(b), *Tennessee Code Annotated*, relating to the Building Finance Committee, states, "The committee shall consist of the vice chair of the former Tennessee Board of Economic Growth, serving ex officio as chair of the committee…" The Tennessee Board of Economic Growth was statutorily deleted in 2009. Management of ECD should ensure that sections of the statute that reference this board are updated to reflect these changes and clearly state who is to serve on the Building Finance Committee.

Observation 2 - Repealing Rule 0500-5-2, Enterprise Demonstration Project, created and funded by the General Assembly in 1998, which is no longer active

As part of the follow-up on the previous finding, that the department's statutes, and rules and regulations need to be updated, we reviewed the rules of the Department of Economic and Community Development as listed on the Secretary of State's website to determine whether the rules were up-to-date and relevant. Based on this review, we found that Rule 0500-5-2 addressing the Enterprise Demonstration Project, which was created and funded by the General Assembly in 1998, is no longer active and the Legislature may want to consider repealing it.

APPENDICES

APPENDIX 1

Title VI Information

Tennessee Department of Economic and Community Development
Staff by Job Title, Gender, and Ethnicity
As of May 24, 2012

Title	Gender		Ethnicity			
	Male	Female	White	Black	Asian	Other
ACCOUNTANT 2*	2	0	1	0	0	1
ACCOUNTANT 3	2	0	1	1	0	0
ACCOUNTING TECHNICIAN 1	0	1	1	0	0	0
ADMIN ASSISTANT 1	1	2	2	1	0	0
ADMIN ASSISTANT 2	2	1	2	1	0	0
ADMIN ASSISTANT 3	0	1	1	0	0	0
ADMIN SERVICES ASSISTANT 3	0	1	1	0	0	0
ADMIN SERVICES ASSISTANT 4	0	1	1	0	0	0
ADMIN SERVICES ASSISTANT 5	1	0	1	0	0	0
ASSISTANT COMMISSIONER 2	3	2	4	1	0	0
ATTORNEY 3	0	1	0	1	0	0
AUDIT DIRECTOR 2	0	1	1	0	0	0
AUDITOR 2*	1	0	1	0	0	0
AUDITOR 3	1	0	1	0	0	0
BUSINESS DEV CONSULTANT 2	0	2	2	0	0	0
BUSINESS RESOURCE ENT CONS	1	0	0	1	0	0
COMMISSIONER 3	1	0	1	0	0	0
COMMUNITY DEV PROGRAM DIR	1	0	1	0	0	0
COMMUNITY PLANNING DIR	1	0	1	0	0	0
COMMUNITY PLANNING REG DIR	4	0	3	1	0	0
CONTRACT AND AUDIT COORDINATOR	0	1	0	1	0	0
CREATIVE SERVICES COOR 1	0	2	2	0	0	0
CREATIVE SERVICES COOR 2	1	0	1	0	0	0
CREATIVE SERVICES DIRECTOR	0	1	0	1	0	0
DEPUTY COMMISSIONER 2	1	0	1	0	0	0
ECD ADMINISTRATOR	1	0	1	0	0	0
ECD BUS DEV CONSULTANT	5	8	11	2	0	0
ECD COMMUNICATIONS OFFICER	0	1	1	0	0	0
ECD DIR OF GLOBAL PROJ MGMNT	0	2	2	0	0	0
ECD PROJECT MANAGER	2	3	5	0	0	0
ECD REGIONAL FIELD DIR	6	2	7	0	0	1
ECD STATEWIDE DIRECTOR	1	0	1	0	0	0
ECONOMIC DEV REGNL SPECIALIST	0	2	2	0	0	0
ECONOMIC RESEARCH ANALYST	1	1	1	0	1	0
ECONOMIC RESEARCH DIRECTOR	0	1	0	0	0	1
ENERGY POLICY DIRECTOR	0	1	1	0	0	0
EXECUTIVE ADMIN ASSISTANT 2	3	2	5	0	0	0

Title	Gender		Ethnicity			
	Male	Female	White	Black	Asian	Other
EXECUTIVE ADMIN ASSISTANT 3	3	0	3	0	0	0
FISCAL DIRECTOR 1	0	2	1	1	0	0
FISCAL DIRECTOR 2	0	1	0	1	0	0
GENERAL COUNSEL 1	0	1	1	0	0	0
GIS TECHNICIAN 2*	1	0	1	0	0	0
GIS TECHNICIAN MANAGER 1	1	0	1	0	0	0
GRANTS ANALYST 2*	1	0	1	0	0	0
GRANTS ANALYST 3	1	2	3	0	0	0
GRANTS PROGRAM DIRECTOR	1	1	2	0	0	0
GRANTS PROGRAM MANAGER	2	3	4	1	0	0
HR DIRECTOR 2	0	1	1	0	0	0
INDUSTRIAL TRNG CONSULTANT 3	1	0	1	0	0	0
INDUSTRIAL TRNG CONSULTANT 4	1	0	1	0	0	0
INDUSTRIAL TRNG MANAGER	0	1	1	0	0	0
INFO RESOURCE SUPPORT SPEC 4	0	2	2	0	0	0
INFORMATION OFFICER	0	1	1	0	0	0
INFORMATION SYSTEMS DIRECTOR 2	1	0	1	0	0	0
INFORMATION SYSTEMS MANAGER 1	1	0	1	0	0	0
JOBS DEV REGIONAL DIRECTOR	0	1	1	0	0	0
LOAN OFFICER 2	1	0	0	1	0	0
LOAN PROGRAM DIRECTOR	1	0	1	0	0	0
LOCATION COORDINATOR 2	1	0	1	0	0	0
MAIN STREET PROGRAM MANAGER	0	2	2	0	0	0
OFFICE AND RESOURCE MANAGER	0	1	1	0	0	0
PROGRAMMER/ANALYST 3	1	0	0	0	1	0
SMALL BUSINESS ENT DIRECTOR	0	1	1	0	0	0
STATISTICAL RESEARCH SPEC	1	0	1	0	0	0
TN FEMC EXECUTIVE DIRECTOR	1	0	1	0	0	0
WEBSITE DEVELOPER 2	0	1	1	0	0	0
Totals	62	61	103	15	2	3

Source: Information obtained from the department's Human Resource Director.

Department of Economic and Community Development
Community Development Block Grant Awards for Calendar Year 2010
Ethnicity and Gender Demographics for Subrecipients

Locality	Activity	Applicant - Direct Benefit			Beneficiary			Total
		White	Black	Other	White	Black	Other	Served
Alamo	Sewer System Improvements	0	0	0	2,084	476	516	3,076
Anderson County	Sewer Line Extension	44	26	13	0	0	0	83
Baxter	Water System Rehabilitation	0	0	0	4,327	26	650	5,003
Bradley County	Water Line Extension	346	1	20	0	0	0	367
Brighton	Housing Rehabilitation	1	39	6	0	0	0	46
Campbell County	Water Line Extension	81	0	12	0	0	0	93
Celina	Water System Rehabilitation	0	0	0	4,130	12	1,003	5,145
Chapel Hill	Sewer System Rehabilitation	0	0	0	1,002	64	212	1,278
Clay County	Water System Improvements	0	0	0	3,200	16	359	3,575
Covington	Sewer Plant Improvements	0	0	0	3,519	4,822	1,574	9,915
Crockett County	Emergency Service Improvements	0	0	0	9,290	3,009	4,718	17,017
Cumberland County	Water System Renovation	0	0	0	210	0	38	248
Cumberland Gap	Water System Improvements	0	0	0	218	0	59	277
Decherd	Sewer System Rehabilitation	0	0	0	2,032	269	596	2,897
Dover	Sewer System Rehabilitation	0	0	0	1,382	14	242	1,638
Doyle	Fire Protection	0	0	0	2,425	10	410	2,845
Dyer	Sewer Plant Improvements	0	0	0	1,850	112	688	2,650
Dyer County	Finley Elementary Wastewater	0	0	0	1,300	11	135	1,446
East Ridge	Drainage	0	0	0	5,412	120	1,178	6,710
Erin	Sewer System Rehabilitation	0	0	0	853	85	162	1,100
Ethridge	Early Warning Sirens	0	0	0	505	7	72	584
Gibson County	Fire Department Improvements	0	0	0	13,810	606	2,057	16,473
Greenfield	Water Plant Improvements	0	0	0	1,695	162	185	2,042
Harriman	Sewer System Improvements	0	0	0	4,703	186	1,135	6,024
Harrogate	Sewer Line Extension	104	0	18	0	0	0	122
Hawkins County	Water Line Extension	433	0	63	0	0	0	496
Henning	Fire Protection	0	0	0	1,062	1,373	1,551	3,986
Henry County	Water Tank Acquisition	0	0	0	1,252	50	154	1,456
Hornbeak	Sewer Line Extension	114	0	30	0	0	0	144
Humphreys County	Water System Improvements	0	0	0	1,938	0	207	2,145
Jellico	Wastewater System Improvement	0	0	0	2,354	29	342	2,725
Kimball	Sewer Line Extension	95	0	12	0	0	0	107
Lafayette	Sewer System Improvements	0	0	0	3,499	33	891	4,423
Lafollette	Sewer System Improvements	0	0	0	8,438	26	1,379	9,843
Lynnville	Water Storage Tank	0	0	0	678	42	95	815
Martin	Sewer System Improvements	0	0	0	5,997	1,314	1,378	8,689
Maynardville	Water Line Extension	75	0	18	0	0	0	93
Monroe County	Water Line Extension	77	0	13	0	0	0	90
Mosheim	Sewer Plant Rehabilitation	0	0	0	3,420	102	539	4,061
Mountain City	Sewer System Rehabilitation	0	0	0	1,783	9	380	2,172
Mt. Pleasant	Sewer System Rehabilitation	0	0	0	2,374	437	703	3,514
Newbern	Sanitary Sewer Rehabilitation	1,946	405	350	0	0	0	2,701
Palmer	Housing Rehabilitation	37	0	4	0	0	0	41

Locality	Activity	Applicant - Direct Benefit			Beneficiary			Total
		White	Black	Other	White	Black	Other	Served
Polk County	Water Line Extension	169	0	8	0	0	0	177
Putnam County	Fire Protection	0	0	0	5,884	32	870	6,786
Red Bank	Sewer System Rehabilitation	0	0	0	12,526	495	2,038	15,059
Red Boiling Springs	Water System Improvements	0	0	0	4,086	4	642	4,732
Ridgely	Water System Improvements	0	0	0	1,033	247	538	1,818
Scott County	Sewer Line Extension	20	0	3	0	0	0	23
Sequatchie County	Water Line Extension	184	0	9	0	0	0	193
Shelbyville	Sewer System Rehabilitation	0	0	0	1,826	389	987	3,202
Sparta	Sewer System Rehabilitation	0	0	0	3,667	138	1,145	4,950
Spencer	Water System Rehabilitation	0	0	0	3,866	4	501	4,371
Spring Hill	Housing Rehabilitation	0	41	17	0	0	0	58
Trimble	Sanitary Sewer Rehabilitation	602	20	99	0	0	0	721
Trousdale County Hartsville	Water System Rehabilitation	0	0	0	5,609	1,200	1,267	8,076
Union County	Water Line Extension	152	0	15	0	0	0	167
Vanleer	Water Line Extension	142	0	16	0	0	0	158
Wartburg	Sewer System Improvements	0	0	0	1,122	0	199	1,321
Watauga	Housing Rehabilitation	24	0	2	0	0	0	26
Westmoreland	Water System Improvements	0	0	0	4,148	64	647	4,859
White Bluff	Sewer System Improvements	0	0	0	2,051	6	320	2,377
White County	Water System Rehabilitation	0	0	0	3,488	12	327	3,827
White Pine	Wastewater I/I	0	0	0	2,001	66	337	2,404
Whiteville	Fire Department Improvements	0	0	0	2,051	1	333	2,385
Woodbury	Water System Rehabilitation	0	0	7,247	89	0	1,430	8,766
Waynesboro	Sewer Plant Improvements	0	0	0	1,317	9	432	1,758
	Totals	4,646	532	7,975	151,506	16,089	35,621	216,369

Source: Information obtained from the Community Development Block Grant Program Manager.

APPENDIX 2

Performance Measures Information
Obtained From Assistant Commissioners of Each Division and Agency Strategic Plans

As stated in the Tennessee Governmental Accountability Act of 2002, "accountability in program performance is vital to effective and efficient delivery of governmental services, and to maintain public confidence and trust in government." In accordance with this act, all executive branch agencies are required to submit annually to the Department of Finance and Administration a strategic plan and program performance measures. The department publishes the resulting information in two volumes of *Agency Strategic Plans*: *Volume 1 - Five-Year Strategic Plans* and *Volume 2 - Program Performance Measures*. Agencies were required to begin submitting performance-based budget requests according to a schedule developed by the department, beginning with three agencies in fiscal year 2005, with all executive-branch agencies included no later than fiscal year 2012. The Department of Economic and Community Development began submitting performance-based budget requests effective for fiscal year 2009.

Detailed below are the department's performance standards and performance measures, as reported in the September 2010 *Volume 2 - Program Performance Measures*. Also reported below is a description of the agency's processes for (1) identifying/developing the standards and measures; (2) collecting the data used in the measures; and (3) ensuring that the standards and measures reported are appropriate and that the data are accurate.

We did not audit, sample, or test this information, the procedures used to determine the information, or the controls over the validity of the information.

Performance Standards and Measures

Administrative Services

Performance Standard 1

Process contracts within 30 days of initiation to the time the contract is submitted to the Department of General Services, Procurement Office.

Performance Measure 1

Percent of contracts processed within 30 days.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
N/A	50%	60%

Performance Standard 2

Process invoices with 30 days of receipt to ensure compliance with state policy.

Performance Measure 2

Percent of invoices processed within 30 days of receipt.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
100%	99%	99%

The contracts performance measure documents the time that elapses between the submission of a contract and when it is returned to the department and processed. The contract administrator is responsible for receiving contract information, drafting the contract, and sending it to the recipient. When the contract is returned to the department, all necessary parties sign it and it is submitted through Edison. The department tracks the contract by using Edison and department logs. The measure is calculated by determining the number of completed contracts that are initiated, reviewed, and returned within a 30-day period to be submitted for approval. The review of data and calculations for the contracts performance measure is done by the Contracts Director, Senior Budget Advisor, Budget Director, and the Assistant Commissioner of Administrative Services.

The invoice performance measure documents the timeliness in processing invoices for payment. The purpose of this goal is to set a high standard of customer service for ECD customers in the area of payments. The fiscal team members record information in a database upon receipt of the invoices. The Accountant 3 runs a database report and incorporates the information into a spreadsheet. The measure is calculated by dividing payments made within 30 days by the total number of invoices submitted. The review of data and calculations for the invoice performance measure is done by the Budget Director.

Business Development

Performance Standard 1

Attract and recruit new jobs by assisting existing business and industry through the recruitment of new business and industry to the state.

Performance Measure 1

Number of jobs created as a result of recruitment and expansion projects.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
12,585	13,000	13,250

Performance Standard 2

Promote new investment in the state through the recruitment of new and existing industry to locate and expand in the state.

Performance Measure 2

Private capital investment leveraged as a result of recruitment and expansion projects.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
$ 3,717,061,627	$ 1,800,000,000	$1,900,000,000

These performance standards are developed directly from ECD's central goal of bringing investment and jobs to the state. Data are collected in three ways. First is through the initial "project in-take" form. Next, projects are tracked in the Project Management Database. Lastly, projects are tracked by the Grant and Loan Database for five years after project completion.

Data are calculated by tracking the Project Management Database and communications with the companies. Data are verified through weekly statewide conference calls. The Commissioner, Chief of Staff, Assistant Commissioner of Business Development, other senior management, and all business development personnel review the performance measure.

Tennessee Job Skills

Performance Standard 1

Assist in creation and retention of jobs through the provision of training assistance to elevate the skills of Tennessee workers and enhance employment opportunities.

Performance Measure 1

Number of jobs created or upgraded related to assistance from Tennessee Job Skills Program.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
1,461	600	600

Data for Tennessee Job Skills Program performance measures are collected from Loan and Grant Committee outcomes. Also, training expenses are reviewed by ECD staff. ECD staff compile the data. The performance measure is calculated by totaling the jobs created or upgraded with funds from the Tennessee Job Skills Program. A review of the compiled data is completed by the Senior Advisor of the Grants Program.

FastTrack Infrastructure and Job Training Assistance

Performance Standard 1

Assist in the creation of jobs through the provision of infrastructure development and training assistance.

Performance Measure 1

Number of jobs created or upgraded in which job training assistance and infrastructure assistance was provided.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
5,854	14,000	15,850

Performance Standard 2

Promote new investment in the state through the provision of infrastructure development and training assistance.

Performance Measure 2

Private capital investment leveraged as a result of infrastructure development and training assistance.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
$2,613,220,845	$1,220,000,000	$2,255,000,000

The FastTrack Program's purpose is to provide to new and existing businesses assistance with infrastructure projects and job training projects. The performance standards are developed according to this purpose. Data are collected for FastTrack from the information presented in the Loan and Grant Committee meetings. This data is compared with and adjusted according to the meeting minutes. The measure is the total number of jobs created or upgraded and total dollar amount of private capital investment. A review is done by the Senior Advisor to the Loan and Grant Committee and by the FastTrack Program Manager.

Community Development

Performance Standard 1

Through provision of the Three Star Program, provide cities and counties with a strong community development foundation.

Performance Measure 1

Number of Tennessee Counties certified as Three-Star Benchmark III communities.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
9	15	17

Performance Standard 2

Through provision of the Main Street Program and related principal, assist cities in development of a plan to revitalize downtown districts.

Performance Measure 2

Number of certified Main Street communities and those pursuing Main Street principles.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
24	40	40

The Community and Rural Development Division's performance standard is made up of information from two programs, the Three Star Program and the Main Street Program.

The Three Star Program's intent is to assist in developing best practices that prepare a community for sustainable economic growth. There are three levels of performance criteria referred to as Benchmarks I, II, and III. Performance is measured by tracking the number of counties that reach Benchmark III. Because of the reduction in force, support staff are no longer available. The program is being redesigned and performance standards will most likely change after December 31, 2012. The written data collection procedures have been reviewed by the Director of Rural Development.

The Main Street Program's intent is to expose downtown districts to the National Main Street Program and to preserve and revitalize neglected downtown properties. The program measures performance by tracking how many downtown districts assessed downtown assets and prepared a plan in accordance with Main Street principles.

The information for the Three Star Program has been collected in the past by an annual report card submitted by the county. The measure is simply the total of communities that reach the Benchmark III level. The staff that have been responsible for this were part of 2012 staff reduction. This issue will be addressed in the redesign of the program.

The information for the Main Street Program is collected from annual performance reports and evaluation of plans proposed by the district board of directors. The performance measure is determined by the number of districts actively pursuing downtown revitalization using National Main Street principles.

The Three Star Program and the Main Street Program are reviewed by the Internal Audit Director for appropriateness and accuracy.

Economic Development District Grants

Performance Standard 1

Provide for the distribution of funds to the development districts as directed by statute, depending on local government contributions.

Performance Measure 1

Number of grants processed.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
9	9	9

The State of Tennessee assists development districts financially with development of economic development plans and coordination of activity. This is achieved through ECD. The development districts must submit to ECD annual plans and confirm matching local funds. Once these items are submitted, it is ECD's duty to issue grants of the designated amount to each development district. ECD uses the number of grants processed to measure performance.

Data are collected annually by the Administrative Services Division. The source of data is the actual, fully processed contract documents. The measure is calculated by summing the number of contracts that have actually been processed. The measurement data are reviewed by the Budget Director, Senior Advisor for Fiscal Policy, Assistant Commissioner for Administrative Services, Internal Audit Director, and Chief of Staff. The data are verified by copies of contract documents and Edison contract queries.

Innovation Division

Performance Standard 1

Attract, support, and recruit new jobs by assisting early-stage companies and existing business by providing expanded access to capital and other support services.

Performance Measure 1

Total jobs resulting from Innovation Program activities.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
N/A	356	1,400

Performance Standard 2

Promote new investment in the state by supporting innovation, entrepreneurship, commercialization, and access to capital.

Performance Measure 2

Total investment resulting of Innovation Program activities.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
N/A	$30,923,533	$73,500,000

Development in the early stages of an enterprise is critical to the state's economic success because generally speaking companies usually remain where they began for the duration of their company life. These performance measures help the department to encourage this type of company development.

The ECD Director of Innovation and Assistant Commissioner of Strategy will be responsible for compiling data for the performance measures. They will use information from research institutions, Salesforce.com, and the TNInvestco firms. Performance measures and data will be reviewed by the ECD Director of Innovation and the Assistant Commissioner of Strategy.

CDBG

Performance Standard 1

The CDBG program ensures that at least 62% of those served will be persons of low to moderate income.

Performance Measure 1

Percentage of low–to-moderate-income people served.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
70%	62%	70%

Performance Standard 2

Within the CDBG program, target areas of economic distress.

Performance Measure 2

Percentage of CDBG contracts awarded in distressed areas.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
40%	40%	42%

ECD provides assistance to distressed counties. The determination of whether a county is distressed is based on the unemployment rate, poverty level, and per capita income. The Community Development Block Grant Program's primary purpose is to assist low-to-moderate-income individuals.

For the performance measure concerning the percentage of low-to-moderate-income individuals served, data are recorded in the project application. When the project is completed, ECD performs a close out report to verify how many of the beneficiaries have low to moderate incomes. The performance measure concerning the number of grants to distressed counties, ECD compares the list of recipients to the published list of distressed counties. There are five grant analysts at ECD who review the percentage of low to moderate income individuals served. The director reviews the list of distressed counties compared to the list of recipients.

Energy Division

Performance Standard 1

Promote energy cost and dollar savings.

Performance Measure 1

Projected energy cost savings to homeowners, businesses and local governments as a result of energy programs.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
N/A	$2,400,000	$2,400,000

Performance Standard 2

Increase the amount of renewable energy produced in TN.

Performance Measure 2

Installed nameplate capacity of distributed renewable energy systems as a result of ECD programs – this is measured in kilowatts.

Actual (FY 2009-2010)	Estimate (FY 2010-2011)	Target (FY 2011-2012)
436 kW	9200 kW	5300 kW

Data are collected for both measures by the Grant Program Managers. For the energy savings measure, information is calculated by using U.S. Department of Energy conversion calculators. The amount of renewable energy measure is calculated by totaling the capacity of installed systems. Review is completed by the Grant Program Managers and the Energy Division Director. After the review, the amounts are provided to the Budget Director.

APPENDIX 3

Revenues and Expenditures Information

Revenues

Obtained from www.tn.gov/financial/bud/budget

Statement of Revenues
Revenues by Source
For the Fiscal Year Ending June 30, 2011

Source	*Amount*	*Percent of Total*
State	$73,302,800	42%
Federal	80,218,300	46%
Other*	19,870,100	12%
Total Revenue	**$173,391,200**	**100%**

* Other sources include fees, interest, contracts with other state agencies, and program reserves.

Statement of Revenues
Revenues by Account
For the Fiscal Year Ending June 30, 2011

Account	*Amount*	*Percent of Total*
Administrative Services	$6,902,600	4%
Business Development	30,045,200	16%
Innovation Programs	161,900	0%
Headquarters Relocation Assistance	20,000,000	12%
Tennessee Job Skills Program	3,463,400	2%
Policy and Federal Programs	*30,555,700	18%
Economic Development District Grants	1,470,400	1%
FastTrack Infrastructure & Job Training Assistance	16,503,200	9%
Film and Television Incentive Fund	1,425,700	1%
Community Development	8,139,700	5%
Energy Division	54,723,400	32%
Total Revenues	**$173,391,200**	**100%**

*Includes Community Development Block Grants.

Budget and Anticipated Revenues
For the Fiscal Year Ending June 30, 2012

Source	*Amount*	*Percent of Total*
State	$141,858,500	35%
Federal	183,839,500	45%
Other *	80,028,700	20%
Total Revenue	**$405,726,700**	**100%**

* Other sources include fees, interest, contracts with other state agencies, and program reserves.

Expenditures

Statement of Expenditures
Expenditures by Program
Expenditures for Fiscal Year Ending June 30, 2010

Account	*Amount*	*Percent of Total*
Administrative Services	$2,130,663	2%
Business Development	27,344,859	27%
Regional Grants Management	28,133,051	28%
Business Services	117,584	<1%
Fast Track Infrastructure and Job Skills	992,361	<1%
Community Development	19,504,982	19%
Energy Division	21,217,038	21%
Small Business Energy	35,008	<1%
Local Government Energy	4,500	<1%
Tennessee Job Skills	112,542	<1%
Economic Development District Grants	665,543	<1%
Film and Television Incentive	(14,728)	<1%
Headquarters Relocation Assistance	N/A	N/A
ECD TNInvestco Private Trust	5,164	<1%
Total Expenditures	**$100,248,567**	**100%**

Source: State Audit Information Systems, 1/17/2012.