STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

DEPARTMENT OF ECONOMIC AND COMMUNITY DEVELOPMENT AND TENNESSEE TECHNOLOGY DEVELOPMENT CORPORATION

Performance Audit Report

October 2016

Justin P. Wilson, Comptroller

Division of State Audit
Sunset Performance Section

DEBORAH V. LOVELESS, CPA, CGFM, CGMA
Director

JOSEPH SCHUSSLER, CPA, CGFM
Assistant Director

DENA W. WINNINGHAM, CGFM
Audit Manager

Catherine B. Balthrop, CPA
Suzanne Sawyers, CFE
In-Charge Auditors

Connie Calloway
Fonda Douglas
Stacey Green, JD
Staff Auditors

Amy Brack
Editor

Amanda Adams
Assistant Editor

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

Reports are available at
www.comptroller.tn.gov/sa/AuditReportCategories.asp

Mission Statement
The mission of the Comptroller's Office is
to make government work better.

Comptroller Website
www.comptroller.tn.gov

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

October 25, 2016

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 Jeremy Faison, Chair
 House Committee on Government Operations
 and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
 and
The Honorable Randy Boyd, Commissioner
Department of Economic and Community Development
312 Rosa Parks Avenue
Nashville, TN 37243

Ladies and Gentlemen:

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

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

Sincerely,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

16105

State of Tennessee

A u d i t   H i g h l i g h t s

Comptroller of the Treasury   Division of State Audit

Performance Audit

Department of Economic and Community Development and
Tennessee Technology Development Corporation

October 2016

AUDIT FINDINGS

The department did not report and track all TNInvestco program data and did not accurately report jobs created and retained, including jobs held by women and minority employees
Our review of the TNInvestco files, scorecards, annual reviews, and annual reports found that the department did not report the amount of designated capital invested in each qualified TNInvestco company in the annual report; did not submit a summary including findings and areas of noncompliance to each TNInvestco company at the end of the annual review; and did not track or report the number of minority-owned and women-owned businesses (page 8).

FastTrack grantees' self-reported data is not always submitted timely; grantees may need more guidance to ensure accurate self-reporting of jobs data
FastTrack grantees are required to submit an Annual Employment Summary Form. We reviewed 42 FastTrack contracts; nine of 28 grantees did not submit a 2014 form, and 29 of 42 grantees did not submit a 2015 form. Grantees submitting annual performance data for their Accountability Agreements may need more explanation and guidance from the department (page 18).

The FastTrack Program's Grant Committee meeting minutes did not include contract approval for 6 of 42 contracts
The Grant Committee makes the final decision regarding funding for FastTrack projects. Six of 42 FastTrack contracts we reviewed did not have contract approval by the Grant Committee prior to the contract date (page 24).

The department did not comply with Central Procurement Office Subrecipient Monitoring Policy

The department's 2016 monitoring plan does not include information required by the policy—a list of all contracts with risk assessments and a list of subrecipients to be monitored. Some programs did not issue monitoring reports, and not all monitoring reports were provided to the Comptroller (page 26).

The Tennessee Job Skills Program's grants and its annual report do not contain all information required by statute

We reviewed the documentation for 7 of the 26 Tennessee Job Skills grants from the February 2016 Tennessee Job Skills grant report. Two of the seven applicant files did not have a Tennessee Job Skills Application, and the grantee had not certified that the project met the requirements of Section 50-7-451(c)(5), *Tennessee Code Annotated*, such as using project participants to fill job openings with a starting wage equal to or greater than the prevailing starting wage for that occupation in the area. The seven files did not document whether the grantees were current on their unemployment taxes, the degree to which the company would increase international trade, or if site visits were completed, as required by department rules (page 32).

OBSERVATIONS

The audit also discusses the following issues: the TNInvestco program (page 6); FastTrack Incentives Approval (page 25); Rural Development (page 34); the Memphis Regional Megasite (page 40); Compliance with Loan Collection Procedures (page 43); and the Tennessee Technology Development Corporation (page 44).

Performance Audit
Department of Economic and Community Development and Tennessee Technology Development Corporation

TABLE OF CONTENTS

TABLE OF CONTENTS (continued)

Performance Audit
Department of Economic and Community Development and Tennessee Technology Development Corporation

INTRODUCTION

PURPOSE AND AUTHORITY FOR THE AUDIT

This performance audit of the Department of Economic and Community Development and the Tennessee Technology Development Corporation was conducted pursuant to the Tennessee Governmental Entity Review Law, Title 4, Chapter 29, *Tennessee Code Annotated*. Under Section 4-29-238, the Department of Economic and Community Development, along with the Tennessee Technology Development Corporation, is scheduled to terminate June 30, 2017. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the Department of Economic and Community Development 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 and the Tennessee Technology Development Corporation should be continued, restructured, or terminated.

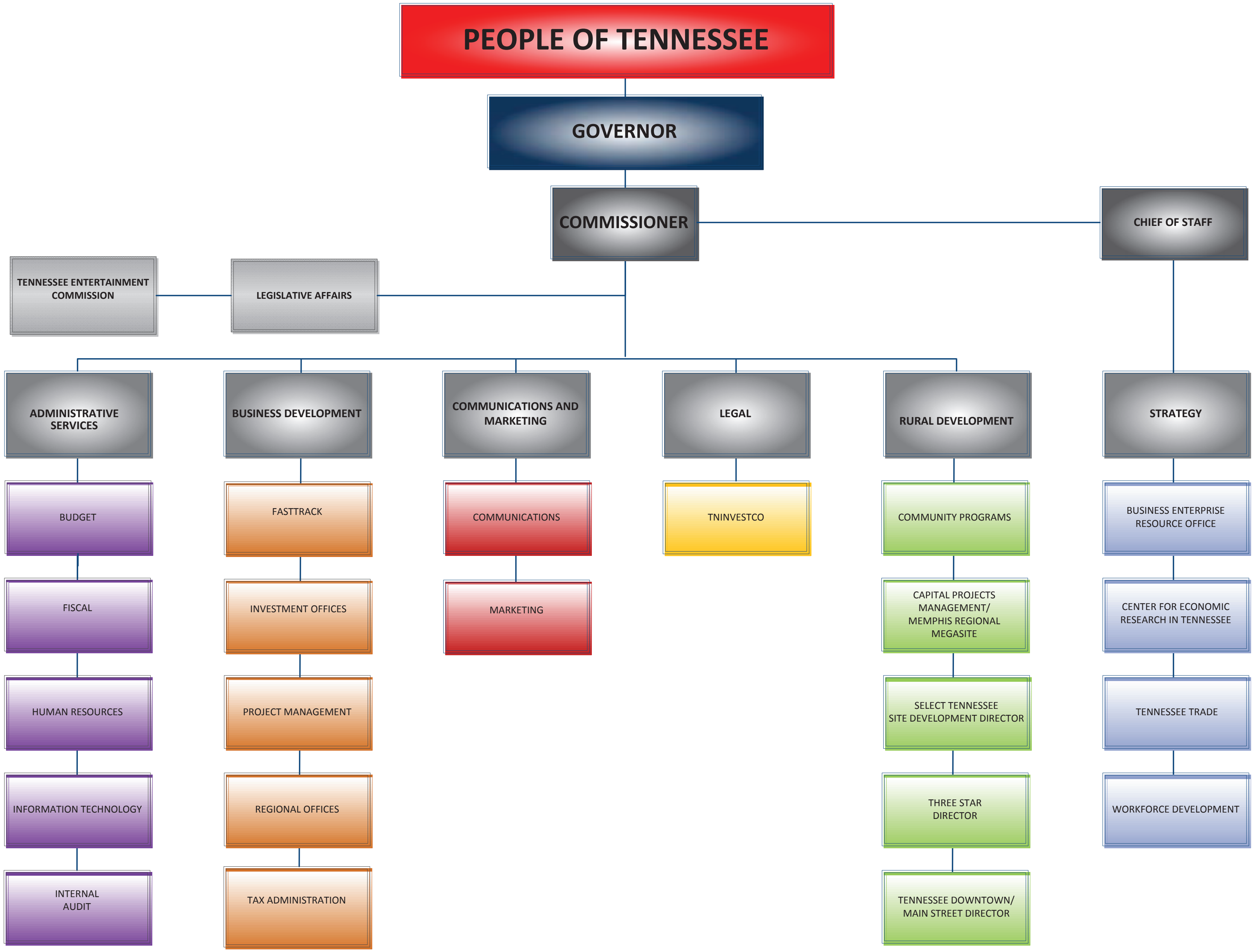
ORGANIZATION AND STATUTORY RESPONSIBILITIES

Section 4-3-701, *Tennessee Code Annotated*, created the Department of Economic and Community Development, which is statutorily responsible for coordinating development services for 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 creating jobs, recruiting new industries, and supporting existing business expansion.

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. The department has headquarters located in Nashville; nine regional jobs base camps across the state, and foreign office representatives in China, Canada, Japan, Mexico, and the United Kingdom, all of which maintain the department's presence, assistance, and programs in Tennessee and internationally.

The department's programs are divided into the following divisions: Administrative Services, Business Development, Communications and Marketing, Legal, Rural Development, and Strategy. The Tennessee Technology Development Corporation (LaunchTN) is also housed in the Department of Economic and Community Development. See the department's organizational chart on page 2.

Tennessee Department of Economic and Community Development
Organizational Structure
July 2016



The Administrative Services Division provides administrative and support services to the department and is responsible for the daily operations and procedures of the department. This division's functions include budget, fiscal, human resources, information technology, and internal audit.

The Business Development Division has the responsibility to attract and recruit new investments and create new jobs for Tennessee. This division oversees the FastTrack Program, investment offices, project management, the regional offices, and tax administration.

The Communications and Marketing Division is responsible for marketing Tennessee to the world's business community, preparing pitch materials, answering media requests, writing material for press conferences, shooting and editing video, managing social media, managing the Governor's Conference on Economic and Community Development, and preparing presentations for the Governor to give at international trade events.

The Legal Division is responsible for all legal issues, legal questions, contract review, and related issues. It also supervises TNInvestco and works with the Office of the State Architect and the State Building Commission for development projects.

The Rural Development Division works with communities to ensure they develop and maintain the leadership, organizations, and community facilities essential for economic growth. This division is also responsible for providing advice and technical assistance on community development, economic development, and other services to local governments; chambers of commerce; and other agencies, groups, and individuals. This division oversees the community programs; capital projects management and the Memphis Regional Megasite; Select Tennessee Site Development programs; the Three Star program; and the Tennessee Downtown and Main Street programs.

The Strategy Division oversees the Business Enterprise Resource Office, the Center for Economic Research in Tennessee, Tennessee Trade, and Workforce Development.

The Tennessee Technology Development Corporation (LaunchTN) was created by Section 4-14-301, *Tennessee Code Annotated,* to foster technology-based economic development on behalf of the state "to strengthen the economy of Tennessee through the development of science and technology and to promote the development of Tennessee businesses by supporting the transfer of science, technology and quality improvement methods to private and public enterprises." LaunchTN is a public-private partnership focused on supporting the development of high-growth companies in Tennessee.

AUDIT SCOPE

We audited the department's activities for the period January 2013 to July 2016. Our audit scope included a review of internal controls and compliance with laws, regulations, and provisions of contracts or grant agreements that are significant within the context of the audit objectives. Managements of the Department of Economic Development and the Tennessee Technology Development Corporation are responsible for establishing and maintaining effective internal controls and for complying with applicable laws, regulations, and provisions of contracts and grant agreements. The Tennessee Film, Entertainment, and Music Commission is administratively attached to the department but has a separate Sunset audit date and was not included in the scope of this audit.

For our sample design, we used nonstatistical audit sampling, which was the most appropriate and cost-effective method for concluding on our audit objectives. Based on our professional judgment, review of authoritative sampling guidance, and careful consideration of underlying statistical concepts, we believe that nonstatistical sampling provides sufficient, appropriate audit evidence to support the conclusions in our report. We present more detailed information about our methodologies in the individual report sections.

We conducted this performance 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.

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 actions taken to implement audit recommendations. The Department of Economic and Community Development filed a report with the Department of Audit on May 10, 2013, following the October 2012 audit report. We conducted a follow-up of all prior audit findings as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the department has corrected the previous audit findings concerning business processes and internal controls for the TNInvestco program; contracts; receivables collection and write-off procedures; and the repeat finding concerning the disclosed conflict-of-interest forms for department-administered boards.

We found new issues with the TNInvestco Program, which are included in this audit report. They are not considered repeat findings because the issues from the prior audit report were resolved.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

TNINVESTCO PROGRAM

In 2009, the General Assembly passed the Tennessee Small Business Investment Company Credit Act, codified as Sections 4-28-101 through 4-28-115, *Tennessee Code Annotated.* The legislation was designed to increase the flow of capital to innovative new companies in Tennessee in the early stages of business development. The TNInvestco program allocated $200 million in tax credits to a cross section of venture capital funds with broad experience in developing new companies in Tennessee. Those funds market the tax credits to insurance companies that purchase the credits with capital reserves, and the venture funds use the capital to help Tennessee companies grow.

Ten companies were chosen by the former Commissioner of the Department of Economic and Community Development and the former Commissioner of the Department of Revenue based on a scoring matrix used to rate each applicant based on data provided through applications and interviews. The General Assembly established reporting requirements and independent audits of the TNInvestco firms to provide oversight and accountability of the program. Additionally, department staff complete an annual review of the program and publish an annual report that is provided to the Governor, the General Assembly, the Comptroller, and the public.

The department administers 11 Local Government Investment Pool (LGIP) escrow accounts for this program. In response to the Department of Economic and Community Development October 2012 Sunset performance audit report, the department created procedures and guidelines for the reconciliations of the LGIP accounts and the processing of annual certified fees to be completed by the Fiscal Division, housed in the Department of Finance and Administration. In December 2015, the department promulgated new rules for the TNInvestco program (0500-08-01.10) to assess penalties to the TNInvestco companies for noncompliance with any of the requirements. The TNInvestco program, now in its sixth year, ends in 2021.

<u>Methodology</u>

Our objectives were to determine TNInvestco's compliance with the Tennessee Small Business Investment Company Credit Act and the effectiveness of the program to date. Our work covered fiscal years 2013, 2014, and 2015. However, the annual reviews for fiscal year 2015 were still in progress during the audit. Our work included

- interviewing TNInvestco staff and Fiscal Division staff to determine how the program is monitored and tracked and to identify the process for reconciling LGIP accounts and annual fees;
- reviewing relevant sections of *Tennessee Code Annotated* and files to determine whether the TNInvestco companies are in compliance with the requirements; whether the completion of annual reviews, scorecards, and required fees is timely; and how many jobs were created and retained; and
- reviewing the liquidity events that have occurred to determine how much money the department has recouped from TNInvestco liquidity events.

Observation

1. As of December 31, 2015, the State of Tennessee has received only $5.3 million from the $200 million of the initial funding for the TNInvestco program

Background

The TNInvestco program is a public-private venture capital program intended to help start-up companies in the effort to create jobs and for the state to eventually receive a return on its investment. The TNInvestco program started in 2009 and was funded through $120 million in gross premium tax credits to insurance companies and an additional $80 million in future premium tax credits for a total of $200 million. The insurance companies received the benefit of $200,000,000 of future tax credits for the discounted price, and the TNInvestcos were able to use the proceeds from the sale for investments in start-up businesses. The total funds available after the sale of the discounted tax credits totaled $149,220,016. The insurance companies may receive the benefits of the tax credits from January 2012 through December 2019.

The insurance companies paid for the tax credits to the Department of Treasury, which put the money into an escrow account for each TNInvestco. To receive the funds, the TNInvestcos had to submit a request, either for a fund investment or administrative reimbursement. After approval, the funds were released from the escrow account to the TNInvestco's bank account, to be invested by the TNInvestco in a qualified business.

The department maintains a database for TNInvestco information. From the annual reviews and scorecards, the department is able to monitor the TNInvestcos' performance by tracking the number of jobs created and retained, as well as the amount of follow-on capital, or capital that is not from the TNInvestcos or the state.

Recovery of Initial Funding

The department's role in administering the TNInvestcos also includes receiving half of the profit upon liquidation of the investment in a company. Usually this takes place three to seven years after the initial investment. For there to be a profit, the start-up company must grow and have a "liquidity event." A liquidity event is the merger, sale, spinoff, or other transaction of a qualified business by which some or all of the investment by a TNInvestco company is converted to cash, securities, assets, distributions, or other proceeds. The start-up company is either bought by a bigger company, or the start-up company has an initial public offering (IPO). When the liquidity event occurs, the profit of the liquidity event is split 50/50 between the TNInvestco and the State of Tennessee. The initial investment in the start-up company returns to the TNInvestco for investment in a new start-up company.

Based on information provided by the department, as of December 31, 2015, the TNInvestco companies had a total of 85 liquidity events. The profits from the liquidity events totaled $10,772,919, of which $5,386,460 (50%) will go back to the State of Tennessee. The table below illustrates this information. It is noteworthy that liquidity events do not always result in a profit.

Table 1
TNInvestco Program
Liquidity Events, Proceeds, and Amount to State Through December 31, 2015

Liquidity Events	Total Proceeds	Total Profit	Amount State Receives at 50% of Profits
85	$26,957,163	$10,772,919	$5,386,460

Source: Department of Economic and Community Development.

According to the TNInvestco Director, these amounts are based only on the profit, the base amount in each portfolio, from liquidity events. In 2017, the profit and principle will be liquidated, provided that no more than 25% of the TNInvestco's base amount may be distributed in any one year until the end of the investment period.

The program, created by the General Assembly in 2009, did not have to recoup those initial funds of $200 million when the program was created, and statute does not require any level of recovery. At the time of the audit, the state had only received $5,386,460 as it completes the sixth year of the TNInvestco program. With five years remaining, the department will likely not receive a return nearing the $200 million in tax credits. Additionally, the department has not reported the amount of proceeds received from liquidity events of TNInvestco companies. Because this program is very unpredictable, the department cannot determine how much of the $200 million the state will recoup when the program ends in 2021. The department states that neither the timing nor the amount of the funds returned to the state is governed by statute, rule, or policy. However, the department should regularly report the amounts returned through the program to provide the public and the General Assembly information on its performance.

Finding

1. The department did not report and track all TNInvestco program data and did not accurately report jobs created and retained, including jobs held by women and minority employees

Program Data and Reporting

State statute requires the Department of Economic and Community Development to conduct an annual review of each qualified TNInvestco company to determine if the company is abiding by the requirements of the program and to ensure that no investments have been made in violation. The TNInvestco Director completes these annual reviews in June after receiving the companies' audited financial statements. After the annual reviews are complete, the director prepares an annual report of the companies, stating whether the companies are in compliance. The director submits this report every year in September to the Governor, the Comptroller, the State Treasurer, and the chairs and ranking minority members of the legislative committees with jurisdiction over taxes and economic development. By statute the annual report must include:

- the number of qualified TNInvestco companies holding designated capital;
- the amount of designated capital invested in each TNInvestco company;
- the cumulative amount each company has invested as of January 1, 2011, and the cumulative total each year thereafter;
- the cumulative amount of follow-on capital that the investments of each company have created;
- the total amount of investment tax credits applied each year;
- the performance of each qualified company with regard to the requirements for continued certification;
- the classification of the companies each TNInvestco company has invested in according to size of company and the industrial sector;
- the gross number of jobs created by investments made by each TNInvestco company and the number of jobs retained;
- the location of the companies each TNInvestco company has invested in;
- the qualified TNInvestco companies that have been decertified and the reasons for decertification; and
- other related information as necessary to evaluate the effect of this statute on economic development.

Sections 4-28-110(2)(c) through 4-28-112(a)(2), *Tennessee Code Annotated,* detail reporting and disclosure requirements for the TNInvestco companies. While the department has made some improvements to the TNInvestco program since the October 2012 performance audit, our review of the TNInvestco files, scorecards, annual reviews, and annual reports found that the department

- did not report the amount of designated capital invested in each qualified TNInvestco company in the annual report;
- did not submit a summary including findings and areas of noncompliance to each TNInvestco company at the end of the annual review; and
- did not track or report the number of minority-owned and women-owned businesses or encourage each TNInvestco company to list the number of minority-owned and women-owned businesses who receive available capital on their websites. Section 4-28-106(g)(4), *Tennessee Code Annotated*, requires TNInvestco companies to strive to maximize participation of such businesses.

The 2013 and 2014 TNInvestco annual reports contained all of the required information except for the amount of designated capital invested in each TNInvestco company. Designated capital is the amount of money invested by a participating investor in a qualified TNInvestco. The department did not provide an explanation for why the designated capital is not listed in the annual report.

The TNInvestco Director uses a summary form to make notes during the annual review. However, the summary form does not capture the date the annual review is conducted or the dates the TNInvestco companies submit the required information. The companies do not receive a summary of the annual review results unless a problem has been noted. To improve communication and reporting, the department should provide each TNInvestco company with a summary memo of the results from the annual review.

While the department reports the number of minority and women employees, the department should also consider tracking the number of minority-owned and women-owned businesses that receive capital from the TNInvestco companies in order to strive to maximize the participation of minority-owned businesses and woman-owned businesses. To be a minority-owned business, at least 51% of the assets or outstanding stock must be owned by one or more individuals who are members of a racial or ethnic minority, and the management and daily operations must be under the control of one or more members of a racial or ethnic minority.

According to Section 4-28-106(g)(5), *Tennessee Code Annotated*, each TNInvestco company should provide information on its website concerning the availability of capital to minority-owned and women-owned businesses. While all of the 10 TNInvestco companies mentioned the availability of funds to minority-owned and women-owned businesses, the information was very hard to find and not easily accessible on 2 of the 10 TNInvestco companies' websites. None of TNInvestco companies indicated how many investment companies are minority-owned and women-owned businesses, or how much capital was provided to the minority-owned and women-owned businesses. Neither the department nor the TNInvestco companies are tracking the number of women-owned and minority-owned businesses.

On a positive note, for 2013, only 2 of the 10 TNInvestco companies (20%) paid the annual fee after the January 31 due date, and only one TNInvestco company (10%) paid the certification fee after the April 1 due date. For 2014, only one TNInvestco (10%) paid the annual fee after January 31.

Additionally, the TNInvestco companies are required to meet the pacing requirement dates on time or early. The pacing requirement dates are investments made at different thresholds—within two years, the TNInvestco company must invest in amounts equal to 50% of the base investment amount; after three years, in amounts equal to 70% of the base investment amount; after four years, in amounts equal to 80% of the base investment amount; and after six years or any year thereafter, in amounts equal to 90% of the base amount in qualified investments. Our review found that all 10 TNInvestco companies have met the fourth pacing requirement of investments equal to 90% of the base investment amount.

Jobs Created and Retained, and Women and Minority Employees

The listed numbers of jobs and women and minority employees in the TNInvestco annual report contain duplications. The department's internal auditor also cited this in the limited review of the department's TNInvestco 2014 annual report, and recommended that the department explain in the annual report why there are duplications in the counting of jobs and incorrect follow-on capital for each individual TNInvestco in the body of the report.

The misstated follow-on capital was because multiple investors submitted the total investment instead of their individual investment. The TNInvestco Director provided no explanation for duplicate counting of jobs. However, it was noted in the internal auditor's limited review that the duplications were a result of self-reporting.

According to the TNInvestco Director, the department eliminated the misstated capital amounts in the 2015 annual report. However, the 2015 annual report was not completed during the time of our audit so we could not determine if the department has eliminated duplications.

The table below lists the total number of created and retained jobs for the TNInvestco companies for 2013 and 2014. Retained jobs are those jobs that existed prior to the company receiving TNInvestco funds. Total jobs are the sum of the retained and created jobs. The TNInvestco companies are required to provide the number of employees who are women or minorities. As shown in the table below, there are discrepancies in the data for the created jobs, total jobs, and women and minority employees for both years.

Table 2
Reported Jobs for 2013 and 2014

TNInvestco Companies' Totals From Audited Financial Statements

vs. TNInvestco Annual Reports

	2013			2014		
Jobs	**Totals for Each TNInvestco**	**Annual Report Totals**	**Difference**	**Totals for Each TNInvestco**	**Annual Report Totals**	**Difference**
Retained	1,304.5	1,304.5	0	1,497.5	1,497.5	0
Created	971.5	951.5	(20)	1,307	595	(712)
Total	2,276	1,605	(671)	2,804.5	2,092.5	(712)
Women and Minority Employees	1,137	758	(379)	1,377	981	(396)

Source: Department of Economic and Community Development, TNInvestco annual reports, and audited financial statements.

Recommendation

We recommend the department include the designated capital for each TNInvestco company in the annual report per statute. The department should provide a summary of the annual review for each TNInvestco company that includes the results of the review and the date the review was completed. The department should track and encourage each TNInvestco company to track the number of minority-owned and women-owned businesses that receive capital from the TNInvestco companies. Lastly, the department should provide a clear explanation in the annual report for how the duplications of jobs and women and minority employees in the annual report occur and are eliminated from the counting.

Management's Comment

We concur in part.

1. We concur that the annual report does not include the amount of designated capital for each TNInvestco company. Under statute (T.C.A. § 4-28-102), "designated capital" is defined as the "amount of money that is <u>invested by a Participating Investor</u> in a qualified TNInvestco." The term "Participating Investor" means the insurance company that contributed the capital to each TNInvestco. However, the "Participating Investor" did not "invest" any funds in a qualified TNInvestco. Each "Participating Investor" purchased tax credits through the TNInvestco program, then had no further involvement in the program. A strict read of the statute would result in a report of zero for each TNInvestco for each year. Based on discussions with the Audit Division, ECD can construe "designated capital" to mean the amount of funds expended on the tax credits for each

TNInvestco. ECD will report these numbers on the next annual report. Note that the sale of tax credits occurred only once, at the beginning of the program, so these numbers will not change as the program continues.

2. We do not concur with the finding that ECD "should provide a summary" of the annual review, given that we already document a summary of all compliance items. Going forward, ECD will add the date that the meeting was held. As background, except for any issues related to the audit and Scorecard, all issues that arise during the year are resolved at that time—we do not wait until the annual review. Issues related to the audit and Scorecard are resolved and documented upon receipt and review. By the time the in-person meeting occurs, most issues or findings have already been addressed and documented so we do not see a benefit to generating an additional memo. Additionally, the relevant statute does not require a specific format.

3. We do not concur that the department should track and encourage each TNInvestco company to track the number of minority-owned and women-owned businesses that receive capital from the TNInvestco companies. The statute states that ECD shall "strive to maximize participation of minority-owned businesses and women-owned businesses." ECD is in full compliance with this statute, which does not require tracking or reporting.

4. We do not concur with the finding that we did not accurately report jobs created and retained. Each TNInvestco's investments, follow-on capital, and job count numbers are presented in the body of the annual reports. Each TNInvestco must report these numbers from the viewpoint of the individual TNInvestco in order to capture all program activity each year. However, at times a company may receive investments from more than one TNInvestco, which results in an overstatement of jobs and follow-on capital numbers if these numbers are simply totaled from the body of the report. Once ECD receives this information from all TNInvestcos and summarizes the data, the summary data is adjusted to remove the duplicative effect of the reporting structure. Thus, the summary information provided on the final page of the annual report reflects accurate numbers of the TNInvestco program as a whole. We must report both sets of numbers to provide accurate information from both (1) the perspective of each TNInvestco, and (2) the perspective of the overall TNInvestco program. We have added language in the 2015 annual report to clarify this concept.

Auditor Comment

Although statute does not require tracking, the department cannot know if TNInvestco companies are striving to maximize participation of minority-owned and women-owned businesses if it does not track this information. Tracking the information or using some other method would help demonstrate whether these businesses are receiving capital from TNInvestco companies.

Section 4-28-111, *Tennessee Code Annotated*, requires the department to conduct an annual review of each TNInvestco company and provide the company with a summary of findings including noncompliance. A summary of each annual review documenting the status and standing of the TNInvestco can ensure that the results of reviews are communicated to department management and the companies.

FASTTRACK PROGRAM

The Department of Economic and Community Development provides grants to businesses through its FastTrack Program. There are three types of FastTrack grants, all of which are state funded; funding was approximately $95 million in fiscal year 2016. The FastTrack Job Training Assistance Program (FJTAP) and the FastTrack Infrastructure Development Program (FIDP) were established in 2005 to "assist new and existing business and industry that locate or expand in this state and create or retain jobs." FJTAP offers reimbursement-based grants to businesses to cover training costs of employees in new businesses and those with new processes requiring retraining. FIDP supports new businesses' basic infrastructure needs, such as rail lines, water service, fiber-optic cabling, and site work.

Fast Track Economic Development (FTED) grants were added in 2012 "to facilitate economic development activities that are not eligible for FastTrack infrastructure development or job training assistance funds. These activities include, but are not limited to, grants or loans for retrofitting, relocating equipment, purchasing equipment, building repairs and improvements, and temporary office space or other temporary equipment related to relocation or expansion." (See maps on pages 16-17 with information on dollars awarded by county for fiscal years 2014 and 2015.) In 2013, Section 4-3-731, *Tennessee Code Annotated*, established accountability agreements, which are required for FTED grants, allowing the department to recover funds in case the grantee fails to fulfill certain commitments of the grant contract.

Eligible businesses complete an application as the first step towards receiving a FastTrack grant. Staff in the nine regional offices and project managers in the Business Development Division assist companies in the application process. The department has revised the application over time, adding additional questions to obtain information for comparison when assessing projects.

Projects are first considered by a pre-grant committee, consisting of the Fast Track Director, the Deputy Assistant Commissioner for Business Development, the Senior Policy/Fiscal Advisor, the Tax Administration Director, two Business Development Specialists, a Special Projects Coordinator, and a Statistical Research Specialist. (See flowchart on page 15.) This pre-grant committee considers information designed to ensure that applicants meet statutory requirements for eligible business under Section 4-3-717(h)(1), *Tennessee Code Annotated*; evaluates the information in the project's application; and assesses due diligence information about the project and the applicant from the department's Research Section. ECD's Tax Administration Director consults with the Department of Revenue and the Office of the Secretary of State to ensure that applicants meet the requirements of an eligible business. The Research Section presents return on investment (ROI) information to the pre-grant committee based upon projected job creation and applicant proposed investment in the project. The pre-grant committee does not keep minutes.

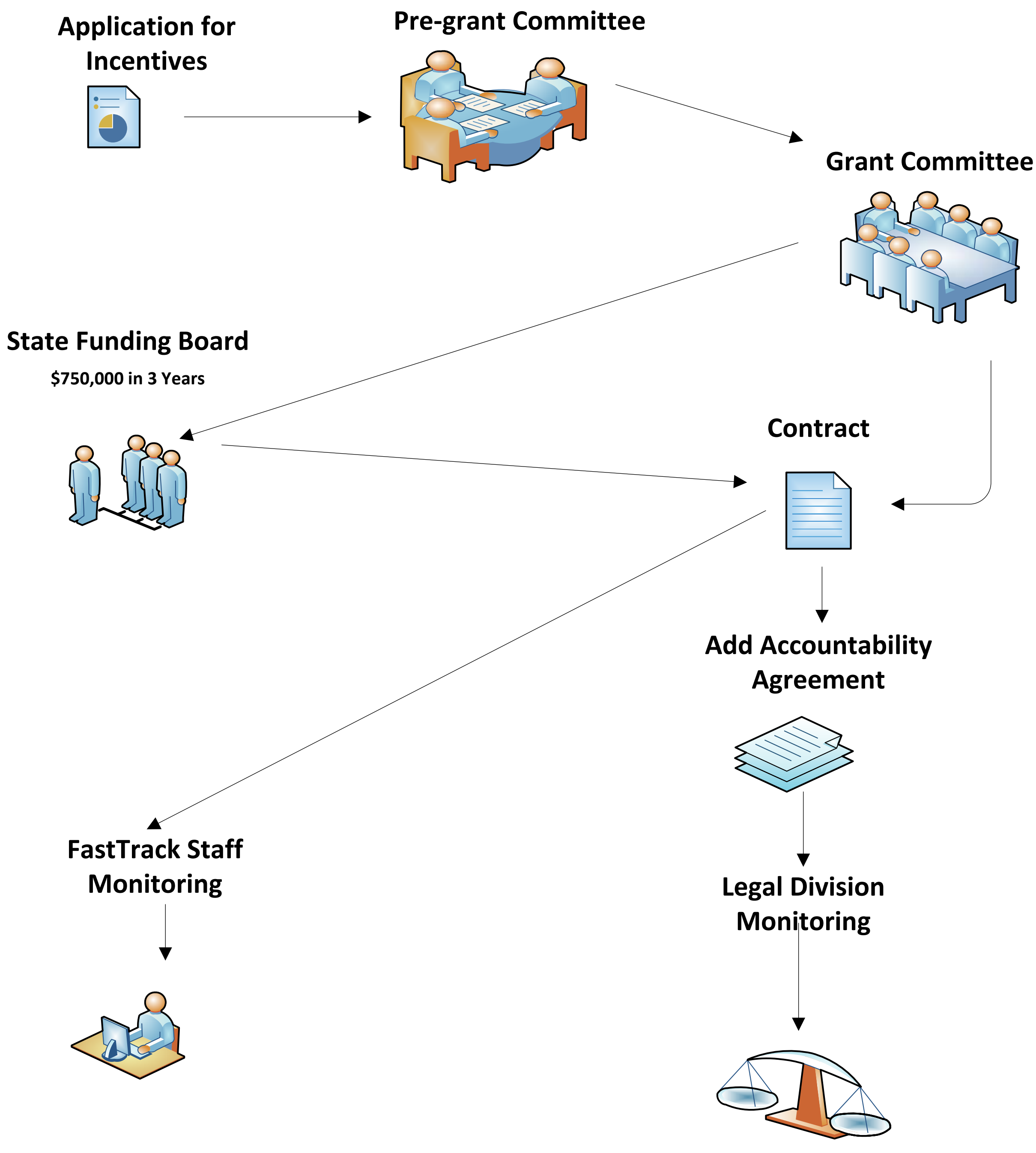
If the pre-grant committee approves a project, information about the project is included in a form developed by the department's Fast Track Director and Senior Policy/Fiscal Advisor. It is a summary of information from the application (capital investment, number of new jobs, and average wages) and other sources, such as average county wages for the project location from the U.S. Department of Labor Bureau of Labor Statistics, a list of past projects in the county that have received incentives, and match percentage required by the county based upon tax tier status.

The eight-member Grant Committee makes the final decision regarding funding for the amount of incentives offered to a company and approving the beginning of the contract process. The Grant Committee includes the Commissioner; Chief of Staff; Legislative Affairs Director; General Counsel; and four Assistant Commissioners—Business Development, Rural Development, Administration, and Communications and Marketing. Grants must also be approved by the State Funding Board if the proposed grantee has received more than $750,000 in FastTrack grants in a three-year period. While FJTAP grants are made to the business whose workers will be trained, FIDP and FTED grants are made to local governments or Industrial Development Boards. Minutes are kept of the Grant Committee meetings. The Grant Committee can table a project, reserve funds for a project, or approve a project for contract.

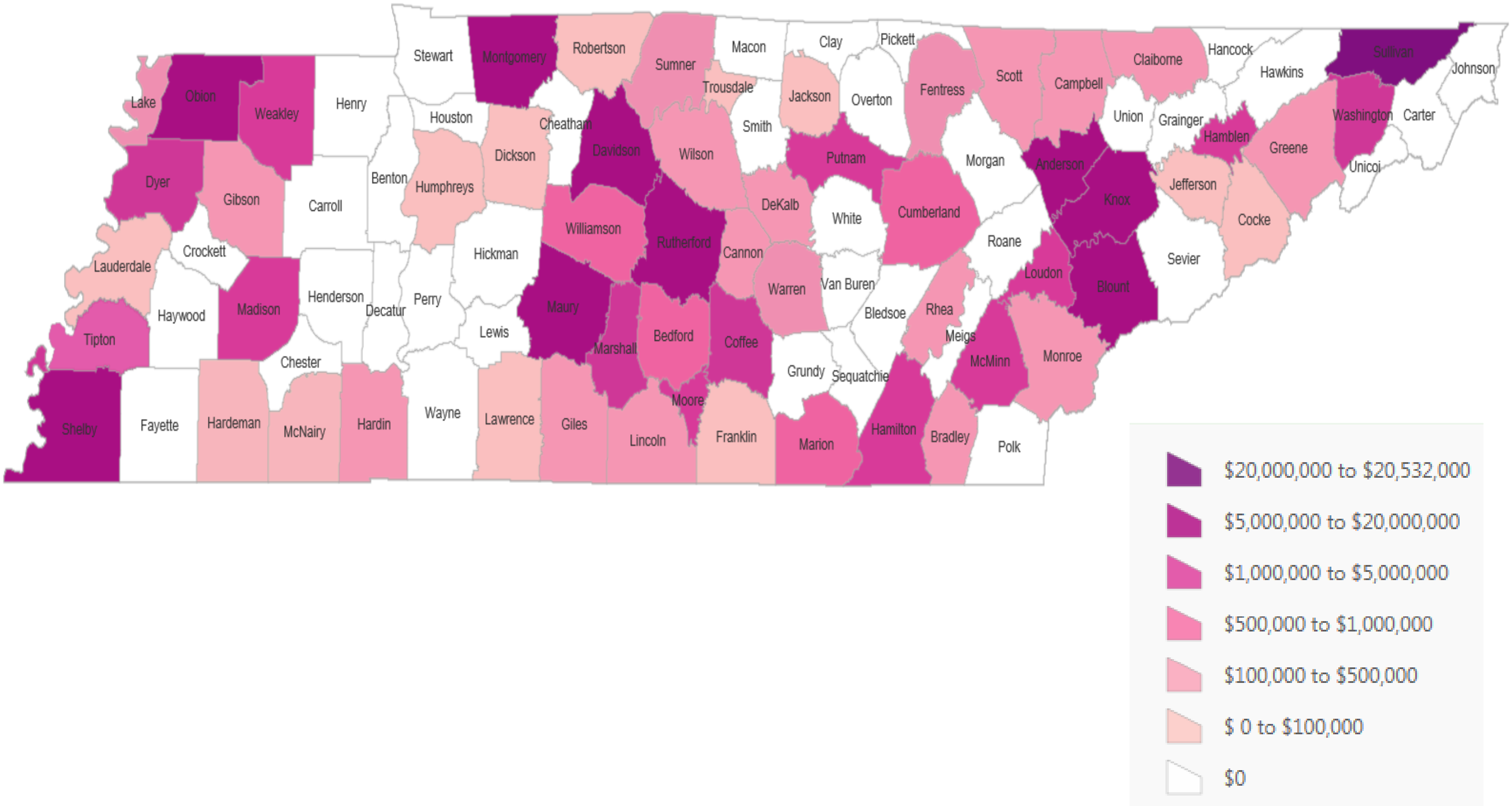
During the contracting process, accountability agreements (also known as "clawback" agreements) are added to Economic Development grant contracts. They have also been added to FastTrack Job Assistance Training, at the discretion of the department. The agreements obligate grantees to repay award money if they do not create at least 80% percent of the contracted number of new jobs. If the number of jobs created is less than 80% percent, the company will be obligated to repay a percentage of the award amount matching the percentage of job shortfall. The agreements also require reporting the number of jobs existing at the contract start (baseline) and the number of jobs created annually (interim). The Legal Division collects these reports from businesses with accountability agreements. The department posts baseline and interim reports to meet the statutory requirement that the name of the company, amount of award, jobs created, and project location be posted on its website. In reviewing other states' processes involving incentive agreements, auditors found that most states reviewed included some kind of clawback mechanism in incentive agreements.

The objectives of our review were to determine whether the FastTrack Program has complied with statutory requirements and whether processes are in place for monitoring and reporting, as well as to gain an understanding of the accountability agreements. We obtained and reviewed file materials and interviewed FastTrack and Legal Division management and staff. To gain an understanding of the distribution of FastTrack contracts by county, we compiled maps using FastTrack contracts starting in fiscal years 2014 and 2015 (see maps on pages 16 and 17). We reviewed a sample of 42 of the 329 FastTrack contracts with start dates in fiscal years 2014 and 2015 to determine compliance with requirements of the FastTrack process.

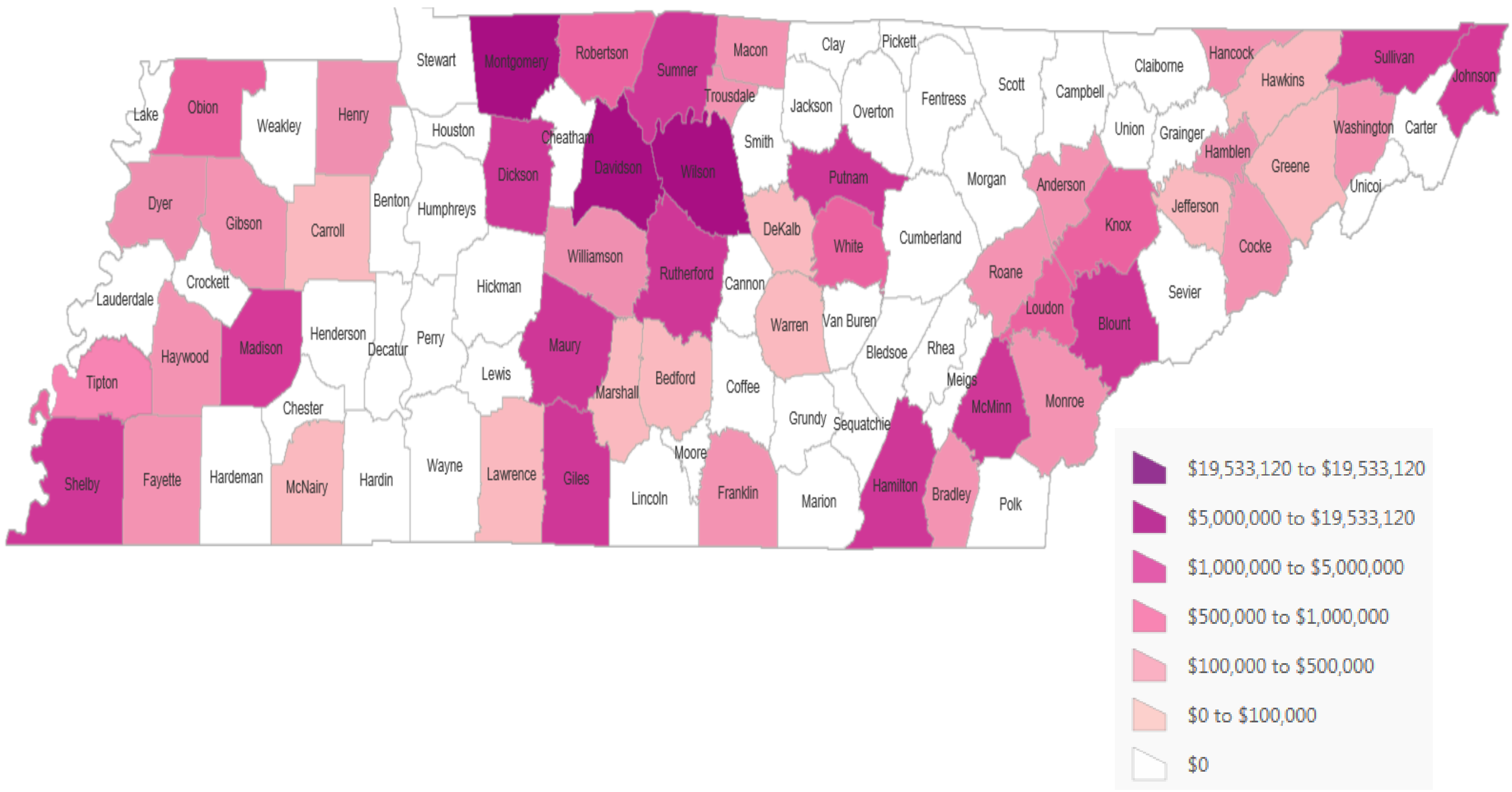
FastTrack Project Approval Process



2014 Fast Track Grants



2015 Fast Track Grants



Finding

2. FastTrack grantees' self-reported data is not always submitted timely; grantees may need more guidance to ensure accurate self-reporting of jobs data

Grantees whose contracts include accountability agreements are required to submit baseline and performance reports to the Department of Economic and Community Development's Legal Division. The baseline reports record the number of jobs at the contract's start, and the performance (or interim) reports track the number of new hires at each anniversary of the contract start date. Examples of the format for these reports are included as attachments to the accountability agreements, but companies may submit their own "substantially similar" forms. The accountability agreement also requires "appropriate back-up data" for the jobs reported that is to "provide reasonable assurance" that information in the forms is "true and correct in all material respects." The agreement defines a job as "a new, full-time position . . . that is held for a minimum of twenty-six weeks in a calendar year by a company employee who is offered medical benefits."

The FastTrack Program requires grantees to submit the Annual FastTrack Employment Summary and a Grant Final Report. The Annual Summary Form requests information on jobs created and on the ethnicity and gender of employees. The department sends the form to companies in October, according to FastTrack staff, and with a requested return date of the end of the year. The grantee submits the Final Grant Report to the FastTrack Program before it makes the final reimbursement request and reports information on jobs created, average wages for new jobs, and capital investment by the company.

FastTrack Program Reporting and Accountability Agreement Reporting

Although the FastTrack Program and Legal Division receive self-reported data at different points during the contract, we reviewed both reports to determine what information is available to the department and whether grantees submitted the data timely. Information from our file review of 42 contracts included the reports sent by grantees to the FastTrack Program and the Legal Division. This random sample cannot be projected to the total population of 389 contracts for that period. To gain an understanding of the data submitted and to compare information, we sorted companies in the file review according to performance requirements in Section 2.2 of the accountability agreement. Some of the contracts had accountability agreements that require companies to meet 80% of contracted jobs by a specified end date; others were 80% of the average of new job totals over three consecutive years. According to the department, using an average over a three-year period ensures that companies cannot hire employees in time to qualify for the job requirement and let them go soon afterwards. Net new jobs are measured on interim dates, with the final date falling on the end date as specified in the accountability agreement. Companies may choose whether the consecutive years will be third through fifth, fourth through sixth, fifth through seventh, etc. We looked at the six companies with contracts ending in 2018 and specifying the end date as the measurement date (see Table 3) and compared accountability agreement reporting and FastTrack program reporting. One company, Teledyne, appears to have surpassed the required total of net new jobs as of the most recent interim report, while two others, Jack Daniels and Aspen Technology, have added more than half of their contracted totals. The three other companies will have to create jobs at a much greater rate than they have thus far in order to meet contracted job creation goals.

Table 3
Accountability Agreement and FastTrack Program Reporting Comparison
Sample of Contracts With End Dates in 2018
As of June 2016

Company	Teledyne	Jack Daniels	Prologue Corporation	Conduit Global	Aspen Technology	Leisure Pools USA
Contract Start Date	9/1/2013	11/11/2013	9/23/2013	12/16/2013	12/11/2013	11/21/2013
Jobs to be Created Per Contract	65	94	100	1,000	161	240
Accountability Agreement Reporting						
Baseline Report Date	1/1/2013	7/11/2013	3/12/2014	5/20/2014	12/11/2013	6/30/2014
Baseline Jobs #	275	431	0	0	0	3
Ist Interim Report Date	12/31/2013	7/11/2014	2/13/2015	12/15/2014	12/11/2014	11/22/2014
1st Interim Jobs #	56	29	3	112	81	50
2nd Interim Report Date	12/31/2014	7/13/2015	1/6/2016	12/15/2015	12/11/2015	11/22/2015
2nd Interim Jobs #	34	33	0*	40	40	22
3rd Interim Report Date	12/31/2015	N/A	N/A	N/A	N/A	N/A
3rd Interim Jobs #	8	N/A	N/A	N/A	N/A	N/A
Cumulative Created Jobs	98	62	3	152	121	72
FastTrack Program Reporting						
2014 Annual Employment Summary Date	11/6/2014	1/16/2015	12/29/2014	12/10/2014	10/20/2014	12/9/2014
2014 Annual Employment Summary Jobs #	70	29	5	691	47	52
2015 Annual Employment Summary Date	No report	No report	3/29/2016	No report	No report	No report
2015 Annual Employment Summary Jobs #	No report	No report	1	No report	No report	No report
ED Grant Final Report Date	No report	No report	No report	12/22/2014	4/8/2015	No report
ED Grant Final Report Jobs #	No report	No report	No report	778	97	No report

*Backup data showed that the three jobs reported by Prologue Corporation in the second interim report were the same three that were reported in the first interim.
Source: FastTrack Division, Legal Division, and OpenECD website.

We noted that Conduit Global's job numbers reported to the FastTrack Program on the 2014 Annual Employment Summary Form (691) and the Grant Final Report (778) differed significantly from number reported to the Legal Division in baseline (0) and performance reports (152).

In November 2014, Teledyne submitted to FastTrack an Annual Employment Summary Form reporting 70 new jobs; however, in December 2014, the second interim report to the Legal Division shows 34 jobs, for a total of 90 new jobs as of that date. Aspen Technology reported 47 new jobs to FastTrack in October 2014 but reported 81 new jobs to the Legal Division in December 2014. If the FastTrack Program and the Legal Division shared and compared self-reported data, the department could determine whether both Teledyne and Aspen added 20 jobs in one month and 34 jobs in two months, respectively.

Table 4 shows report dates and job creation numbers on five contracts with job creation to be measured in the third, fourth, and fifth years.

Table 4
Accountability Agreement and FastTrack Program Reporting Comparison
Sample of Contracts With Job Measurement for Three, Four, and Five Years
As of June 2016

Company	MVP Group	Asurion Insurance Services	Del Conca USA	Plastic Omnium Auto Exteriors	Target Corp.
Contract Start Date	5/23/2014	1/10/14	9/30/13	7/7/14	12/1/14
Jobs to be Created Per Contract	100	800	160	300	462
Accountability Agreement Reporting					
Baseline Report Date	6/1/14	1/10/14	4/22/13	7/7/14	12/1/14
Baseline Jobs #	19	1,900	0	6	0
Ist Interim Report Date	5/23/15	1/10/15	4/22/14	7/7/15	12/1/15
1st Interim Jobs #	30	800	86	72	597
2nd Interim Report Date	No report	4/19/16	4/22/15	N/A*	N/A*
2nd Interim Jobs #	No report	381	0	N/A*	N/A*
Cumulative created jobs	30	1,181	77	72	597
FastTrack Program Reporting					
2014 Annual Employment Summary Date	11/10/14	11/12/14	10/22/14	No report	N/A*
2014 Annual Employment Summary Jobs #	84	800	79	No report	N/A*
2015 Annual Employment Summary Date	No report	12/30/15	No report	3/30/2015	1/4/2016
2015 Annual Employment Summary Jobs #	No report	959	No report	122	597

*Indicates that the report was not yet due at the time of our file review.
Source: FastTrack Division, Legal Division, and OpenECD website.

Two of these companies, Asurion and Target, appear to have already met targeted job goals. However, MVP Group provides another example of a conflict between numbers reported to FastTrack and to the Legal Division. MVP is consistent in reporting a baseline of 19 jobs, but the company reports 84 new jobs created to FastTrack in November 2014 and only reported 30 jobs created to the Legal Division by May 2015. Plastic Omnium Auto Exteriors reported 122 jobs created to FastTrack in March 2015 and 72 jobs created to Legal staff as of July 2015. Alternatively, this reporting could represent job losses.

Del Conca's reporting also serves as an example of the difficulty of interpreting what the numbers on the forms mean. Del Conca reported 86 jobs created during the first interim period ending April 2014 but reported only 79 jobs created in its annual summary to FastTrack in October 2014. The ED Final Report to FastTrack shows even fewer jobs, 71, on April 9, 2015. The second interim report shows 0 new jobs created as of April 22, 2015, but gives a cumulative total of 77 created jobs. Del Conca is only one example of unclear reporting.

Although the department provides examples of the formats for reporting, providing more instruction or guidance would assist grantees in their understanding of reporting requirements and allow more accurate reporting.

Backup Data Submitted

In addition to the discrepancies above, we noted issues with the backup data for the Legal Division reports. Auditors reviewed backup data submitted with performance reports for the 42 contracts in our file review. The backup data showed that companies did not always calculate or report the number of "new jobs" according to the definition in the accountability agreement. We found examples of backup data that did not include relevant information (typically hire dates) to confirm that employees had worked 26 weeks. We also found backup data that included hire dates which, upon review, confirmed that employees counted toward net new jobs had not worked 26 weeks.

Legal Division staff stated that they review reports and question those that are unclear or insufficient. In addition, General Counsel pointed out that language in the form requires the signatory to certify that all listed jobs meet the definition of new jobs given in the accountability agreement. Requiring company management to certify information in the form establishes responsibility for the information provided but does not verify that the data is accurate for use in evaluating the program.

The FastTrack Program Has Not Enforced Reporting Requirements From Grantees Regarding Annual Employment Data

The FastTrack Program's Tennessee Application for Incentives requires grantees to submit the Annual Employment Summary Form. The application states that "if incentives are awarded, the applicant agrees to submit yearly reports for five years detailing the total number of employees and the total number of women, veterans and minorities employed." The department sends out the form to companies in October, according to FastTrack staff, with a requested return date of the end of the year.

We reviewed 42 FastTrack Program contracts with start dates in fiscal years 2014 and 2015. This random sample cannot be projected to the total population of 389 contracts for that period. We determined that 28 of the contracts were with grantees required to submit the 2014 Annual Employment Summary Form, and all 42 contracts required submission of the 2015 form. Nine of 28 grantees did not submit the 2014 form, and 29 of 42 grantees did not submit the 2015 form. Two of the 2014 forms and one of the 2015 forms submitted did not include Title VI information. None of the forms submitted for 2014 and 2015 reported the number of veterans hired (the forms did not have a veterans category). We found no evidence that FastTrack staff verify self-reported data or compare it with prior reporting to track trends.

The information available to the FastTrack Program from these forms is a valuable way of determining whether the project is successful. Data on jobs from these forms can be used to compare the actual project data with the projected data used by the Grant Committee.

Comparison of Final Grant Reports to Application for Incentives Information

According to FastTrack staff, projected average wages of new hires are an important criterion in formulating incentive offers. Six of the 42 contracts in our sample had Grant Final Reports. Table 5 compares the average wages of new hires compared to the companies' average wages in the Application for Incentives. Five of the six companies report average wages less than wages in the application.

Table 5
Comparison of Sample of Grant Final Report Information

Company	Heritage Glass	HP Pelzer	Conduit Global	Pacific Industries	Del Conca	Aspen Technologies
Contract Start Date	4/10/2014	8/5/2013	12/16/2013	5/30/2014	9/30/2013	12/11/2013
Jobs to Be Created Per Contract	237	201	1,000	190	160	161
Final Grant Report						
Final Grant Report Date	4/10/2015	6/18/2015	12/22/2014	4/26/2016	4/9/2015	4/8/2015
Jobs Created per Final Grant Report	95	113 full-time; 87 temporary	778	40	71	97
Average Wage of New Hires	$17.36	$12.25	$8.93	$17.91	$16.83	$9.75
Application for Incentives						
Average Wage	$22.80	$29.02	$14.93	$15.10	$19.00	$12.95

Source: FastTrack Program.

Actual Data to Determine Return on Investment

One of the tools the FastTrack Program uses when assessing a project is a return on investment calculation. According to FastTrack Program staff and the department's Tax Administration Director, the department must rely on grantee's self-reported data of job creation, wages, and capital investment. The actual amount of tax credits in exchange for creating jobs and making capital investments is handled by the Tennessee Department of Revenue and is considered confidential by statute. While the projected numbers help department management select companies to incentivize, return on investment calculations using data reported by grantees over the course of the contract could, in broader, terms help determine which uses of funds best help attract more business to the state.

Therefore, monitoring the self-reported data and working with grantees to ensure they understand requirements would provide the department with tools to model future programs. Information on job creation has value for its potential use in evaluating the success of the FastTrack Program, but this use requires that the numbers are accurately reported.

Recommendation

Both FastTrack staff and legal staff are collecting data from grantees on job creation, but in order for this data to be useful, management must ensure that the reports are collected when due and that grantees understand their reporting requirements. The department could calculate return on investment based upon actual performance of companies receiving grants. Information on individual companies' progress should inform future decisions on incentives to those entities, and collective data on rates of progress towards goals could be helpful in anticipating which companies will ultimately be required to repay funds for failing to meet performance goals.

Management's Comment

We concur in part.

1. We concur that reports are not always submitted timely. FastTrack and legal staff spend many hours requesting data from companies and following up with companies if we do not receive the required reports. It often takes many phone calls or letters before companies send in the data requested. It is possible that some grantees may need additional guidance to ensure accurate self-reporting of jobs data, and we are always available to assist.

2. We do not concur with the suggestion that ROI should be calculated on actual performance for companies that receive a subsequent grant. Decisions on whether to award incentives to a company are based on many factors. For example, information on previous incentives, industry data, location, capital investment, and the number of promised jobs is currently used as part of the analysis of whether to award additional incentives to a company. ECD implemented the ROI model within the last year. The

model was designed to be used as a part of our due diligence to determine the level of funding for projects under consideration on a forward-looking basis. ECD will review this suggestion to determine if this ROI model could be helpful in the manner suggested.

3. We do not concur with the suggestion that jobs related data be used to anticipate which companies may be required to repay funds for failing to meet performance goals. Although, as suggested, data may suggest which companies are unlikely to meet their goals, the legal remedy provided by the Accountability Agreement is not triggered until an actual default has occurred.

Auditor Comment

The department has established reporting requirements designed to show whether important benchmarks are met. Monitoring those reports would assist the department in determining whether grantees are on progress to meet goals and whether results are being achieved with the state funds expended to incentivize companies.

Finding

3. The FastTrack Program's Grant Committee meeting minutes did not include contract approval for 6 of 42 contracts

The Department of Economic and Community Development's eight member Grant Committee makes the final decision regarding funding for FastTrack projects. We reviewed Grant Committee minutes for the years January 2013 through June 2015. In those minutes, the committee votes to reserve funds for a project, table a project, extend a project offer for an additional time period, or approve a project for contract.

For a sample of 42 FastTrack contracts, we reviewed meeting minutes to determine if the Grant Committee voted to approve the project for contract prior to the contract date. This random sample cannot be projected to the total population of 389 contracts for that period. We specifically looked for language in the minutes that said the project was presented for contract approval and the request was approved. Six of the 42 contracts did not have contract approval prior to the contract date.

We asked FastTrack staff about the six contracts for which minutes did not reflect contract approval. They responded that one of the contracts was never approved and that one was approved, but such approval not recorded in the minutes. For the other six contracts, they provided meeting minutes dates. However, when we reviewed the minutes for those meetings, we found that the Grant Committee discussed the project and reserved funds or revised a prior reservation of funds, but the minutes did not state that the project was voted for contract approval.

The Grant Committee meeting minutes are the formal record of discussion about a project and its merits. The FastTrack staff should ensure that meeting minutes reflect the vote to approve a project for contract approval.

Recommendation

The department should ensure that all projects are approved by the Grant Committee before the project commences and that the approval is documented in the minutes.

Management's Comment

We concur. "Contract Approval" was inadvertently excluded from the Grant Committee minutes due to a clerical error. We have implemented measures to accurately reflect all actions of the Grant Committee moving forward.

Observation

2. The Fast Track Program's processes of approving incentives involve consideration of all factors as required by statute, but a rubric or points system could achieve more structure and consistency

All requirements for the FastTrack programs are set forth in statute; there are no additional rules for the program as there are for the Tennessee Job Skills Program. According to the FastTrack staff, the key factors in awarding incentives to companies are the number of new full-time jobs, the amount of capital investment by the company, the wage rates of jobs offered, and the location of the project. (See map of FastTrack grants per county for location information.)

At times, the Grant Committee chooses to offer a company a larger incentive than it has applied for, demonstrating that in some cases, the committee views bringing a particular grant to contract as highly desirable. There is nothing in the record to indicate the specific factors that guide such decisions. While the pre-grant committee is diligent in presenting each of the factors that should drive decision-making, it has not taken the further step of making a rubric, or assigning points or percentages, to each decision factor as a method of bringing more consistency to the process. In the absence of a way to prioritize projects, it is difficult to ascertain whether resources are spent on the projects most advantageous to the state. Because the set of companies currently applying for incentives is constantly changing, the committee cannot prioritize companies as if the choices were static. A rubric or points system could serve to rank companies into categories. A more formal-decision making process will also show regional stakeholders how the department considers location alongside types of businesses projected to bring the greatest economic growth.

2016 Subrecipient Monitoring Plan

We assessed the Department of Economic and Community Development's 2016 Grant Management and Subrecipient Monitoring Implementation Plan to determine whether the department is complying with Central Procurement Office (CPO) Policy 2013-007, "Grant Management and Subrecipient Monitoring Policy and Procedures." All state agencies awarding state or federal funds or non-cash assistance to subrecipients must follow Policy 2013-007, which includes submitting an annual monitoring plan to the CPO, located in the Department of General Services. The CPO reviews and approves the monitoring plans. The Department of Economic and Community Development budget for fiscal year 2016 is $95.5 million in grant funds for programs such as FastTrack (see page 13 for information on FastTrack grants), SelectTN, ThreeStar, Tennessee Downtowns, and Community Development Block Grants (see Rural Development section on page 34 for information on these grants).

To accomplish this objective and to gain an understanding of the monitoring processes of the department's subrecipient programs, we interviewed the department's program managers and Internal Audit Director. We reviewed the department's monitoring plans, monitoring guides, monitoring reports, risk assessments, and program manager training materials. To gain an understanding of requirements for plan submission and monitoring under CPO Policy 2013-007, we interviewed Central Procurement Office staff.

Policy 2013-007 Grant Management and Subrecipient Monitoring Policy and Procedures

9.2.1 *Monitoring Plan Components*

- The total subrecipient contracts population;
- The agency's monitoring cycle, e.g., the state or federal fiscal year;
- All subrecipient contracts the agency will monitor during its monitoring cycle;
- A description of each state or federal program to be monitored;
- Sample monitoring guides to be utilized for each monitored program;
- Full-time equivalents and personnel classifications for all staff dedicated to monitoring activities;
- A risk assessment for each subrecipient and its related contracts;
- An explanation of the criteria used to assign risk to subrecipients and their related contracts;
- An explanation of each finding from the previous monitoring cycle;
- An explanation of the agency's corrective action process for each finding.

Finding

4. The department did not comply with the subrecipient monitoring policy as it did not include required monitoring plan components, did not base monitoring selections on the criteria outlined in the policy, did not issue monitoring reports for the majority of grant programs, and did not provide monitoring reports to the Comptroller

The Department of Economic and Community Development's 2016 monitoring plan does not include required information on a list of contracts to monitor in the upcoming fiscal year, total current contracts, or the comparative risk level of subrecipients. These omissions prevent an assessment of whether basic monitoring requirements are met. The plan contains generalized, repetitive language that is sometimes used for programs to which it does not apply, and that fails to provide the Central Procurement Office (CPO) or department management with an accurate understanding of how each program monitors its contracts.

Department’s Monitoring Plan Lacked Key Components

The department’s fiscal year 2016 Subrecipient Monitoring Plan submitted to the CPO omitted a list of the subrecipients to be monitored during the plan year and the risk assessment for all subrecipients. The plan also did not include monitoring checklists for some programs, or an explanation of each finding from the previous monitoring cycle.

Effect of Missing Lists and Risk Assessments

CPO Policy 2013-007 requires agencies to monitor subrecipients once every three years. Requiring two lists—(1) the total subrecipient contracts and (2) the contracts the agency will monitor in the plan year—allows CPO reviewers to ascertain whether a given contract is monitored once over any three-year period. If an agency does not provide a list of contracts to be monitored in the current plan year, neither the CPO nor the agency’s management can determine if the programs are monitored once every three years.

Monitoring selections should be driven by results of the risk assessments. Policy 2013-007 lists criteria for agencies to use in choosing subrecipients to monitor in a given year—risks of noncompliance with federal regulations, and programmatic and financial risks to the state. If risk assessments, or at least the scores, are not provided to CPO with the monitoring plan, CPO reviewers have no way to assess whether subrecipients chosen for monitoring are higher-risk subrecipients.

Conditional Approval of Monitoring Plan

The CPO Grants Program Manager, in an email dated December 3, 2015, approved the department’s monitoring plan conditional upon the department’s providing a list of subrecipients to be monitored and the risk assessments; as of April 11, 2016, the department had not provided the items.

Monitoring Selections Were Not Based on Risk; Some Programs Did Not Complete All Risk Assessments

Interviews revealed that, in practice, program managers monitored all their subrecipients the same, with no evidence that decisions about the timing or frequency of monitoring are based upon prioritizing higher-risk subrecipients. FastTrack subrecipients all receive monitoring at the desk review level. The ThreeStar and Downtowns programs’ subrecipients all receive onsite visits from program managers, but the managers do not produce formal monitoring reports with findings. Timing of onsite monitoring for Community Development Block Grants (CDBG) projects is based on the projects arriving at the point of approximately 50% completion, with projects lasting more than three years tracked so that an additional onsite visit can ensure compliance with the “monitor once every three years” rule. Every project for these programs receives essentially the same degree and frequency of monitoring regardless of assessed risk.

Based on audit work, programs are not assessing risk as required by the policy. The Rural Development Deputy Commissioner stated that risk assessments for CDBG programs had been done for the first time in 2015, and a list of risk assessment scores provided for CDBG programs suggested that risk assessments were not done for prior-year contracts that are still open. Our file review of 42 FastTrack Program contracts found the risk assessments were dated 294 to 1,025 days after the contract start dates. Seven of those risk assessment scores (total grants of $24 million) required on-site monitoring. All of the assessments were performed subsequent to the auditors' requests for the file materials. Risk assessments can only effectively prioritize monitoring if they are performed timely and on all open contracts. In order to incorporate the most recent information, they should be performed annually.

However, there are examples of programs taking measures to track and reduce programmatic risks. The department chose to monitor CDBG contracts at 50% completion because at this point monitors have learned that much of the required paperwork will be completed and construction projects will be underway, but there is still time for problems to be corrected.

Another example is the ThreeStar program, whose monitoring includes data collection and comparison to benchmarks in five areas identified as pillars of community success. Publicly available scorecards for the counties track past performance and progress, creating data for the counties to use in selecting future projects to fund with the ThreeStar grant money. In addition, the department requires annual activities to fulfill some goals and detailed self-reporting.

ThreeStar's section of the subrecipient monitoring plan does not emphasize the tighter control afforded by its structured nature and the level of data collection and reporting used because the majority of the content is standardized language used across program descriptions. Questions on the risk assessment used across most programs are not tailored to county governments receiving grants of the exact same size. Instead of using one-size-fits-all program descriptions, risk assessments, and monitoring checklists, ThreeStar could provide a program description in the monitoring plan that reveals how the program structure helps reduce risks and a risk assessment tailored to the programmatic and financial risks to which its program is vulnerable.

<u>Total Contract List Did Not Include All Contracts</u>

The contract list that the department attached to its Subrecipient Monitoring Plan did not list all contracts because the department used delegated authority for some programs, and individual contracts made under delegated authority were not listed separately in the submitted spreadsheet. Delegated authority is used for multiple contracts that are nearly identical in scope, allowing the grantor to put in one request and receive one approval for the group. Delegated authority is used by multiple FastTrack and Rural Development programs; 43 individual contracts were made under just one of these delegated authority contracts in 2015 (FastTrack Job Training Assistance Program).

Standardized Language Did Not Always Fit

While auditors were told that each program manager is responsible for preparing his or her section of the monitoring plan, there is a considerable amount of standardized language in the plan, some of which is inapplicable to the programs it is used for. For instance, the paragraph describing programs' corrective action plans is used for programs that do not issue monitoring reports, such as the ThreeStar program. Corrective action plans outline steps the subrecipient will take to clear findings; since no monitoring reports with findings are produced for the ThreeStar program, there is no need for corrective action plans. The department's monitoring plan for fiscal year 2016 uses a consistent structure and standardized language across programs, resulting in program descriptions that do not yield important information for CPO reviewers, which at worst can be inaccurate.

CDBG Program Incorrectly Reported No Findings in Previous Year

An explanation of each finding from the previous monitoring cycle is a required element for the Subrecipient Monitoring Plan. The Community Development Block Grants (CDBG) program reported no findings in each of the monitoring plans reviewed; however, we determined there were at least 19 monitoring reports issued during the applicable time period which contained one or more findings. (See following section, Monitoring Reports Not Provided to the Comptroller's Office.)

Monitoring Reports Not Provided to the Comptroller's Office

The Comptroller of the Treasury correspondence file is the repository for monitoring reports submitted to the Comptroller per Policy 2013-007; between 2013 and 2015, the department submitted five monitoring reports and five follow-up letters sent to grantees during the corrective action process, all pertaining to the CDBG programs. The follow-up letters were sent to grantees acknowledging actions taken to clear a finding: a follow-up letter means there was first a monitoring report with findings.

The Rural Development Deputy Commissioner stated that substantially greater numbers of CDBG audit reports had been produced during this time. However, upon further questioning, the department provided only one additional monitoring report and eight additional follow up letters. The department did not forward monitoring reports that contain no findings to the Comptroller, according to the Internal Audit Director, who believes this is consistent with Policy 2013-007. However, the policy states that the agency must distribute copies of monitoring reports to the Comptroller of the Treasury, with no distinction made concerning the presence of findings. The CPO Grants Program Manager agreed that all reports sent to subrecipients should also be provided to the Comptroller's Office.

Failure to Issue Monitoring Reports

Policy 2013-007 states that grantor agencies should issue reports summarizing any findings or observations identified during monitoring activities, and defines monitoring activities to include reviewing programmatic and financial reports as required by the grant contract, and ensuring that the subrecipient takes action on any deficiencies that have been communicated to them. Our interviews found that program staff were performing monitoring activities as defined by the policy, but were not communicating what they learned through these activities in monitoring reports. During interviews, program staff told us of problems that should be documented but for which there were no formal monitoring reports.

With only the CDBG program issuing formal monitoring reports, $69.6 million of state and federal funds in the department's fiscal year 2016 budget will go to grants for which no formal monitoring reports were issued. Because a majority of the department's programs make grants to local government entities, the same counties, cities, and Industrial Development Boards will continue to be future subrecipients of the different programs. Formal documentation through monitoring reports provides a repository of information on these entities.

Recommendation

The department should ensure that its monitoring plan has all required elements and should submit complete and accurate lists of current contracts, separated by program. The grant programs should perform meaningful risk assessments for all open contracts and should use them to select specific subrecipients to monitor during the plan year. Programs that do not issue formal monitoring reports should do so. Program managers should provide monitoring reports to the Comptroller of the Treasury.

Future revisions of the monitoring plan should focus on presenting an accurate picture of the planned monitoring for the year, with program-specific details to help the reader understand how monitoring selections and practices make sense for the program and follow policy.

Management's Comment

We concur. The department's Grant Management and Subrecipient Monitoring Implementation Plan (Implementation Plan) as submitted to the Central Procurement Office (CPO) in accordance with CPO Policy 2013-007 did include a listing of all contracts recorded in the state's official accounting system, but not all of the related purchase order contracts to individual subrecipients under the delegated grant contracts. This oversight has been corrected for the submission of the FY2017 Implementation Plan on September 30, 2016.

However, the Grant Management and Subrecipient Monitoring Implementation Plan is set up to achieve the consistency of coverage across programs and to reflect the criteria that are required to be monitored for grantees that receive federal funding rather than individually tailored for every program. All monitoring plans reference the *U.S. Code of Federal Regulations* (CFR) monitoring criteria for subrecipient monitoring even though some criteria may not apply equally to all State-funded programs. The CFR is named in CPO Policy 2013-007 as the standard and has proved sufficiently flexible for all federal programs and entities.

While it is the intent to provide risk assessments and monitor all contracts according to their level of risk, CDBG always completes an on-site visit of all projects based on HUD recommendations and common practices in other states. ThreeStar projects and Tennessee Downtown projects all receive site visits which may or may not have included monitoring. Some of the risk assessments were not prepared timely. This is partly due to the reduction of staff resources. Risk assessments were not submitted to CPO with the Implementation Plan due to the large volume of data that entailed for more than 750 grant contracts and more than 500 purchase orders under delegated grant authorities. Risk Assessments are conducted for each grantee after contracts are issued. The Rural Development Division is keeping track of risk assessment results through our programmatic spreadsheets. Other programs are moving toward that process. Otherwise, risk assessments are maintained in the department for reference.

Also by reason of the large volume of contracts, not all monitoring reports for every contract are submitted to the Comptroller, but as we interpret the CPO Policy, only the reports with findings were necessary. Our requests for clarification to CPO, et al. provided no clear response. Unfortunately, the full monitoring reports were not provided to the Comptroller, only the "Follow-up" letters showing corrective actions that had been taken to resolve the findings. That process is being changed to submit the complete monitoring reports with findings rather than the "Follow-up" Letter.

TENNESSEE JOB SKILLS PROGRAM

The Tennessee Job Skills Program is a grant program that gives priority to the creation and retention of high-wage jobs and focuses on employers in industries that promote high-skill, high-wage jobs in high-technology areas, emerging occupations, or skilled manufacturing jobs. The objectives of our review were to determine whether grants awarded by the Department of Economic and Community Development for the program complied with laws and program requirements and to determine whether the department complied with the requirements of *Tennessee Code Annotated*, Section 507-451(c)(2) in filing an annual report on the status of the Job Skills Fund.

To accomplish our objectives, we interviewed staff, reviewed laws and rules, and reviewed the department's Tennessee Job Skills Program status reports dated February 2015 and February 2016. We selected a sample of grants awarded to ensure the awards were in compliance with laws, regulations, and program requirements.

Finding

5. The Tennessee Job Skills Program's grants and its annual report do not contain all information required by statute

Section 50-7-451, *Tennessee Code Annotated*, states specific information that should be included in a Job Skills grant application. This information includes the number of jobs available; skills and competencies required for the identified jobs; starting wages to be paid to trainees on successful completion of the project; goals, objectives, and outcome measurements for the project; proposed curriculum for the project; projected cost per person enrolled, trained, hired, and retained in employment; and any other information deemed necessary by the Department of Economic and Community Development.

The rules for the Tennessee Job Skills Program also require evidence of qualifications of training instructors. Applications are to be reviewed based on the total number of jobs the training project will impact; the degree that the training will increase job skills, job responsibilities, and wages of participants; whether the training project focuses on demand, emerging, or high-skill, high-wage, manufacturing jobs; whether the employer is current on payment of unemployment insurance premiums; the level of monetary and in-kind contributions made to the project by the applicant(s); and the degree the company will increase its current international trade activities.

Each employer who receives a Tennessee Job Skills grant is required to file a final report with the department at the conclusion of the grant with: (1) the number of participants in the project who are employed at the end of the project; (2) the number of participants in the project who are not employed at the end of the project; (3) the starting wage of each participant employed; and (4) any other information required by the department. Rules also require a site visit when the department receives an application and visits during the training project.

We reviewed the documentation for a sample of 7 of the 26 Tennessee Job Skills grants on the February 2016 Tennessee Job Skills grant report. This random sample cannot be projected to the total population of 26 grants. Two of the seven applicant files did not have a Tennessee Job Skills Application. Therefore, we could not determine whether the jobs were demand; emerging; or high-skill, high-wage manufacturing jobs. In addition, for these two files, the grantee had not certified that the project met the criteria in Section 50-7-451(c)(5), *Tennessee Code Annotated*. For all seven of the contracts in the sample, we could not determine whether the grantees were current on their unemployment taxes or the degree to which the company would increase international trade as required by Chapter 0500-6-1-.05 of the department rules. None of the seven files contained documentation of any site visits as required by Chapter 0500-6-1-.06(1)(2) of the rules.

Final reports are due when the grantee submits the last reimbursement request. One of the seven grantees had submitted a final report as required. However, the final report did not include two of three items required by Section 50-7-451(d), *Tennessee Code Annotated*. The grantee did not report the number of participants in the project who are not employed at the end of the project and the starting wage of each participant employed.

Tennessee Job Skills Program Annual Report

Section 50-7-451(f), *Tennessee Code Annotated*, requires the department to annually report to the Finance, Ways and Means Committee of the Senate and House of Representatives on the status of the Jobs Skills Program. Statute requires the report to include the information required to be filed by each employer who receives a grant—the number of participants in the project employed at the end of the project; the number of participants in the project who are not employed at the end of the project; and the starting wage of each participant employed. Also required is the amount of each grant authorized; each commitment accepted since the previous report; the name of the employer receiving the grant; the total outstanding grants and commitments; and the total unobligated appropriation.

According to department staff, the Tennessee Job Skills Program has not been funded for several years and when the current funds are expended, the program will no longer be available. However, the FastTrack Program provides grants for training. in lieu of the Job Skills Program.

Auditors reviewed the annual reports submitted and dated February 2015 and 2016. Those two reports do not include the information required to be filed by each employer—the number of participants in the project employed at the end of the project; the number of participants in the project who are not employed at the end of the project; and the starting wage of each participant employed. The reports do include the amount of each grant authorized; commitments accepted since the previous report; the name of the employer receiving the grant; the total outstanding grants and commitments; and the total unobligated appropriation.

Recommendation

The department should ensure that all awards for the Jobs Skills Program contain evidence of compliance with Section 50-7-451, *Tennessee Code Annotated*. The department should require grantees to file a final report prior to their last reimbursement, and should ensure all information required by Section 50-7-451, *Tennessee Code Annotated*, is included in the final report.

Management's Comment

We concur. In efforts to streamline the application process across the FastTrack and Job Skills Programs, information was inadvertently excluded from the requirements of Job Skills.

As this program winds down, we will ensure that the Tennessee Job Skills applications going forward will contain the required information and criteria required by statute and rules. All existing and future Job Skills grants will be monitored through site visits and we will retrieve the required final report. From this point forward, the Annual Report for the Tennessee Job Skills that is submitted to the Finance, Ways and Means Committee of both House and Senate; the House Commerce Committee; and the Senate Commerce, Labor and Agriculture Committee will be modified to include when applicable the number of participants in the project employed at the end of the project, the number of participants in the project who are not employed at the end of the project, and the starting wage of each participant employed.

The process for verification of unemployment insurance status has been implemented with a new contact with the Department of Labor and Workforce Development, Employer Accounts Operations.

OTHER WORK PERFORMED

Rural Development

In February 2015, the Department of Economic and Community Development created the Assistant Commissioner of Rural Development position to lead a taskforce of 19 members to develop initiatives in rural areas. The Rural Development Division uses established funding programs and new initiatives to connect communities to funding and technical assistance to identify and build off their assets, and to advance economic development across the state. The department requested $10 million for the Rural Development Division in the 2016-2017 budget.

In August 2015, Governor Haslam created the taskforce to bring resources together from a wide range of organizations to advance rural communities and economic development throughout Tennessee. The taskforce will develop and adopt an initial three year strategic plan that will include a comprehensive vision for rural development, and will organize working groups to design and implement highly effective programming to address key issues that impact rural life. The long-term objective of the taskforce is to implement statewide policies and programs that improve the economy in all rural communities and decrease the number of counties that are at risk and distressed.

Methodology

Our objectives for the Rural Development Division were to review the division's programs and funding for distressed counties by interviewing staff; researching and reviewing reports outlining their responsibilities; and reviewing the policies, procedures, and best practices used to accomplish rural development growth in distressed areas in Tennessee.

Rural and Community Development

The Rural Development Division provides advice and technical assistance on community and economic development, as well as other services to local governments; chambers of commerce; and other agencies, groups, and individuals. Our audit work revealed that the division has been diligent in providing resources to rural areas of the state to brand them attractive for business. Based on the Rural Development grant data obtained from Edison for fiscal year 2015, approximately $1,440,060 has been awarded through the various programs within Rural Development to assist the distressed counties.

Tennessee has a total of 21 distressed counties: Lake, Lauderdale, Hardeman, McNairy, Perry, Lewis, Wayne, White, Van Buren, Grundy, Bledsoe, Rhea, Morgan, Pickett, Fentress, Scott, Campbell, Claiborne, Hancock, Cocke and Johnson. Distressed counties by definition rank in the lowest 10% of all counties in the nation according to an index score based on per capita market income, three-year average unemployment rate, and the poverty rate.

The Rural Development Division includes the following programs:

The Select Tennessee Site Development program is designed to help Tennessee businesses prepare to attract industrial development by providing site certification through the Certified Sites and Property Evaluation programs. The Certified Sites program sets a standard to rely on when making critical location decisions to get a business up and running at a Tennessee certified site, and assists with wetland surveys, geo-technical services, water supply, and other issues. The Property Evaluation Program helps to develop the state's inventory of both industrial sites and existing buildings through an assessment of a community's existing inventory that selects where investment may be valuable.

- The Three Star program is designed to focus on job and economic development; fiscal strength and efficient government; education and work force development; health and welfare; and public safety. Participation in this program is based on an annual evaluation and activity plan to address areas identified as critical to ensure the success of Tennessee communities. Counties are broken down into three tier groups ranging from the wealthiest to the economically distressed counties. Tier 1 counties are the wealthiest (e.g., Davidson County) and Tier 3 counties are economically distressed, (e.g. Hancock County). The grants awarded to the eligible Tier 2 and 3 counties are for $10,000 each.

- The Tennessee Main Street program serves as a statewide resource for communities seeking to revitalize and manage their traditional downtowns. The General Assembly established the program to assist these communities with their economic development and revitalization efforts.

- The Tennessee Downtowns program is affiliated with the Tennessee Main Street program and was designed to help communities fully understand what it takes to embark on a comprehensive revitalization effort for their downtown. Eligible participants are awarded a $15,000 grant and two years of training and services. A total of 34 communities have participated in the program to date.

- The Community Development Block Grant grants federal funds to entities that align with one of three national objectives: principally benefit low- and moderate-income persons; eliminate slums and blight; and address imminent health and safety problems. There are a number of federal regulations that apply to these, including environmental review, Davis-Bacon wage rates, civil rights legislation, and competitive procurement.

- The Tourism Enhancement Grant was developed to provide tourism infrastructure resources to enhance and improve the tourism economic impact in Tennessee counties. Each award is granted up to $50,000 with a match requirement. The project must be completed on city- or county-owned property, and the grantee must be a city or county government.

Table 6
2015 Rural Development Program Grant Totals

Grant	Total Awarded	Number of County Participants
Select Tennessee	$110,060.00	3
Tennessee Downtowns	$60,000.00	4
ThreeStar	$1,270,000.00	72
Total	**1,440,060.00**	**79**

Source: Edison system as of June 28, 2016.

The division's programs are geared toward asset-based training and planning. In asset-based economic development, assets such as infrastructure, tourism, and agriculture are evaluated to determine how to improve these areas.

The maps on pages 38 and 39 demonstrate which counties have received grants for rural development initiatives and growth in their communities for years 2014 and 2015. The map is color coded by county in relation to the amount of grant money each county received. In fiscal year 2014, 2 of the 21 distressed counties, Scott and Hancock, did not receive any rural development grant money. However, in fiscal year 2015, all 21 distressed counties received rural development grant funds. The department should continue to compare results of the Rural Development programs by looking at the per capita income, employment rate, and the poverty rate in each of the distressed counties from year-to-year.

In an effort to provide additional resources to rural areas, the General Assembly passed the Rural Economic Opportunity Act of 2016 on April 18, 2016. This act authorizes a job tax credit for qualified business enterprises located in enhancement counties; specifies the minimum jobs criteria and requirements to qualify for the credit; establishes the propelling rural economic progress (PREP) fund; and establishes guidelines for making grants from the PREP fund.

Broadband

Our review of the department's rural development efforts included the department's evaluation of the availability of broadband Internet in rural areas. The department's regional directors recognize broadband access as a challenge because the connection is not consistent. Additionally, the lack of broadband impedes some from receiving educational opportunities.

The challenges facing Tennessee are unequal access to high-speed Internet and under-utilization of Internet-enabled applications. These gaps have major tangible impacts on businesses, households, and communities. Broadband Internet access impacts quality of life, educational opportunities, health-care, and a business's ability to compete. As a result of these challenges, the department conducted a broadband study and released the report on July 19, 2016. The report identified several key findings:

- 87% of Tennessee's population has access to broadband that meets the Federal Communications Commission (FCC) definition (25 megabytes per second [mbps] download speed and 3 mbps upload speed). This leaves 366,115 households (834,545 people) without access, the vast majority of which are located in rural regions of the state. The existing broadband infrastructure is not fully utilized because 69% of businesses and 76% of households have speeds below the FCC's definition of broadband.

- Businesses and households in counties designated as at-risk and distressed are less likely to meet the FCC standard than those in counties designated as transitional, attainment, or competitive.

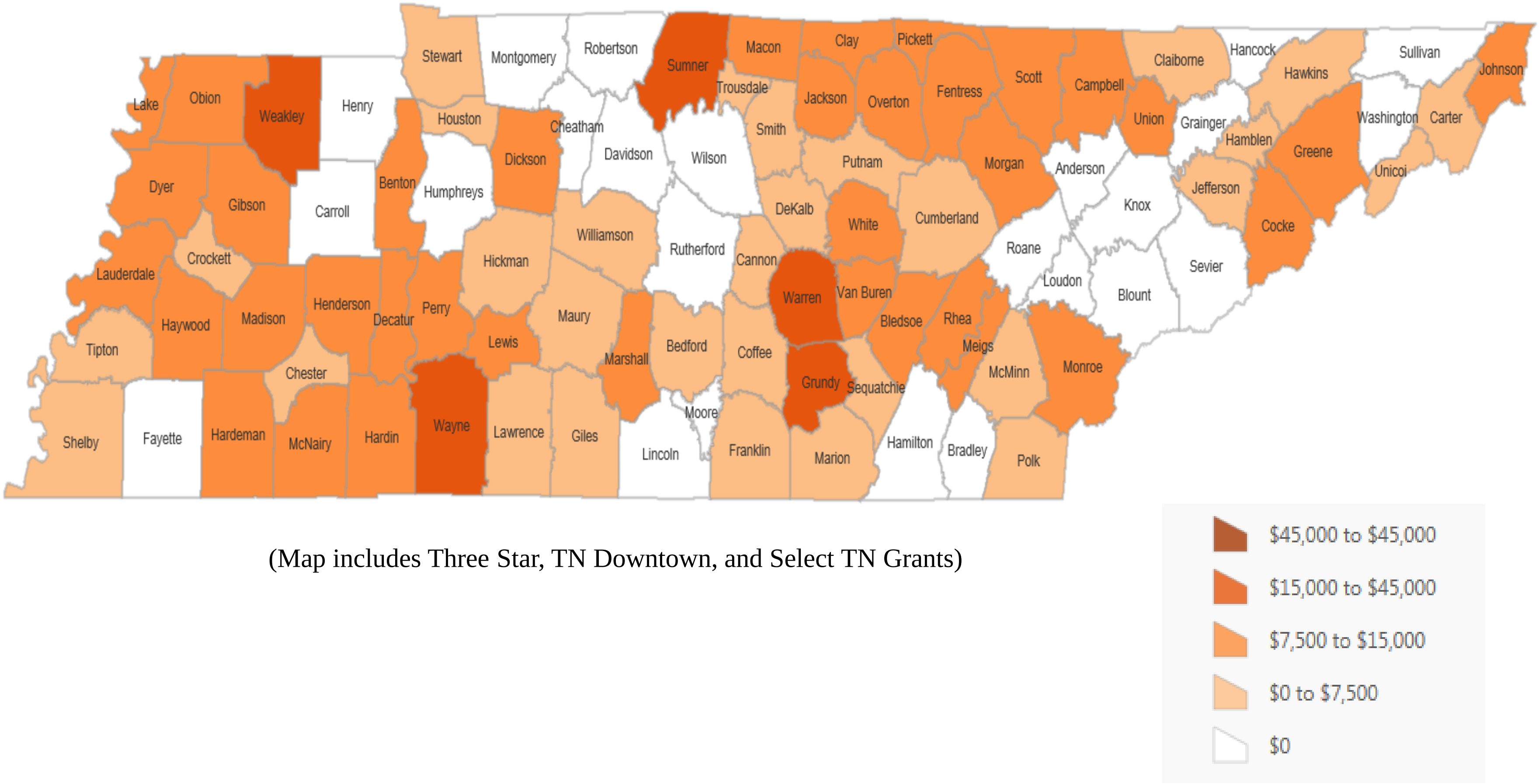
- 4.6% of household respondents do not have an Internet connection at home. Over half of these respondents (54.1%) stated that there was no broadband available where they lived.

- The second most frequently mentioned reason for not having an Internet connection was affordability. Only 2.1% said that they did not have a need for the Internet.

The study found that having access to rural broadband is significant for job creation. The Internet helps promote economic stability and thriving communities; refine technology innovations; provides better and less expensive health-care, and improvements to public safety; and facilitates more telework and telecommuting opportunities for the state's workforce.

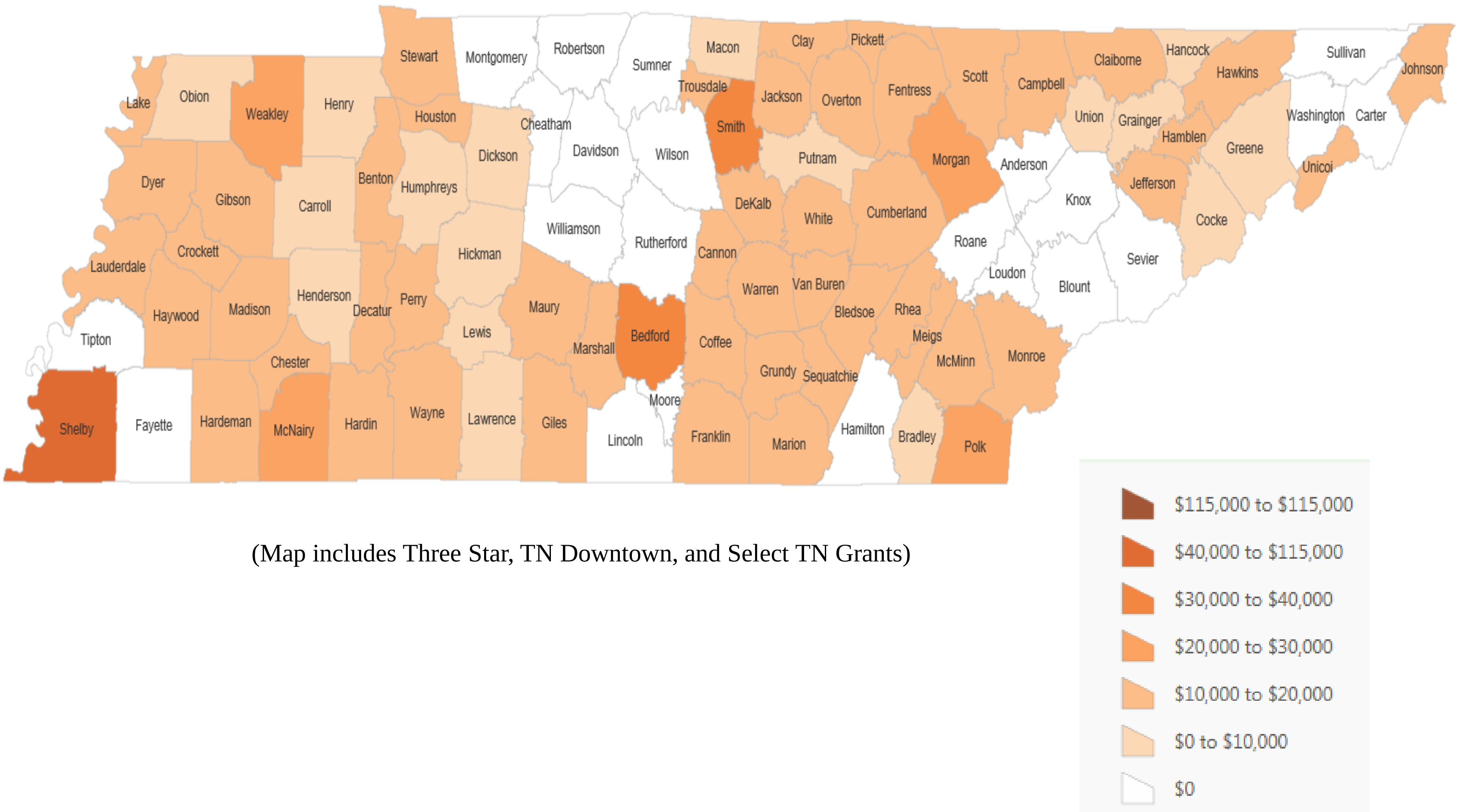
We also reviewed other reports from the Tennessee Advisory Commission on Intergovernmental Relations (TACIR) and Connected TN. TACIR will continue to collect and review information for the study on broadband Internet deployment, availability, and adoption in Tennessee.

2014 Rural Development Grants



(Map includes Three Star, TN Downtown, and Select TN Grants)

2015 Rural Development Grants



(Map includes Three Star, TN Downtown, and Select TN Grants)

Memphis Regional Megasite

The Memphis Regional Megasite is an industrial site located on Interstate 40 between Memphis and Jackson, Tennessee. We reviewed documentation, conducted interviews, and toured the site to determine the responsibilities of the Department of Economic and Community Development and other state agencies regarding the megasite. We also reviewed the status of two other industrial sites in the state by contacting a local industrial board and the Department of General Services.

Site Development

The Memphis Regional Megasite consists of 4,100 acres in Haywood and Fayette counties purchased by the state in 2009 and certified by the Tennessee Valley Authority (TVA) in 2006 as suitable for large-scale manufacturing. The department markets the site to potential tenants and recruits prospective businesses. Its website includes a video that informs viewers of the state's 2.1 million population and 24 post-secondary institutions within a 90 minute drive, and includes maps of highways and utilities accessible to the site.

Criteria for TVA Megasite Certification

- Site size of 1,000 acres or more
- Proximity to interstate highways, rail lines, and suppliers
- A plentiful labor supply
- An acceptable infrastructure development plan

According to the department, the goal of the ongoing site infrastructure development is to have the site in an "18-month window," meaning that all needed infrastructure would be in place within 18 months from the time a tenant announced they would to build on the site. Development of infrastructure is funded as a capital project approved by the State Building Commission (SBC). The department works with the Department of General Services' Real Estate Asset Management Division to present the projects to the SBC based on the department's past experience of industry tenants' needs. The Department of General Services' Capital Projects Group and Land Transactions Team assist with contract management and land procurement for utility easements. The Department of Environment and Conservation processes applications for any environmental permits for work on the site and provides advice on environmental impact to the site. The Tennessee Department of Transportation realigned a state highway adjacent to the site and maintains that highway.

The state's investment in the megasite is $89.1 million as of February 2016. In addition to re-routing of the state highway, a water tower has been completed and the interstate interchange improved. The department is working with TVA's certification contractor to recertify the site, but recertification is on hold while a new wastewater treatment plan is in design. According to the department, the megasite is approximately one year from the 18-month window and additional costs will be incurred.

Status of Clarksville-Montgomery County and Chattanooga-Hamilton County Megasites

The Clarksville-Montgomery County and Chattanooga-Hamilton County megasites have been successful in attracting tenants. The sites were purchased and developed by their local Industrial Development Boards with state grant monies.

The Clarksville site, Commerce Park, was developed from farmland purchased by the Montgomery County Industrial Development Board in 2003. The 1,214 acre property was purchased for $20.4 million, and the Montgomery County Industrial Development Board funded $108,000 in due diligence costs to get the site ready to market. It was certified by TVA as a megasite in 2006. According to the Clarksville-Montgomery County Industrial Development Board, total infrastructure development for the site was $68.5 million, $13.7 million of which was a grant from the state to attract Hemlock Semiconductor, LLC. In 2008, Hemlock announced that it would locate a $1.5 billion silicon manufacturing operation at the site that would employ over 400 personnel and be completed in 2012. However, Hemlock never started operations and announced in December 2014 that they would not activate the Clarksville site because of market conditions. On December 22, 2015, Google announced it would build a data center on the former Hemlock site with an investment of $600 million and a potential of 70 to 100 available jobs.

The Chattanooga site, Enterprise South Industrial Park, is co-owned by the city and Hamilton County, which, from 2000 to 2002, purchased 3,000 acres of the former Volunteer Army Ammunition manufacturing plant. The plant was converted to civilian use in the 1990s and underwent federal hazardous waste remediation from 1978 to 2005. The location consists of 1,350 acres and was certified by TVA in 2005. In July 2008, Volkswagen Group of America, Inc. announced that it had chosen Chattanooga for its plant operations and would invest $1 billion and create 2,000 jobs. The department provided $54 million in grants for the Chattanooga site. We contacted the Industrial Development Board of the City of Chattanooga to gain information on total infrastructure costs; they did not respond.

In 2015, two automotive suppliers to Volkswagen expanded and/or established new manufacturing operations in Hamilton County and are expected to create a combined total of 825 new jobs and $235 million in investments.

Factors Affecting the Completion of the Memphis Megasite

The department is committed to finding a tenant for the Memphis Regional Megasite within the next three years by marketing the site to original equipment manufacturers. In April 2016, the department took recruitment efforts to Asia to “pitch the megasite.” The department’s website includes video of the site with facts about the location, population, workforce, post-secondary institutions, etc. However, there are some factors that the department has identified or is working to resolve in order to find a tenant for the site.

The size of the Memphis Regional Megasite may be too big for one major company’s needs; at 4,100 acres, it is larger than the Clarksville-Montgomery County and Chattanooga-

Hamilton County sites and could accommodate multiple tenants. Since the site was purchased, the only use considered for the site has been industrial; no alternatives have been considered.

The Clarksville-Montgomery County and Chattanooga-Hamilton County sites were already heavily populated and industrial areas in comparison to the Memphis Regional site. West Tennessee remains predominantly rural with less infrastructure and fewer amenities in place.

Support for the megasite was not unanimous. Environmentalists and local residents objected to the state's plan to discharge treated wastewater from the site into the Hatchie River and expressed concerns about ozone monitoring requirements from increased commuting by employees. Presently, the state is working on a wastewater solution.

In addition to the wastewater issue, Memphis Regional Megasite Authority meeting minutes reflect local citizens concerns about the need to expedite infrastructure to attract a tenant; concerns about the availability of a skilled labor force and that a tenant might draw the labor force away from existing industry.

Memphis Regional Megasite Authority

In 2007, the General Assembly ratified the Tennessee Regional Megasite Authority Act, Section 64-6-101, *Tennessee Code Annotated*, which allows for the creation of a regional authority to allow local governments to create a regional megasite for the purpose of "acquiring land, improving, financing, operating maintaining and marketing" a megasite. The authority also has the power to accept federal, state, or municipal funds, provide technical assistance to municipalities for megasite development; and issue bonds upon approval of the State Funding Board. The Memphis Regional Megasite Authority was created by the department in 2009 under Section 64-6-110, *Tennessee Code Annotated.* The authority meets quarterly, and the department presents an update to the authority at those meetings. At its June 2015 Sunset public hearing, the authority reported that it had not prepared an economic impact plan as authorized by statute. However, the department expects the authority to be "integral to the success of the megasite as development of the site progresses."

Department's Rural Development Initiative

In 2015, the department began an emphasis on rural development and appointed an Assistant Commissioner for Rural Development to work with a taskforce of state agencies and private companies to focus on and develop initiatives in rural areas. Because Haywood County is identified as an at-risk county by Rural Development, and has one of the lower per capita incomes compared to other counties in the area, this initiative can benefit the megasite as well. (See section on Rural Development on page 34.) Some have expressed optimism that development of the megasite would lower unemployment and create growth for a large area of West Tennessee.

The department provides incentives to companies under its FastTrack Program for job training and infrastructure development. As mentioned above, the Chattanooga-Hamilton

County site received $54 million in grants from the department. However, in 2014 and 2015, Haywood County received $0 and $137,000 in FastTrack funds, respectively. (See FastTrack finding on page 18.) According to the department, once a tenant is secured, the tenant can apply for FastTrack assistance.

The department should continue its efforts to develop the Memphis Regional Megasite, including implementing a wastewater system; determining whether dividing the site into smaller tracts is feasible; and collaborating with the Rural Development Division, the task force, and the Memphis Regional Megasite Authority. The department may wish to consider alternative uses for the site should the recruitment efforts not be successful by its three-year goal.

Compliance With Loan Collection Procedures

We reviewed the department's loan collection practices to determine if the department complies with its Loan Collection Procedures, adopted in March 2014. The October 2012 audit included a finding that the department did not always follow loan collection policies and recommended that policies be consistently enforced.

As of June 2016, the department had a portfolio of 18 Community Development Block Grant loans with outstanding principal balances of $3.7 million. These loans were made to communities and businesses to whom conventional business loans were not available and the department determined there was a need to foster job development. Therefore, debtors are given time and every opportunity to repay the loans. The department's annual risk assessment describes the loans as "reasonably high risk and possibly uncollectible." The department suspended taking applications for the program in 2011; however, the department continues to monitor the outstanding balances and actively pursue amounts due.

Audit work determined that the department has an effective internal control environment for loan collections. The Department of Finance and Administration records payments and tracks loan principal and interest. The information is available for the Department of Economic and Community Development's use. FastTrack Program and General Counsel staff communicate with delinquent borrowers, local governments handling collections, and the Office of Attorney General, and staff document all contacts in monthly collection memos

Departmental Loan Collection Procedures

- 30 to 90 days delinquent – phone call and document discussion
- Over 90 days delinquent, but some amount has been received within 90 days, ask debtor to pay as much as possible and document discussion
- Over 90 days delinquent, but no payment made, begin a series of notification letters
- If needed, the General Counsel recommends a course of action to the Grant Committee
- The department meets with Office of Attorney General representatives quarterly
- Maintain contact with Office of Attorney General handling collections for bankrupt debtors
- Maintain contact with local government representatives handling collections for the department

and collection letters. They meet with staff from the Office of the Attorney General quarterly to discuss collection efforts and as needed to discuss bankrupt debtors. General Counsel staff report to the department's Grant Committee on the status of individual loans as needed.

Based on our review of documentation and interviews, we determined that the department complies with its Loan Collection Procedures.

TENNESSEE TECHNOLOGY DEVELOPMENT CORPORATION

The Tennessee Technology Development Corporation (LaunchTN) was created in March 1998 by Section 4-14-301, *Tennessee Code Annotated*, to foster technology-based economic development on behalf of the state. The Department of Economic and Community Development oversees the operations of LaunchTN.

We reviewed board meeting minutes, conflict-of-interest statements, LaunchTN investor information, and related documentation. We interviewed department staff and LaunchTN staff to obtain an understanding of the department's oversight of LaunchTN with a focus on determining if the findings in a 2014 Department of Treasury audit and a 2015 Appalachian Regional Commission Office audit had been resolved.

LaunchTN focuses on

- entrepreneurship
- capital formation
- commercialization
- outreach
- corporate engagement

Organization and State Funding

LaunchTN has 22 board members, including the Commissioner of the Department of Economic and Community Development as an ex-officio member (see Title VI information for the board in the Appendix 1). We reviewed board meeting minutes and conflict-of-interest disclosures. State law requires LaunchTN to submit an annual report to the Governor and the General Assembly each November. In its November 2015 report, LaunchTN defined its mission as follows: "To make Tennessee the No. 1 place in the Southeast for entrepreneurs to start and grow a company."

In July 2012, LaunchTN was the recipient of a $10.4 million contract (representing a five year budget) with the department to monitor and collect data on innovation-related activities in the state, to develop a co-investment fund for supporting early-stage companies, and to foster technology statewide through regional business accelerators. In 2012, the department contracted with LaunchTN to serve as administrator for the INCITE Co-Investment Fund, a venture capital fund that invests in high-growth, high-potential, small technology businesses. The U.S. Department of Treasury awarded $29.7 million to the state to establish the fund as part of its State Small Business Credit Initiative. The credit initiative supports state venture capital programs such as LaunchTN's INCITE fund. LaunchTN also receives recurring budgeted funding through the department.

LaunchTN Operations

LaunchTN has nine regional entrepreneur centers in the state that provide mentorship and support to entrepreneurs (some funding was provided by the Appalachian Regional Commission). According to LaunchTN's 2015 annual report, 120 companies were assisted by those centers during 2015 with $34 million in capital raised by start-ups companies. In addition, LaunchTN hosted the Statewide University Venture Challenge where entrepreneurial students from Tennessee universities compete as teams. LaunchTN believes this will create a more connected entrepreneurial community by using existing university programs that could lead to more student-led entrepreneurial ventures. LaunchTN also hosts 36/86, an entrepreneur and technology conference that brings investors and start-up companies together.

According to department staff responsible for overseeing LaunchTN, one goal of LaunchTN is to keep college graduates in Tennessee and prevent a "brain drain" of workers moving to other states. One of the problems that contributes to this is that companies will not relocate to states without a sizeable workforce. Other states with large companies also have university systems that work together to keep graduates working in-state.

LaunchTN has a 2015-2016 class of eight start-up companies that will participate in a "roadshow," a four-day statewide bus tour with stops in Kingsport, Knoxville, Chattanooga, Nashville, and Memphis. The start-ups have opportunities to pitch at investor roundtable events. An example of a successful LaunchTN business venture is an entrepreneur from the agricultural accelerator who received a federal Small Business Innovation Research grant to initiate the farming of indigo in place of tobacco.

INCITE Co-Investment Fund

As mentioned earlier, since 2012, LaunchTN has served as the department's administrator for the INCITE Co-Investment Fund, a venture capital fund. Any investor that meets the approved investor criteria and submits a qualified investment is eligible to take advantage of the program on a first-come, first-served basis. Investors in companies receive stock certificates. As part of the agreement with the state to administer the co-investment fund, LaunchTN administers exits. According to the LaunchTN June 30, 2015, financial statements, four exits occurred during the year. Total proceeds were approximately $912,000; $39,000 was returned to investors, with the remaining $873,000 re-invested in the program. Total losses are $1.8 million to date. The financials also document an exit after June 30, 2015, at a loss of $272,000.

LaunchTN Reporting

LaunchTN generates and submits to the department quarterly grant reports for the Appalachian Regional Commission and monthly metrics for events, mentoring, and meetings related to the Co-Investment Fund, including reports for the numbers of capital and jobs created. According to LaunchTN management, there have been 1,000 jobs created by companies that have gone through the program. This reporting is in addition to the annual report required by statute.

Resolution of Department of Treasury and Appalachian Regional Commission Audit Findings

The U.S. Department of Treasury's 2014 audit of the Department of Economic and Community Development's oversight of the State Small Business Credit Initiative found that LaunchTN had not complied with the program's National Standards for Compliance and Oversight. Specifically, investor use-of-proceeds assurances were missing for 20 transactions and 12 investor sex-offender assurances were signed after funds were transferred.

In response to the finding, LaunchTN revised their procedures approved by the Department of Treasury. Forms and instructions are available on LaunchTN's website.

We reviewed the files of the thirteen qualified investment applicants and fifteen investor applicants approved by LaunchTN from September 2015 through January 2016. All qualified investment applicants and their main investor applicants signed the sex offender assurance and use-of-proceeds assurance prior to funding.

A 2015 audit by the Appalachian Regional Commission found that final reports submitted by LaunchTN in relation to sub-grantees did not reflect the allowable match amounts and metrics were not reported to the commission in a standard table and format.

According to department staff overseeing LaunchTN, the department submitted additional supporting documentation to support match amounts, and a standard template for the table, obtained from the Appalachian Regional Commission, is now in use. The commission accepted the additional supporting documentation and informed LaunchTN that the issue is closed.

Based on the above, we conclude that the department and LaunchTN have implemented the recommendations to address by the U.S Department of Treasury's 2014 audit and that the Appalachian Regional Commission has closed the findings from the 2015 audit.

APPENDICES

APPENDIX 1
Title VI and Other Information

The Tennessee Human Rights Commission (THRC) issues a report, *Tennessee Title VI Compliance Program*, that details agencies' federal dollars received, Title VI and other human rights related complaints received, whether the agency Title VI implementation plans were filed timely, and THRC findings taken on agencies. Below are staff and board member demographics, as well as a summary of the information in the latest THRC report for the Department of Economic and Community Development.

The department received $26,654,800 in federal dollars in 2016. For fiscal year 2015, the department filed its Title VI implementation plan by the commission's deadline of October 1, 2014. THRC received no complaints filed against the department and reported no findings based on its review of the department.

The following tables detail the corporation and the department staff by job, title, gender, and ethnicity as of June 2016.

Tennessee Technology Development Corporation (LaunchTN) Board
July 2016

	Gender		Ethnicity				
	Male	**Female**	**Asian**	**Black**	**Hispanic**	**White**	**Other**
Members	20	2	0	2	0	19	1

Economic and Community Development (ECD) Department Staff
July 2016

	Gender		Ethnicity					
Description	**Male**	**Female**	**American Indian**	**Asian**	**Black**	**Hispanic**	**White**	**Other**
Administrative Assistant 2	1	0	0	0	0	0	1	0
Administrative Services Assistant 2	0	2	0	0	0	0	2	0
Administrative Services Assistant 3	0	2	0	0	0	0	2	0
Administrative Services Assistant 4	0	1	0	0	0	0	1	0
Assistant Commissioner 2	2	2	0	0	1	0	3	0

	Gender		Ethnicity					
Description	**Male**	**Female**	**American Indian**	**Asian**	**Black**	**Hispanic**	**White**	**Other**
Attorney 3	0	1	0	0	0	0	1	0
Attorney 4	0	1	0	0	0	0	1	0
Audit Director 2	0	1	0	0	0	0	1	0
Auditor 2	1	0	0	0	0	0	1	0
Auditor 3	1	0	0	0	0	0	1	0
Business Development Consultant 2	0	2	0	0	0	0	2	0
Clerk 2	1	1	0	0	2	0	0	0
Commissioner 3	1	0	0	0	0	0	1	0
Community Development Program Director	0	1	0	0	0	0	1	0
Creative Services Coordinator 1	0	1	0	0	0	0	1	0
Creative Services Coordinator 2	1	0	0	0	0	0	1	0
Deputy Commissioner 2	1	0	0	0	0	0	1	0
ECD Administrator	1	1	0	0	0	0	2	0
ECD Budget Director	0	1	0	0	1	0	0	0
ECD Business Development Consultant	9	7	0	0	2	0	14	0
ECD Communications Officer	0	1	0	0	0	0	1	0
ECD Contract and Audit Coordinator	0	1	0	0	0	0	1	0
ECD Director of Global Project Management	0	2	0	0	0	0	2	0
ECD Grants Coordinator	0	3	0	0	0	0	3	0
ECD Innovation Director	1	0	0	0	1	0	0	0
ECD Marketing Director	1	0	0	0	0	0	1	0
ECD Office and Resource Manager	0	2	0	0	1	0	1	0
ECD Program Director	1	1	0	0	0	0	2	0
ECD Project Manager	6	3	0	0	1	0	8	0
ECD Regional Field Director	6	3	1	0	0	0	8	0

	Gender		Ethnicity					
Description	**Male**	**Female**	**American Indian**	**Asian**	**Black**	**Hispanic**	**White**	**Other**
Economic Development Regional Specialist	0	1	0	0	0	0	1	0
Economic Research Director	0	1	0	0	0	0	1	0
Executive Administrative Assistant 2	1	1	0	0	0	0	2	0
Executive Administrative Assistant 3	1	0	0	0	0	0	1	0
General Counsel 3	0	1	0	0	0	0	1	0
Grants Analyst 2	1	0	0	0	0	0	1	0
Grants Analyst 3	2	0	0	0	0	0	2	0
Grants Program Director	1	0	0	0	0	0	1	0
Grants Program Manager	1	0	0	0	0	0	1	0
HR Director 2	0	1	0	0	1	0	0	0
Industrial Training Director	0	1	0	0	0	0	1	0
Industrial Training Manager	0	1	0	0	0	0	1	0
Information Officer	1	1	0	0	0	0	2	0
Loan Officer 2	1	0	0	0	1	0	0	0
Loan Program Director	1	0	0	0	0	0	1	0
Music & Media Coordinator	0	1	0	0	1	0	0	0
Small Business Enterprise Director	0	1	0	0	0	0	1	0
Statistical Analyst 3	1	1	0	0	0	0	1	1
Statistical Research Specialist	2	1	0	0	0	0	3	0
TN FEMC Executive Director	1	0	0	0	0	0	1	0
Website Developer 2	1	0	0	0	0	0	1	0
Total	**49**	**52**	**1**	**0**	**12**	**0**	**87**	**1**

APPENDIX 2
Performance Measures Information

As stated in the Tennessee Governmental Accountability Act, "accountability in program performance is vital to effective and efficient delivery of government services, and to maintain public confidence and trust in government." In accordance with this act, all executive-branch state agencies are required to submit annually to the Department of Finance and Administration a strategic plan and program performance measures. The Department of Economic and Community Development's (ECD) priority goals are reported on the Governor's Transparent Tennessee website. The timeframe for when the goals were submitted by the agency was not published on the website.

Performance Standards and Measures

Performance Standard 1: By calendar year, (December 31st) to be the first in the Southeast to increase high quality jobs to reach 55% by 2025.

Purpose of the Goal: Improve Customer Service by recruiting new businesses and supporting existing business expansions to lead to job creation in the State of Tennessee.

Measuring the Goal:

Metrics	Frequency	Baseline	Target	Prior	Current	Status
Yearly job creation	Calendar year Dec 31	0	25,000		25, 837	✓

Initiative: To achieve the highest average household income and the lowest unemployment.

Performance Standard 2: Coordinate alignment at local level through workforce 360, and align with education.

Measuring the Goal:

Milestones	Frequency	Completion Date	Current Status
Research and aggregate statewide totals of ECD landed and pipeline projects, and match the data with THEC [Tennessee Higher Education Commission] to outline the pathway individuals take to receive the correct training/education to be qualified to till positions. Share regional data with at least one region's Workforce 360 team.	Fiscal Quarterly	December 31, 2015	

Milestones	Frequency	Completion Date	Current Status
Share regional data with remaining 8 regions and begin focusing on county specific data if applicable.	Fiscal Quarterly	December 31, 2016	
Create a dashboard with current view of ECD landed and projected projects by county. Include job type and hiring schedule when applicable.	Fiscal Quarterly	June 30, 2017	

Source: Governor's Transparent Tennessee website.

`

APPENDIX 3
Financial Information

Revenues by Source
For the Fiscal Year Ended June 30, 2016

Source	*Amount*	*% of Total*
State	$168,801,500	84%
Federal	$26,654,800	13%
Other*	$6,746,800	3%
Total Revenue	**$202,203,100**	**100%**

* The category "Other" for allotment codes is interest earned.
Source: *The Budget 2015-2016.*

Expenditures by Account
For the Fiscal Year Ended June 30, 2016

Account	*Amount*	*% of Total*
Administration	$6,358,100.00	3%
Business Development	$17,527,100.00	9%
FastTrack	$95,340,500.00	47%
Tennessee Job Skills	$5,285,200.00	3%
Headquarters Relocation Assistance	$400,900.00	0%
Film and Television Incentive Fund	$16,048,600.00	8%
Innovation Programs	$362,700.00	0%
TNInvestco Tax Credits	$30,000,000.00	15%
Policy and Federal Programs	$26,646,500.00	13%
Community and Rural Development	$2,223,400.00	1%
Economic Development District Grants	$2,010,100.00	1%
Total Expenses	**$202,203,100**	**100%**

Source: *The Budget 2015-2016.*

APPENDIX 4
2015 Single Audit Findings

The 2015 *State of Tennessee Single Audit Report* contained the following findings on the Department of Economic and Community Development.

Finding Number	Finding	Page Number
2015-002	The department did not provide adequate internal controls in two specific areas.	page 25
2015-003	For the second consecutive year, the department did not monitor subrecipients for federal audit requirements.	page 26
2015-004	The Department of Economic and Community Development, in coordination with the Department of Finance and Administration, did not accurately report financial data in the 2014-2015 Performance and Evaluation Report	Page 29