



*METROPOLITAN GOVERNMENT OF NASHVILLE AND
DAVIDSON COUNTY*

INTERNAL AUDIT SECTION

Professional Audit, Advisory, and Consulting Services

AUDIT REPORT

Limited Review of the Industrial Development Boards' Cash Management Procedures and Compliance with Stated Agreements

Date Issued: January 16, 2007

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METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

INTERNAL AUDIT SECTION

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January 16, 2007

Mr. David Manning, Director of Finance
Metropolitan Government of Nashville and Davidson County
Metropolitan Courthouse
Nashville, Tennessee 37201

Report of Internal Audit Section

Dear Mr. Manning:

Per your request, we have completed our limited review related to the cash management procedures and compliance with stated agreements for the Industrial Development Board, specifically those transactions related to the financial relationship with Dell Computer Corporation ("Dell").

The scope for our limited review has focused primarily on the internal controls related to the payments made to the Industrial Development Board by the Metropolitan Government of Nashville and Davidson County ("Metropolitan Government"), how the Industrial Development Board managed those funds, and the Industrial Development Boards' compliance with applicable rules and regulations. Although our scope was narrowed to the above mentioned tasks, our work still was governed by performance audit standards promulgated by *Generally Accepted Government Auditing Standards*, which entail an objective and systematic examination of evidence to provide an independent assessment of the performance and management of a program against objective criteria as well as assessments that provide a prospective focus or that synthesize information on best practices or cross-cutting issues. Performance audits encompass a wide variety of objectives including objectives related to assessing program effectiveness and results, economy and efficiency, internal control, compliance with legal or other requirements, and objectives related to providing prospective analyses, guidance, or summary information.

Internal control objectives relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal control includes the processes and procedures for planning, organizing, directing, and controlling program operations, and the system put in place for measuring, reporting, and monitoring program performance.

In planning limited reviews, auditors should obtain a sufficient understanding of internal control as it relates to the subject matter to which the auditors are examining. The subject matter or assertion may be of financial or non-financial nature, and internal control material to the subject matter the auditor is testing may relate to:

- a. effectiveness and efficiency of operations, including the use of an entity's resources;
- b. reliability of financial reporting, including reports on budget execution and other reports for internal and external use;
- c. compliance with applicable laws and regulations, provisions of contract, or general agreements; and
- d. safeguarding assets.

Auditors' Responsibility

In order to maintain and broaden public confidence, auditors need to perform all professional responsibilities with the highest degree of integrity, professionalism, and objectivity when dealing with audited entities and users of the auditors' reports. Additionally, auditors should be honest and candid with the audited entity and users of the auditors' work in the conduct of their work, within the constraints of the audited entity's confidentiality laws, rules, or policies.

Service and the public trust should not be subordinated to personal gain and advantage. Auditors should be objective and free of conflicts of interest in discharging their professional responsibilities. Auditors are also responsible for being independent in fact and appearance when providing audit and attestation services. Independence precludes relationships that may in fact or appearance impair auditors' objectivity in performing the audit or attestation engagement. The maintenance of objectivity and independence requires continuing assessment of relationships with the audited entities in the context of the auditors' responsibility to the public.

In applying *Generally Accepted Government Auditing Standards*, auditors are responsible for using professional judgment when establishing scope and methodologies for their work, determining the tests and procedures to be performed, conducting the work, and reporting the results. Auditors need to maintain integrity and objectivity when doing their work to make decisions that are consistent with the broader public interest in the program or activity under review. When reporting on the results of their work, auditors are responsible for disclosing all material or significant facts known to them which, if not disclosed, could mislead knowledgeable users, misrepresent the results, or conceal improper or unlawful practices.

Management's Role

Department process owners and managers are entrusted to properly manage the resources under their control. To meet their obligations, process owners and managers are responsible for:

- Applying those resources efficiently, economically, effectively, and legally to achieve the purposes for which the resources were furnished or the program was established;
- Complying with applicable laws and regulations, including identifying the requirements with which the entity and the official must comply and implementing systems designed to achieve that compliance;
- Establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met; resources are used efficiently, economically, and effectively, and are safeguarded; laws and regulations are followed; and reliable data are obtained, maintained, and fairly disclosed;

- Providing appropriate reports to those who oversee their actions and to the public in order to be accountable for the resources used to carry out government programs and the results of these programs; and
- Addressing the findings and recommendations of the auditor's work, and establish and maintain a process to track the status of such findings and recommendations.

Department Overview

As codified in the Tennessee Code Annotated § 7-53, industrial development boards are allowed to incorporate within a municipality with the intent to finance, acquire, own, lease, or dispose of properties to the end that such corporations may be able to maintain and increase employment opportunities, increase the production of agricultural commodities, and increase the quantity of housing available in affected municipalities by promoting industry, trade, commerce, tourism and recreation, agriculture and housing construction by inducing manufacturing, industrial, governmental, educational, financial service, commercial, recreational and agricultural enterprises to locate in or remain in this state and further the use and production of its agricultural products and natural resources, and to vest such corporations with all powers that may be necessary to enable them to accomplish such purposes. As stated in Tennessee Code Annotated § 7-53-308, Corporation nonprofit - Net earnings, "The corporation shall be a nonprofit corporation and no part of its net earnings remaining after payment of its expenses shall inure to the benefit of any individual, firm or corporation, except that in the event the board of directors of the corporation shall determine that sufficient provision has been made for the full payment of the expenses, bonds, and other obligations of the corporation, then any net earnings of the corporation thereafter accruing shall be paid to the municipality with respect to which the corporation was organized; provided, that nothing contained in this section shall prevent the board of directors from transferring all or any part of its properties in accordance with the terms of any lease, sale contract, loan agreement, mortgage or deed of trust entered into by the corporation."

The Industrial Development Board of the Metropolitan Government assists private business in obtaining public financing through the issuance of nontaxable bonds. The Industrial Development Board is governed by a board of directors appointed by the Metropolitan Government Council. The Industrial Development Board, incorporated through Tennessee Code Annotated § 7-53, was approved by the Metropolitan Government Council through Ordinance O99-1679 to enter into an agreement with Dell wherein Dell agreed to make a payment in lieu of taxes to the Metropolitan Government zero percent of the amount of ad valorem real and personal property taxes from years one through ten. For years 11 through 40, Dell agreed to make a payment in lieu of taxes to the Metropolitan Government zero percent of the amount of ad valorem real and personal property taxes as long as the number of full time equivalent employees is greater than 1,500. If the number of full time equivalent employees falls below 1,500, Dell would be required to pay two percent of the ad valorem taxes that Dell would be required to pay if Dell owned such property would be made for each 15 Dell employees less than 1,500 Dell employees that are employed in Nashville during the immediately preceding year. For this arrangement, Dell was granted access to three different tracts of land and other property interests that either Dell designates as being subject to Ordinance O99-1679 or the Metropolitan Government Council approves by resolution.

Also approved by the Metropolitan Government Council was Ordinance O99-1680 establishing the Economic and Community Development Incentive Program, which was provided to Dell, authorizing the Metropolitan Government to make economic and community development incentive grants to the Industrial Development Board to encourage economic growth and creation of at least 2,000 new jobs during the first five years of operations. The amount of the grant during any year will be determined by multiplying the average number of full time equivalent employees in Nashville during the preceding year by an amount up to \$500. Ordinance O99-1680 establishing the Economic and Community Development Incentive Program allows the Industrial Development Board to acquire real or personal property for use in a qualified project. Ordinance O99-1680 also created several other ordinances conveying right-of-ways, rezoning, property transfers, and other related development plans.

Financial Information

The most current Comprehensive Annual Financial Report for the Metropolitan Government available during our review was independently audited by the accounting firm KPMG LLP for the year ended June 30, 2005. The opinion based on the work performed by KPMG LLP and other auditors was that the financial statements present fairly, in all material respects, the respective financial position of the government activities, the business type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information. The financial statements for the component units were audited by other auditors whose reports were furnished to KPMG LLP, and KPMG LLPs' opinion, insofar as it relates to the amounts included for the component units, was based on the reports of the other auditors. In the case of the Industrial Development Board, the financial statements were audited by Parker, Parker and Associates PLC for the fiscal year ended March 31, 2005. The audited financial statements presented in the fiscal year ended June 30, 2005 Comprehensive Annual Financial Report can be summarized below:

Statement of Net Assets

Assets

Cash and cash equivalents	\$ 4,481,775
Restricted assets	63
Furniture, machinery, and equipment	1,125
Accumulated depreciation	(300)
Total assets	4,482,663

Liabilities

Other current liabilities	2,309,746
Total liabilities	2,309,746

Net Assets

Invested in capital assets, net of related debt	825
Restricted for other purposes	2,172,092
Total net assets	\$ 2,172,917

Statement of Activities

Net changes in net assets Revenue (expense)	\$ 91,267
General revenues	1,804
Changes in net assets	93,071
Net assets, beginning	2,079,846
Net assets, ending	\$ 2,172,917

Objectives, Scope, and Methodology

The primary objectives of our limited review included the following:

- An examination of the detail working papers from the audit of the Industrial Development Board for fiscal year ended March 31, 2006, performed by Parker, Parker, and Associates PLC;
- A limited examination of the detail working papers from the audit of the Industrial Development Board for fiscal year ended March 31, 2005, performed by Parker, Parker, and Associates PLC;
- Meeting with the attorney for the Industrial Development Board, who manages the day-to-day operations of the Industrial Development Board, to obtain supporting documentation justifying the issuance of check number 172 dated January 19, 2005 for \$45,000 written from the Industrial Development Board checking account and made payable to Bobby D. Davis, Attorney;
- Determine why interest earnings on sizable cash balances have been disproportionately low when compared to cash balances;
- Assess the level of operational oversight by the Members of the Industrial Development Board;
- Identification of weaknesses and strengths of the internal control environment and their impact on operations;
- Identification of the actual financial and/or operational impact on operations from weaknesses and strengths identified; and
- Provide guidance and deliver recommendations to management that supply a direction for improvement in the internal control structure, if necessary.

Our work focused primarily on the period April 1, 2004 through March 31, 2006, financial balances, transactions, and processes in place during the time of the engagement. Certain analyses required the consideration of financial results, performance, and operations outside that time period.

The methodology employed throughout this engagement was one of objectively reviewing various forms of documentation, including written policies and procedures, financial information and various forms of data, reports and information maintained by the Industrial Development

Boards' attorney, Bobby Davis and the accounting firm of Parker, Parker and Associates PLC. We performed our procedures in accordance with *Generally Accepted Government Auditing Standards*.

In discharging our professional responsibilities, we observed the principles of serving the public interest and maintained the highest degree of integrity, objectivity, and made decisions that were consistent with the broader public interest. Additionally, we were free both in fact and appearance from personal, external, and organizational impairments to independence. Additionally, we did not have any reservations about the engagement, the subject matter, or the assertion related thereto. In applying *Generally Accepted Government Auditing Standards*, we used professional judgment when establishing scope and methodologies for our work, determining the tests and procedures to be performed, conducting our work, and reporting results.

Findings and Recommendations

The following findings were noted during our engagement:

1. Inadequate segregation of duties in the accounting function.

One individual receives cash receipts, makes deposits, performs the bank reconciliations, and post to the general ledger of the Industrial Development Board. This lack of proper segregation of duties could result in errors or asset misappropriations going undetected.

Recommendation

Given the limited staffing, management should implement new procedures that would provide some level of segregation and management review of the accounting function.

2. Documentation was not provided for the \$45,000 payment from the Industrial Development Board to the attorney for the Industrial Development Board to the Metropolitan Government Internal Audit Department or Parker, Parker and Associates PLC.

Check # 172 from the Industrial Development Board checking account in the amount of \$45,000 was written on January 19, 2005 payable to the attorney for the Industrial Development Board and deposited into his firms escrow account. Documentation to support the payment was not provided to Parker, Parker and Associates PLC or the Metropolitan Government Internal Audit Department to support the transfer from the Industrial Development Board account to the attorney's escrow account. Transactions that are not properly documented could result in funds being used for non-business related purposes.

Recommendation

All transactions, especially those of a material amount, should be authorized and properly documented to assure that the public trust is not violated and avoid the appearance of non-business related transactions.

3. There was a delay in the Incentive Grant payment to Dell.

Incentive Grants in the amount of \$3,994,560.59 earned by Dell for the period 1999 through 2004, which should have been paid annually, were not requested and documentation was not provided by Dell until April 18, 2006. Even after this delay by Dell in requesting the payments, the Industrial Development Board did not issue the payment to Dell until October 16, 2006. Check # 197 for \$45,000 written on the escrow account of the Industrial Development Board attorney and check # 217 for \$3,949,560.59 written on the Industrial Development Board account dated October 16, 2006 and were received by Dell on October 23, 2006. We did not receive an explanation from the management of the Industrial Development Board why there was a six month delay in paying the request by Dell.

Recommendation

Dell should provide proper documentation annually for the earned Incentive Grant and the Industrial Development Board should make the payment in a timely manner. Additionally, the Metropolitan Government should not submit the annual payment to the Industrial Development Board until proper documentation has been provided for the Incentive Grant earned.

4. Interest earnings from cash on hand were not maximized during the period 2002 through 2006 by the Industrial Development Board.

Parker, Parker and Associates PLC annual audited financial statements from 2002 through 2006 show only \$19,306 in interest earnings. Listed below are calculations made by the Metropolitan Government Finance Department detailing the actual investment earnings and the missed investment earnings using the funds controlled by the Industrial Development Board:

**Industrial Development Board
Interest Income Projection**

Year Ending	Projected Interest Income			IDB Audit Report	Difference		Year Ending
	Operations	Dell Grant	Total		Annual	Cumulative	
3/31/2002	\$32,230	\$11,175	\$43,405	\$6,647	\$36,758	\$36,758	3/31/2002
3/31/2003	30,384	29,243	59,627	6,269	53,358	90,116	3/31/2003
3/31/2004	15,360	16,242	31,603	2,983	28,620	118,736	3/31/2004
3/31/2005	12,957	14,485	27,442	1,804	25,638	144,374	3/31/2005
3/31/2006	41,563	67,588	109,151	1,603	107,548	251,923	3/31/2006
9/30/2006	31,331	69,713	101,043		101,043	\$352,966	8/31/2006
	\$163,826	\$208,447	\$372,272	\$19,306	\$352,966		

Assumptions

- >Interest rates based on monthly Local Government Investment Pool net returns.
- >Interest income on Industrial Development Boards' annual net income calculated in March since monthly periods cannot be determined.
- >Interest on the Dell Grant based on actual cash payments to the Industrial Development Board from the Metropolitan Government.
- >The period selected for analysis commenced April 1, 2001, prior to the time of the first Dell Incentive payment.
- >Additional analysis would only have concluded the same results.
- >September 2006 interest rate estimated.

Based on the above assumptions and calculations, the Industrial Development Board should have earned \$352,966 if the funds in the custody of the Board had been properly invested. The lack of proper oversight by the Industrial Development Board has resulted in the loss of significant interest earnings for the Metropolitan Government based on the Tennessee Code Annotated 7-53-308, which requires that after operating expenses of the Industrial Development Board are paid, any net earnings shall be paid to the Metropolitan Government.

Recommendation

The Metropolitan Government should retain the Incentive Grant earnings due to Dell in a Local Government Investment Pool account until Dell provides the annual supporting documentation and formally requests the funds. At that point, the Metropolitan Government should issue a check to the Industrial Development Board for the requested amount and the Industrial Development Board should promptly pay Dell. By not paying the Industrial Development Board until the payment(s) to Dell are actually due, the Metropolitan Government will be afforded the opportunity to maximize interest earnings.

5. Parker, Parker and Associates PLC incorrectly reported the \$45,000 payment to the Industrial Development Board attorney as a payment to Dell in the March 31, 2005 financial statements.

The \$45,000 payment to the Industrial Development Board attorney on January 19, 2005 was incorrectly reported in the March 31, 2005 and 2004 audited financial statements as a payment to Dell by Parker, Parker and Associates PLC and not as a payment to the Industrial Development Board attorney. The reporting error was discovered by a Metropolitan Government Finance Department employee during an examination into the delay in payments to Dell. The material misstatement could have resulted in misappropriations going undetected. As a result, for the years ended March 31, 2006 and 2005 Parker, Parker and Associates PLC has corrected the understatement of previously reported payables as of March 31, 2005 in the audited financial statements.

Recommendation

Parker, Parker and Associates PLC should improve its review process to at least detect incorrect entries that are within their calculated level of materiality. This will not only improve their chance of detecting errors but also possible misappropriations.

* * * * *

We appreciate the cooperation provided by Parker, Parker and Associates PLC and attorney Bobby Davis.

This report is intended for the management of the Metropolitan Government. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Internal Audit Section

Don Dodson

Don Dodson
Internal Audit Director

Copy: Mayor Bill Purcell
Members of the Industrial Development Board
Karl Dean, Director of Law
Eugene Nolan, Associate Director of Finance
Talia Lomax-O'dneal, Deputy Finance Director
Metropolitan Council Audit Committee
Bobby Davis, Industrial Development Board Attorney
Richard V. Norment, Assistant to the Comptroller for County Audit
KPMG, Independent Public Accountant