



# City of Chattanooga

Stan Sewell  
Director

INTERNAL AUDIT  
City Hall  
Chattanooga, Tennessee 37402

Ron Littlefield  
Mayor

August 7, 2007

Honorable Ron Littlefield  
Mayor, City of Chattanooga  
City Hall  
Chattanooga, TN 37402

RE: Post Audit Review of Chattanooga Neighborhood Enterprise Management and Development Agreement for Morrison Springs Apartments, Audit 06-06

Dear Mayor Littlefield:

On January 25, 2007, the Internal Audit Division released an audit on the Management and Development Agreement for Morrison Springs Apartments. We performed certain procedures, as enumerated below, with respect to activities of Chattanooga Neighborhood Enterprise (CNE) in order to render a conclusion on the status of the recommendations made as a result of that audit.

This Post Audit Review consisted principally of inquiries of CNE and City personnel and examinations of various supporting documentation. It was substantially less in scope than an audit in accordance with generally accepted government auditing standards.

The evidence obtained provided a reasonable basis for our conclusions; however, had an audit been performed, other matters might have come to our attention that would have been reported to you and our conclusions may have been modified.

The conclusions of Audit 06-06 were that:

1. It appears that CNE was not in compliance with the guidelines specified in the Management and Development Agreement.
2. It appears financial data contained in the contractor's reports was not reasonable.

3. It appears rental income was collected for all units.
4. It appears that competitive bids were not obtained for all expenditures where required and all proper channels/procedures (including written approvals) were not followed per the agreement guidelines.
5. The purpose and terms of City receivables specified on CNE's books were documented. However, it appears City receivables on CNE's books are not reasonable.
6. It appears that insurance proceeds were received and properly accounted for.

The audit contained ten (10) recommendations that addressed the audit's findings. Based on the review performed, we concluded that recommendations 7 and 9 were implemented, recommendations 1, 2, 3, 4, 5, and 10 were partially implemented, and recommendations 6 and 8 were not implemented. Based on the review performed, we concluded that several parts of several recommendations were no longer applicable due to the sale of Morrison Springs Apartments. It appears the City obtained all proceeds from the sale of Morrison Springs. Therefore, they have not made any efforts to obtain additional funds from CNE.

### **Recommendations Implemented (7, 9)**

We recommended (**Recommendation 7**) the City should ensure that they receive all proper documentation (and perform a diligent review) from any outside agency managing a property they own. More importantly, when made aware of potentially wasteful, abusive, or fraudulent activity, the City should take immediate and aggressive steps to investigate and correct. If CNE continues to manage the Morrison Springs property, they should follow all requirements specified in the Management and Development Agreement and Contract of Sale. Further, because CNE was responsible for obtaining HUD approvals, contingent on anticipated denials from HUD, CNE should credit their Morrison Springs (City) receivable account for the difference between improvement expenditures and the amount approved by HUD.

It appears the City is ensuring that they receive all proper documentation and perform diligent reviews (when necessary) from outside agencies that are managing their property. It appears when made aware, the City has systems in place to take immediate and aggressive steps to investigate and correct any fraudulent activity. Due to the sale of the Morrison Springs property, CNE is no longer managing this property for the City. In addition, it appears HUD approved substantially all expenditures prior to the sale of the property.

We recommended (**Recommendation 9**) that the City should not fund projects with debt unless absolutely necessary. The City should only incur long-term debt by bond issue. City Administration should not subject the City to long-term liabilities without sufficient written documentation that has been reviewed by the City Attorney.

It appears based on discussion with City personnel, the City is not funding projects with debt unless absolutely necessary and the City is only incurring long-term debt by bond issue. In addition, the City does not acquire long-term liabilities without sufficient written documentation that has been reviewed by the City Attorney.

### **Recommendations Partially Implemented (1, 2, 3, 4, 5, 10)**

We recommended (**Recommendation 1**) that if CNE continues to manage the Morrison Springs property, they should follow all guidelines specified in the management agreement. The City should begin ensuring receipt of, reviewing, and maintaining all information received from CNE in regards to the Morrison Springs account. We recommended the City investigate the possibility of recovering questionable expenditures as detailed in this report, as well as other amounts that may be deemed wasteful or unreasonable. The City Finance Officer should maintain original copies of all City contracts.

Due to the sale of the Morrison Springs property, CNE is no longer managing this property for the City. However, it appears prior to the sale of the Morrison Springs property, they were providing the City with copies of bank statements on a monthly basis. It appears prior to the sale, the City did ensure receipt of and review and maintain all information received from CNE in regards to Morrison Springs.

The City has maintained all proceeds (net of the amount owed HUD) from the sale of the Morrison Springs property. The City has taken the position that unless CNE can provide a detailed, organized, and documented accounting to clearly indicate a right to any of those funds, the city intends to retain all of those funds and does not recognize the Note Receivable on the books at CNE as valid. The City further feels the cost of determining and collecting any further amounts due to the City by CNE (beyond the amount of the Note Receivable) would likely outweigh the amount received.

It appears the City's Finance Officer has implemented policies to maintain all original copies of City contracts. However, per the City's Finance Officer, if departments do not send the original contract when executed to the finance office, the Finance Officer does not have the original copy until such time.

We recommended (**Recommendation 2**) that if CNE continues to manage the Morrison Springs property, they should follow all guidelines specified in the Management Agreements. The City should begin ensuring receipt of, reviewing, and maintaining all information received from CNE in regards to the Morrison Springs account. We recommended the City investigate the possibility of recovering questionable expenditures as detailed in this report, as well as other amounts that may be deemed wasteful or unreasonable.

Due to the sale of the Morrison Springs property, CNE is no longer managing this property for the City. It appears prior to the sale, the City did ensure receipt of and review and maintain all information received from CNE in regards to Morrison Springs. As discussed above, due to the sale of the Morrison Springs property, in which the City has maintained all the proceeds, the City has chosen not to pursue further efforts to recover funds from CNE.

We recommended (**Recommendation 4**) that CNE should ensure written contracts are executed for services provided under the management agreement. CNE should institute control procedures that require invoices with documentation of deliverables be matched with associated contracts prior to payment. We recommended that CNE's Board of Directors consider further investigation. This recommendation was made taking into consideration other indicators of fraud. We recommended the City consider taking action to recoup amounts paid by CNE from the special account that lack the appropriate documentation to determine what, if any, service or product was received.

It appears based on discussion with CNE personnel, CNE did not ensure written contracts were executed for all services provided under the management agreement. CNE indicated this was due to the anticipated sale of the Morrison Springs property. It appears CNE's Board of Directors did investigate further. However, they ruled that they were in no position to take action until their annual audit was complete.

As discussed above, due to the sale of the Morrison Springs property, in which the City has maintained all the proceeds, the City has chosen not to pursue further efforts to recover funds from CNE.

We recommended (**Recommendation 5**) that if CNE continues to manage the Morrison Springs property, they should abide by the Management Agreement related to Morrison Springs purchases. The City should consider taking action to recoup amounts paid by CNE for expenditures made to Heritage. Because it appears that excessive payments were intentionally made to Heritage by CNE, we recommended the City and CNE's Board of Directors consider further investigation. We further recommended that CNE credit their Morrison Springs (City) receivable account for the total amounts paid to Heritage.

Due to the sale of the Morrison Springs property, CNE is no longer managing this property for the City. As discussed above, due to the sale of the Morrison Springs property, in which the City has maintained all the proceeds, the City has chosen not to pursue further efforts to recover funds from CNE.

It appears CNE's Board of Directors did investigate further. However, they ruled that they were in no position to take action until their annual audit was complete. CNE has not credited the Morrison Springs receivable account for this amount paid to Heritage Renovations. However, based on discussion with the interim Executive Director, they are in the process of discussing this issue with the City.

We recommended **(Recommendation 3)** that if CNE continues to manage the Morrison Springs property, they should obtain written approval from the City prior to making expenditures that exceed the \$10,000 limit. CNE should immediately credit their Morrison Springs (City) receivable account for the undocumented transactions amount of \$54,174.89, as well as any other expenditures posted to the Morrison Springs account that are not documented. Further, we recommended the City consider taking action to recoup amounts paid by CNE in violation of the agreement. In order to limit the risk of waste, abuse and fraud, we recommended the City monitor the performance of its contractors. In particular, organizations that provide property management services.

Due to the sale of the Morrison Springs property, CNE is no longer managing this property for the City. CNE has not credited the Morrison Springs receivable account for these transactions or any other transactions. Per the interim Executive Director for CNE, they are in the process of discussing this issue with the City to settle this issue.

As discussed above, due to the sale of the Morrison Springs property, in which the City has maintained all the proceeds, the City has chosen not to pursue further efforts to recover funds from CNE. It appears the City has taken steps to ensure it is monitoring the performance of its contractors.

We recommended **(Recommendation 10)** that CNE needs to discontinue allowing employees from Morrison Springs to perform duties at other locations unless they are being paid from the location account in which they have performed the duty. Further CNE should reimburse (credit the City/Morrison Springs receivable account) the City for amounts related to non-Morrison Springs services performed by Morrison Springs staff. CNE should implement accounting system procedures to ensure expenditures are recorded to the appropriate entity (cost center).

It appears per discussion with the Chief Financial Officer and interim Executive Director for CNE, CNE discontinued allowing Morrison Spring employees to perform other duties not related to Morrison Springs. However, CNE has not credited the Morrison Springs account for the amount related to non-Morrison Springs services performed by Morrison Springs staff. In addition, CNE has not implemented any accounting system procedures to ensure expenditures are recorded to the appropriate entity. However, per the interim Executive Director for CNE, they are now working with their external auditors to implement new internal controls and policies and procedures.

### **Recommendations Not Implemented (6, 8)**

We recommended **(Recommendation 6)** that CNE should credit their Morrison Springs (City) receivable account for the double paid invoices. CNE should implement control systems to ensure that invoices are not paid twice.

It appears based on discussion the interim Executive Director and Chief Financial Officer for CNE, CNE has not credited the receivable account for the double paid invoices. However, based on discussion, they are in the process of discussing this issue with the City.

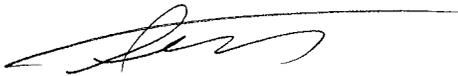
Based on discussion with the interim Executive Director and Chief Financial Officer for CNE, CNE has not implemented control systems to ensure that invoices are not paid twice. However, per the interim Executive Director for CNE, they are now working with their external auditors to implement new internal controls and policies and procedures.

We recommended (**Recommendation 8**) that CNE should remove any entries related to deferred interest from the books maintained for Morrison Springs Apartments. To ensure prompt attention by the City to claims made by CNE, in the future, CNE should make direct billings, invoices or assertions to the City for claims of liability.

Based on discussion with the Chief Financial Officer and interim Executive Director for CNE, the entry for the deferred interest has not been removed from the books maintained for Morrison Springs Apartments. However, per the interim Executive Director, they are in the process of discussing this issue with the City and settling the dispute.

We thank the personnel at CNE and in the General Services Department for their assistance in conducting this review. We will consider this report to be final unless directed to continue our review.

Sincerely,



Stan Sewell, CPA, CGFM  
Director of Internal Audit

cc: Dan Johnson, Chief of Staff  
Daisy Madison, City Finance Officer  
Paul Page, Director of General Services  
John Foy, Chairman (CNE)  
Sandra Williams, Interim Executive Director (CNE)