

Office of the State Inspector General

Report on the Virginia Tobacco  
Indemnification and Community  
Revitalization Commission

January 2014





# COMMONWEALTH OF VIRGINIA

## Office of the State Inspector General

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January 31, 2014

The Honorable Terence Richard "Terry" McAuliffe  
Governor of Virginia  
Patrick Henry Building, 3rd Floor  
1111 East Broad Street  
Richmond, Virginia 23219

Dear Governor McAuliffe:

Under [§ 2.2-309.2](#), of the *Code of Virginia* (the *Code*), the Office of the State Inspector General (OSIG) was required to review the condition of the Tobacco Indemnification and Community Revitalization Commission's accounting, financial, and administrative controls to ensure that the purposes set forth in Chapter 31 (§ [3.2-3100](#), et seq.) of Title 3.2 were lawfully achieved.

Our review included an examination of internal controls over the Commission's grant award and payment process for monies expended from the Revitalization Fund and tests of transactions from grant projects that were initially opened between January 2011 and March 2013 or were closed between those same dates. Only a limited review was performed of the indemnification process because related claims for payment ended on June 30, 2012.

Our report, which documents the results of the review, is attached. Overall, we found that the Commission's accounting, financial, and administrative controls were functioning as intended except for the instances noted within this report.

On behalf of the OSIG, I would like to express our appreciation for the invaluable assistance provided by the Commission and its staff during this review.

Please call or email me if you have any questions, or I would be happy to meet with you in person to discuss this report.

Respectfully,

Michael F. A. Morehart

State Inspector General

CC: Mark R. Herring, Attorney General  
Paul J. Reagan, Chief of Staff to the Governor  
Maurice Jones, Secretary of Commerce and Trade  
Delegate Terry G. Kilgore, VTICRC Chairman  
Senator Frank M. Ruff, Jr., VTICRC Vice Chairman  
Timothy S. Pfohl, VTICRC Interim Executive Director

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## Executive Summary

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The Office of the State Inspector General (OSIG) performed a review of the Virginia Tobacco Indemnification and Community Revitalization Commission (Commission) pursuant to the *Code of Virginia (Code)* [§ 2.2-309.2](#). The review focused primarily on community revitalization grants as indemnification payments came to a close in Fiscal Year (FY) 2012. The review did not include Tobacco Bonds and related funding as those duties are handled by the Department of the Treasury (Treasury).

Overall, we found that the Commission's accounting, financial, and administrative controls were functioning as intended except for instances noted within this report.

We reached this conclusion after:

- Gaining an overall understanding of the indemnification and community revitalization grant processes performed by both the Commission and its staff.
- Confirming that understanding with the Deputy Executive Director.
- Identifying risks associated with the processes performed by both the Commission and its staff.
- Identifying internal controls associated with the more significant risks.
- Testing internal controls to ensure that they were functioning as designed.
- Reviewing selected grant documents—applications and approvals for the grants, support for the expenditures of the grant monies, and proper closure of the grant projects—to ensure compliance with the grant agreements.
- Conducting site visits of projects.
- Reviewing Statement of Economic Interest forms for potential conflicts of interest associated with the specific grant projects.
- Attending both committee and Commission meetings to observe how grant business was conducted.
- Determining the Commission's compliance with the Information Technology Resource Management (ITRM) IT Information Security Standard [SEC501-07.1](#).
- Reviewing reconciliations between systems.
- Reviewing the Commission's *Strategic Plan* for updates.

Below are several of our more significant recommendations, which if implemented, will improve current processes. We recommend:

- The Commission staff improve grant file documentation so that all relevant information is contained within one central file for each grant.
- Written policies and procedures be established for the work performed by the Commission staff in administering the grant process.
- The Commission members avoid situations where the appearance of conflicts of interest may be observed even when the members technically comply with the Conflict of Interest Act (*Code* § [2.2-3100](#) et seq.).
- Restricted funds be used only for capital expenditures.
- Improvements be made to the Tobacco Region Opportunity Fund grant approval process and committee makeup to ensure tobacco funds are properly used and protected from loss.

## Purpose and Scope of the Review

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The Office of the State Inspector General (OSIG) performed a review of the Virginia Tobacco Indemnification and Community Revitalization Commission (Commission) as required by *Code of Virginia* (Code) [§ 2.2-309.2](#):

*The State Inspector General shall (i) review the condition of the Tobacco Indemnification and Community Revitalization Commission's accounting, financial, and administrative controls to ensure that the purposes set forth in Chapter 31 (§ [3.2-3100](#) et seq.) of Title 3.2 are lawfully achieved; (ii) investigate to resolve allegations of fraudulent, illegal, or inappropriate activities concerning (a) disbursements from the Tobacco Indemnification and Community Revitalization Endowment created pursuant to § [3.2-3104](#) and (b) distributions from the Tobacco Indemnification and Community Revitalization Fund created pursuant to § [3.2-3106](#); and (iii) detect fraud, waste, and abuse and take actions to prevent the same.*

The review included an examination of internal controls over the Commission's grant award and payment process from the Revitalization Fund and tests of transactions from grant projects that were initially opened between January 2011 and March 2013 or were closed between those same dates. Only a limited review was performed of the indemnification process as related claims for payment ended on June 30, 2012.

### Master Settlement Agreement

In 1998, forty-six states, including Virginia, signed a Master Settlement Agreement (MSA) with the four largest tobacco companies in the United States. The purpose of the MSA was to settle state suits to recover billions of dollars in costs associated with treating smoking-related illnesses. Virginia's estimated share was \$4.1 billion. In 1999, the General Assembly directed that Virginia's share of the tobacco MSA funds be split as follows (detailed in *Code* [Titles 3.2 and 32.1]):

- Fifty percent to the Tobacco Indemnification and Community Revitalization Fund ([§ 3.2-3106](#)).
- Forty percent to the General Fund—redirected to the Virginia Health Care Fund for the State's Medicaid program by the 2004 General Assembly ([§ 32.1-366](#)).
- Ten percent to the Tobacco Settlement Fund, originally administered by the Tobacco Settlement Foundation, now administered by the Virginia Foundation for Healthy Youth to reduce tobacco use and obesity among children ([§ 32.1-354](#) et seq.).<sup>1</sup>

### Tobacco Bonds

Virginia securitized half of the future tobacco settlement payments through bonds issued in 2005 and 2007. The bond sales were handled through an entity specifically created by law: the Tobacco Settlement Financing Corporation. Net proceeds of over \$1 billion were deposited in an endowment fund that is managed by the Department of the Treasury (Treasury). The bonds are expected to be paid off in 2032.<sup>2</sup>

Tobacco producers proposed an amendment to reduce the amount of the annual settlement payout because they believed the states were not adhering to their responsibility to collect from domestic tobacco companies not participating in the Master Settlement Agreement. As a result, in January 2013 Moody's Investor Services placed tobacco bonds on a watch list.<sup>3</sup> Viability of the bonds fell under the Treasury's control in managing the endowment. We did not include the management of the bonds within the scope of our review based on our purpose as stated above. However, the viability of the bonds is a significant issue to the Commonwealth of Virginia (Commonwealth).

According to the Treasury's Director of Bond Finance, the bonds are a combination of term and capital appreciation bonds and would only default if the current interest could not be paid or the principal could not be paid at maturity in 2046 and 2047. Per our review, there is a difference of at least 14 years between the expected retirement date and the actual maturity date; presently, failing to make the current interest payments is a critical factor that could possibly cause a default. Proceeds from the MSA payment go first to paying current interest, then to funding the bond's debt service reserve, and then to paying principal. There have already been years when the debt service reserve has been tapped to make current interest payments.

The Commonwealth has no liability for funding the bonds should the MSA payments not be sufficient to avoid a default, but that does not preclude the General Assembly from passing legislation to fund the bonds if that were to become an issue.<sup>4</sup>

## Commission Responsibilities

The Commission was created on July 1, 1999, and its responsibilities are defined in *Code* § 3.2-3100 et seq. The Commission determines the appropriate recipients of monies from its fund established with bond proceeds to address economic losses from tobacco sales and to fund programs for revitalization of the economy in Virginia's tobacco regions.<sup>5</sup> The Commission is made up of 31 commissioners, and its specific makeup is delineated in *Code* § 3.2-3102.

- *Six members of the House of Delegates appointed by the Speaker of the House of Delegates;*
- *Four members of the Senate appointed by the Senate Committee on Rules;*
- *The Secretary of Commerce and Trade or his designee;*
- *The Secretary of Finance or his designee;*
- *The Secretary of Agriculture and Forestry or his designee;*
- *Three nonlegislative citizen members who shall be active flue-cured tobacco producers appointed by the Governor. Of the active flue-cured tobacco producers, two shall be appointed by the Governor from a list of six persons provided by the members of the General Assembly appointed to the Commission;*
- *Three nonlegislative citizen members who shall be active burley tobacco producers appointed by the Governor. Of the active burley tobacco producers, one member shall be appointed by the Governor from a list of three persons provided by the members of the General Assembly appointed to the Commission;*
- *One nonlegislative citizen member who shall be a representative of the Virginia Farm Bureau Federation appointed by the Governor from a list of at least three persons provided by Virginia Farm Bureau Federation; and*
- *Eleven members shall be nonlegislative citizens appointed by the Governor. Of the 11 nonlegislative citizen members, three shall be appointed by the Governor from a list of nine provided by the members of the General Assembly appointed to the Commission.*

*With the exception of the Secretary of Commerce and Trade or his designee, the Secretary of Finance or his designee and the Secretary of Agriculture and Forestry or his designee, all members of the Commission shall reside in the Southside and Southwest regions of the Commonwealth and shall be subject to confirmation by the General Assembly. To the extent feasible, appointments representing the Southside and Southwest regions shall be proportional to the tobacco quota production of each region.*

The Commission has eight committees that report to it. Seven of the committees are comprised of nine to 13 members. The eighth committee, the Tobacco Revitalization Opportunity Fund Committee, is comprised of the Commission's Executive Director, the Chairman of the Commission, and the respective Chairmen of the Southside and Southwest Economic Development Committees. The primary function of the eight committees is to recommend grant awards. In general, each committee is tasked with a specific responsibility associated with the categories described below under Community Revitalization Grants.

Economic losses sustained by tobacco growers and quota owners were determined to be \$479 million, and as of June 30, 2012, the Commission completed the acceptance of indemnification claims. Revitalization of tobacco-dependent communities remains the sole purpose of the Commission. As of June 30, 2012, there were 1,400 projects in 41 localities dedicated to this purpose.<sup>6</sup>

### Indemnification Claims Payments

Indemnification claims were completed in Fiscal Year (FY) 2012. Amounts owed for indemnification claims were established annually. The Commission set a reimbursement rate per pound for the two types of tobacco—flue-cured and burley. Claimants' entitlements to the Tobacco Program benefits were based on the number of pounds of basic quota or producer pounds of each type of tobacco produced. A claimant could have one or multiple claims depending on whether the claimant is a quota owner, a producer, or both. The number of farms and tracts of land in which the claimant has an interest also impacts the number of claims for the claimant. Payments were made through a third-party contractor who issued claim forms and received the completed forms back from claimants. Once verified, the Commission staff would process the claims payments through the Virginia Department of Agriculture and Consumer Services (VDACS). According to the Auditor of Public Accounts, \$9.7 million was paid to claimants in FY 2012.<sup>7</sup> A small number of payments were anticipated in FY 2013 based on claims filed in the last months of FY 2012.

### Community Revitalization Grants

Applications for community revitalization grants are accepted by the Commission staff based on predefined submission schedules preceding Commission meetings. Applications are reviewed by the Commission staff members specifically tasked with grant management and recommendations for funding are made to the appropriate committees based on the category of grants discussed below. Committees then recommend or disapprove the grant requests and the respective chairperson will present the recommended grants to the Commission for approval.

Community revitalization grants remain the sole duty of the Commission. Currently, community revitalization is classified by program.

- **Economic Development Programs**—These programs build regional economic development capacity to diversify the economic base through creation or improvement of sites, buildings, and utility infrastructure; workforce training facilities; tourism infrastructure; etc. Two economic development committees exist, the Southwest Virginia region and the Southside Virginia region.

- **Special Projects**—This program implements projects that are innovative in nature and regional in their impact, including health care and multi-jurisdictional economic developments.
- **Special Projects – Megasite**—The Special Projects Committee also provides funds for the development of large industrial real estate (“megasites”) in order to attract major job-creating private industry projects to the Tobacco region.
- **Education**—This program prepares citizens for new-economy employment through General Education Development (GED) and workforce development, higher education scholarship programs for the two regions, and competitive grants to community colleges and other educational entities.
- **Agribusiness**—This program encourages regional efforts that reduce dependency on tobacco and increase the production of value-added crops, livestock, products, facilities, etc.
- **Reserve**—Commission dollars were used to attract non-Commission funding such as the American Recovery and Reinvestment Act of 2009 funds for projects in Southside and Southwest Virginia. Applications were no longer accepted after November 2010 for this program.
- **Research and Development**—This program provides grant funding to government or non-profit entities working with private partners, conducting research that has anticipated significant commercialization and growth potential for the tobacco-dependent region.
- **Tobacco Region Opportunity Fund (TROF)**—This fund provides performance-based monetary grants to tobacco region localities to assist in the creation of new jobs and investments, whether through new business attraction or existing business expansion.

During FY 2012 the Commission spent \$89.6 million on Community Revitalization.

#### **Administration**

The Commission also spent \$2.7 million on administration during FY 2012. These expenditures included costs paid to the third party handling indemnification claims payments, as well as payments to the Office of the Attorney General (OAG), the Department of Taxation, and other central agencies within the Commonwealth.

#### **Prior Fraud in Fiscal Year 2002**

The Commission was victim to a \$4 million fraud that took place in FY 2002 when a \$5 million grant was advanced to a not-for-profit shell company whose owner used \$4 million of the grant for personal expenses.<sup>8</sup> As a result of this fraud, grant funds were provided to grantees on a reimbursement basis only. Grantees were required to spend their own funds up front and then to be

reimbursed upon submission of qualifying expenditures. The Commission also increased its three-person staff to include a Grants Director.<sup>9</sup> Currently, the Commission's staff consists of 12 positions, including regional grant coordinators, as well as positions to assist with the administration of the program.

## Previous Reviews

This OSIG review is the third review of the Commission. In 2008, the Commission created the Blue Ribbon Review Panel to evaluate Commission structure and operations. One intent of the review was to make recommendations regarding the Commission's operations into the next decade. The Panel made recommendations regarding organization, staffing, and coordinating with Treasury regarding the bonds. Some recommendations were implemented by the Commission, including requesting a review by the Joint Legislative Audit and Review Committee (JLARC).

The JLARC reviewed the Commission and issued its report in June 2011. Its review focused on the effectiveness of the revitalization efforts and included recommendations to improve the strategic processes for awarding grants and monitoring the performance of funded programs. As part of the strategic approach, JLARC recommended improvements to governance such as a smaller Commission with more expertise. Recommendations were also made to fund projects that had long-term revitalization impacts on the economy instead of a one-time impact. However, the Commission did not implement all of the JLARC recommendations. Some of the notable items not implemented included:

- Removing the allocation of funds within Southside Virginia based on historical tobacco production.
- Requiring a third party economic impact analysis for all awards over a certain threshold and requiring independent cost estimates or verification of those estimates for all grants.
- Allowing Commission staff to make award determinations on less significant grant requests.
- Consolidating the two Economic Development Committees and the Special Projects Committee.
- Creating a committee to oversee the audit and compliance of grantees.

A number of recommendations were also made regarding General Assembly action to strategically revise the number of Commissioners and the qualifications of the Commissioners and the Executive Director. No action was taken on these recommendations.

OSIG staff developed an understanding of the Commission's function and how its staff operates to provide support. OSIG staff conducted an assessment to identify those risks that could prevent the Commission from achieving its goals and performing its duties and then identified internal controls in place to mitigate those risks. Staff tested the internal controls for significant risks, as described below, to ensure that they were in place and functioning.

Tests of internal controls included:

1. Identifying a grant population and dividing it into three groupings: less than one year old, over one year old, and completed.
2. Selecting samples from each grouping as well as from those in grants that exceeded \$6 million.
3. Reviewing the documentation supporting the selected grants to determine whether the grant process was in compliance with the grant agreements. This review included, but was not limited to:
  - o The evaluation and scoring of proposals.
  - o The completeness of grant applications.
  - o The approval and award of the grants.
  - o The completeness of the grant agreements.
  - o The propriety of grant payments.
  - o The monitoring of progress by Commission staff.
  - o The proper closeout of the grants.
4. Making visits to selected grant project sites to determine whether items funded by the grants approved by the Commission physically existed.
5. Reviewing Statement of Economic Interest forms completed by Commission members and staff for potential conflicts of interests with the grant projects and compliance with the Conflict of Interest Act ([Code § 2.2-3100](#) et seq.). As part of our testing in this area, a cursory review of administrative expenditures was also performed to identify any questionable items.
6. Reviewing the contract for the automated grant management system (GIFTS) to determine if it complied with the Information Technology Resource Management (ITRM) IT Security Standard [SEC501-07.1](#).
7. Reviewing reconciliations of grant payments between the grant management system and the accounting system.
8. Reviewing the Commission's *Strategic Plan* to determine if it was recently updated.
9. Conducting a limited review of indemnification claims payments.
10. Reviewing updated community revitalization grant agreement templates.
11. Observing Commission and committee meetings on a sample basis during May and June 2013.

### Review of Grant Documentation

Our review of grant documentation focused on applications for grants and awards, scoring of applications and approvals, payments, and grant reporting and monitoring. Overall, we found that grant file documentation was not consistently collected in a central location. Many grant documents were maintained separately or in the Chatham and Abingdon field offices. Additionally, the documentation contained in the grant files was not consistent ([Issue #1](#)).

Our review of grant files also revealed that the Commission lacked documented policies and procedures pertaining to the execution of staff responsibilities ([Issue #2](#)). Although we documented overall processes in flowcharts during our review planning, those were based on high level documents and discussions with Commission staff. Several of the controls we identified during review planning that would have mitigated the risks either did not exist or were not functioning as described. For example, localities in certain instances were not required to pay back TROF grants when grant programs were unsuccessful ([Issue #5](#)), outcome monitoring of grant programs had not been established ([Issue #11](#)), and ineligible expenditures were not being identified ([Issue #7](#)).

### Application and Award

Based on our review of selected grants, we found that applications included a summary of proposed outcomes, expected outcomes, budget sheets, and certifications by the applicant. We also found that award letters from the Commission were issued to the grantees and the grantees returned signed agreements. Templates approved by the Attorney General or outside counsel were used, and where restricted funds were involved, appropriate clauses and the required bond counsel opinions were included.

### Scoring and Approval

During our review planning, we determined that a scoring sheet was completed during the evaluation of a grant; however, we found that scoring sheets were not consistently completed based on the type of grant. The Commission staff explained that scoring sheets are only used for specific types of grants that require competition for funding. This matter did not result in a reportable issue but was discussed with management at the exit meeting.

Our review planning also revealed that grantees were assessed on their ability to complete the project; however, when we tested that control we found no documentation to support that such assessment took place. This finding was discussed with Commission staff at the exit meeting and is not considered a reportable issue for this report. We did find that staff completed a short narrative analysis and recommendation for the respective committee reviewing the application and that the staff recommendation was documented in the committee minutes. Committee recommendations were also documented in the

minutes, and were largely consistent with staff recommendations. In one instance, a grant was approved without a recommendation from the staff or the relevant committee ([Issue #3](#)).

We did note two potential conflicts of interest, which concerned two Commission members: one who was on the board of a grant recipient entity and another who had a related family member representing a locality. In both instances the Commission members did not abstain during the grant approval voting ([Issue #4](#)).

In the case of TROF grants, we noted during our planning that the TROF Committee did not meet, electing to conduct its business and voting by email. However, during the course of our review a change was made and the TROF Committee began meeting in person in June 2013. We also noted that the makeup of the committee, while consistent with the bylaws, was not consistent with the TROF Guidelines ([Issue #5](#)), and in one instance, the grant award exceeded the Commission staff's estimated need calculation ([Issue #6](#)).

### **Payments**

Payment request forms were properly signed by the grantees, accompanied with budget drawdown sheets, and approved by the Commission staff. However, some payments were made for ineligible expenditures ([Issue #7](#)). Required matching fund payments were verified in some instances, but there were other instances where this verification did not occur ([Issue #8](#)).

Although the typical payment is a reimbursement, in some instances advance payments are made. In all instances of advance payments, we found that they were properly approved.

Our review for unusual payments revealed one payment that was made to a business owned by the grantee's administrator ([Issue #9](#)).

### **Grant Reporting and Monitoring**

Four of the 14 grant files reviewed did not contain the required annual and final reports ([Issue #10](#)). All 14 files documented that monitoring through site visits took place. Monitoring through performance and grant outcomes was not taking place for three of the six grant files reviewed ([Issue #11](#)).

We noted that TROF grants had "claw back" provisions in which the locality could recover grant money from the beneficiary company when it did not meet its stated goals. The localities are liable to the Commission for the grant money received when this occurs. However, we found one instance where a locality's liability of \$280,000 was waived by the Commission, resulting in a loss of Commission funds ([Issue #5](#)).

### **Observation from the Meeting Minutes**

Our review of the grant documentation included the Commission and committee meeting minutes. Through the review of the minutes, we noted that the

Commission was left without legal representation by the Attorney General's office for a period of at least 18 months ([Issue #12](#)).

### Site Visits

From the grants selected for our review, we judgmentally selected eight grant projects to visit. There we verified that either construction was taking place or the assets purchased were physically present. The sites visited included a research and development lab, wireless communication site, building construction site, dental clinic, and boat ramp. All construction activity and assets selected were verified during our site visits.



Illustration #1–Site Visits

### Review for Conflicts of Interests

We selected three members of the Commission and two members of the Commission staff at random, in addition to the Commission Chairman and Vice Chairman, to determine if any conflicts of interest existed in their dealings with organizations that were awarded grants. For those grants that we reviewed, we examined the members' Statement of Economic Interests forms to determine if any organizations that were awarded the grants were listed. Although we did not identify any conflicts under the Conflict of Interests Act, we did find through other steps in our review process where perceived conflicts of interest that were not reportable under the Act, did exist ([Issue #4](#)).

During our review of administrative expenditures, we noted that the Deputy Secretary of Commerce for Rural Economic Development position is funded through Commission Funds ([Issue #13](#)).

### Grant Management System Security

The Commission staff uses a grant management system called GIFTS, which is produced by a company named Microedge. Originally GIFTS was a commercial off-the-shelf software loaded on the Commission's server. Over time, the system was transformed from locally installed software to a cloud-based Internet system where the programming and data reside on the vendor's server. Although our review step called for verifying compliance with the Commonwealth's Security Standards, we learned that as a political subdivision the Commission is not bound by those standards. However, Commission staff was working to obtain a

[Statement on Standards for Attestation Engagements \(SSAE\) 16](#) report as defined by the American Association of Certified Public Accountants (AICPA) that certifies the vendor was providing proper security over GIFTS. The vendor provided that report on November 4, 2013.

### **Payment Reconciliations**

During the planning phase of our review, we identified an internal control that is utilized to ensure that payments are reconciled between GIFTS and the accounting system. The Commission uses the financial accounting system, FINSYS, which then interfaces with the statewide accounting system, CARS. However, when we tested the control we found the reconciliation was actually a visual comparison made by the Director of Finance while preparing an internal financial report for the Commission members and not a documented reconciliation of payments between the two systems. This matter did not result in a reportable issue but was discussed with management at the exit meeting.

### **Review of Strategic Plan Updates**

JLARC recommended in their report that the General Assembly amend the *Code* to reassess and revise the Commission's strategic plan at least biennially. In response, the Commission indicated that their bylaws were amended to require biennial revisions. We verified that the last update to the *Strategic Plan* was within the last two years as of the date of our fieldwork.

### **Indemnification Payments**

Because the financial audits performed by the Auditor of Public Accounts included annual reviews of indemnification payments, we elected to perform only a limited review for reasonableness of the payments made in FY 2013. Our limited review was also supported by the fact that claims for indemnification payments had to be submitted by June 30, 2012. We identified \$179,500 of indemnification payments made in FY 2013. The Commission staff explained that these payments consisted of claims filed late in June 2012 as well as payments that had been disputed or tied up in legal action. Based on the amount of payments and the explanations provided, we found the amounts paid in FY 2013 reasonable.

### **Review of Updated Grant Agreement Forms**

During our planning, the Commission staff told us that to improve processes and ensure agreements contained necessary clauses they were going to update their grant agreement forms. We verified during our fieldwork that the forms were updated as described.

### **Observations at Commission Meetings**

We attended several of the committee meetings and the Commission meetings between May 2, 2013 and June 11, 2013. Overall, we noted that Commission members did a critical review of the business before them as evidenced by the discussion and questions asked.

However, we noted the following items during the course of our attendance.

- A presentation was made by the Executive Director of the Scott County Economic Development Authority, who was also the brother of the Commission Chairman. The matter came to a vote from which the Chairman did not recuse himself ([Issue #4](#)).
- The King College project, commonly known as the King School of Medicine project, is a program to establish a medical college in Southwest Virginia that the Commission has funded for a number of years. A significant amount of money has been spent and the leadership of the group has changed since the beginning of the project. Questions from committee members disclosed that most funds in the past year were spent on salaries and consultants ([Issue #14](#)).
- In instances where committee meetings were held the day before the Commission meeting, we found that Commission members did not appear to have sufficient time to review the recommendations received from the committee meeting ([Issue #15](#)).
- During a closed executive session, a matter was discussed involving the reimbursement of legal costs through the payment of a bonus to a Commission staff employee. The intent was to pay an amount net of taxes that approximated the legal costs incurred by the employee, but which the OAG had not provided the authorization to pay. OSIG staff brought the matter to the attention of the State Inspector General who met with Office of the Secretary of Commerce staff to ensure that the matter was appropriately handled by Risk Management and the Attorney General's Office. OSIG staff remained in the room during the executive session at the request of the Executive Committee Chairman.

### **Issue #1—Lack of a Grant Documentation Central Storage Area and Incomplete Grant Documentation**

Certain supporting documentation was not always maintained in a central location for each grant. The Commission's Richmond office maintained a grant file containing a majority of the project documentation. The GIFTS system was also used to maintain payment activity, site visit information, and pictures. Other pertinent file documentation was maintained in Commission staff's offices or on its file server.

In general, the grant documentation missing from the reviewed files was as follows:

- Bond counsel opinions where required for the use of "restricted" funds. These opinions are maintained in the Deputy Executive Director's office.
- Grant application scores and summary forms. Scoring information is maintained in the Grant Manager's office.
- Site visit information. The Commission maintains site visit information on its shared server, in the GIFTS system, or in the Regional Grant Administrator's office.

Other specific documentation not located included:

- Documentation supporting \$500,000 in grant funds that were returned. The GIFTS system, however, did reflect receipt of the returned funds.
- Supporting documentation for a grantee's request to change the grant from a general renovation to a specific-need renovation. Documentation provided to us for the change request consisted of a series of emails between the Grant Administrator and the Mecklenburg Industrial Development Authority (IDA). These emails were not included in the file.
- Supporting documentation for a grantee's request to change the project scope from renovation to construction. Other than a sticky note that stated that the Commission staff considered this acceptable, there was no documentation to show that the proposal had been formally approved and communicated to Ferrum College. An email where the Grant Administrator had prepared an approval document for the Executive Director to sign was provided to us as documentation outside of the file, but a signed document was not located, nor was evidence provided that the document was sent to Ferrum College.

#### **Recommendation:**

Adequate supporting documentation should be maintained in a central location for each grant to provide evidence that required information was obtained and reviewed and to ensure the history of the grant project is complete. The lack of

complete documentation in the files contributed significantly to our findings in other areas.

**Interim Executive Director’s Response:**

*The Commission maintains all necessary information, which can be accessed as and when needed. The referenced grant file documentation (e.g. bond counsel opinions, grant application scores and summary forms, and site visit information) is saved on the Commission’s hard drives, which are backed up on a daily basis, and is accessible to Commission staff as and when needed. Commission staff is currently populating GIFTS with site visit information in the database’s “Activities” section. Staff will include site visit information (e.g. date conducted, staff conducting the visit, and any relevant project notes and photos) in GIFTS, and other relevant documentation in hard copy files. Any grants obtaining “restricted” funds are recorded as such in GIFTS for accounting purposes. Bond counsel opinion files will be relocated into the central file room for easier access to all by June 30, 2014. Finally, Grant application scoring documents are stored in an electronic archive on a shared server available to all, so Staff is of the opinion that such archives are adequate. No further action will be taken on that item.*

**OSIG Response:**

The above response confirms our finding and resolves the issue of central filing, provided future documentation is retained. However, it does not resolve the issue of documentation missing from the reviewed files.

**Issue #2—Lack of Written Policies and Procedures**

Internal policies and procedures have not been fully developed and written to provide a record of the methods used by the Commission staff in administering the grant process. For example, internal processes such as how to conduct site visits, score grant applications, and prepare detailed financial information for the Commission is not documented. Additionally, required approvals by the Regional Grant Administrator, the Grant Manager, and the Executive Director were not documented. The Commission staff has limited documented grant program guidelines and instructions to follow and instead follows the grant process outlined on the Commission’s website. Policies should reflect the “rules” governing the grant process. Procedures should be written that implement the policy and should be amended as necessary when a new process is used or a change to the current process occurs. Documented policies and procedures serve as a guide for ensuring Commission staff administers the grant process in an accurate and consistent manner.

**Recommendation:**

Policies and procedures providing a record of the methods used by the Commission staff in administering the grant process should be developed, written, and implemented. These procedures should include a description of the processes followed for grant application scoring, TROF administration and scoring, financial reconciliations, invoice documentation reviews for

reimbursement, site visits and the documentation of the visits, and outcome reviews and verification.

**Interim Executive Director's Response:**

*Staff acknowledges that certain internal procedures have not been written, but generally disagrees with the statements that "Internal policies and procedures have not been developed and written" (p. 14) and "The Commission has limited documented grant program guidelines and instructions to follow." Staff is of the opinion the current policies and procedures – both internal and external – have served the Commission well. The Commission's files (electronic and hard copy) document the evaluation, making and administration of its grants. The following policies and procedures are and have been in existence at the Commission for years, were provided to OSIG, and collectively have contributed to the prevention of fraud, waste, abuse and illegal activities:*

- a. General Funding Policies (in Strategic Plan)*
- b. Grant Disbursement Guidelines*
- c. Guidelines for Advance of Funds*
- d. Process flow charts for Grant Disbursement, Cash Receipts etc*
- e. Payment Request Instructions and Forms*
- f. Grantee Authorization Form*
- g. Grant Reporting Form*
- h. Grant Management Issues & Information for Grantees*
- i. TROF Guidelines*
- j. Low Funding Priorities*

*Staff and legal counsel periodically review the grant agreement templates to ensure such forms embody the appropriate provisions (as recently as spring, 2013). Commission staff also provides grantees in all award packets with its implemented guidelines and policies, including general grantee information, reimbursement instructions and advances guidelines. These materials can also be downloaded under the "Current Grantees" section of the Commission website, and are referenced by Commission staff as needed with grantees to ensure/obtain compliance. Staff, as directed by the Commission, will continue to use these policies to manage the programs responsibly and take further action to revise policies/procedures as needed. Staff notes that these policies have collectively contributed to preventing fraud, waste, abuse and illegal activity, of which none was found or reported in this OSIG study. Staff further acknowledges it will place in writing internal procedures for financial reporting and the announcement, acceptance, review and reporting of grant proposals by December 2014.*

**OSIG Response:**

The above response confirms our finding and will partially resolve this issue once implemented as it relates to writing internal procedures for preparing financial reports and for the announcement, acceptance, review, and reporting of grant proposals. To fully resolve the issue, the Commission Staff should also write internal procedures for administering the grants once they are awarded.

### **Issue #3—Application Approval without a Committee Recommendation**

A Southside Economic Development (SSED) grant application was received in December 2011 for the purpose of purchasing equipment for a new dental office. The Commission staff analysis indicated that healthcare projects were not currently a funding priority for the Commission, although it was to be discussed at an upcoming strategic planning meeting. The Commission staff recommended, and the SSED Committee approved at its December 6, 2011 meeting, the request be sent to the Special Projects Committee.

The SSED Committee Chair made a motion during the Commission meeting to add this request to the block of SSED applications for funding consideration. The grant was approved by block vote without discussion or opposition at the Commission meeting on January 10, 2012. We found that the process leading to approval of the grant was not consistent with the Commission's funding policy for projects involving non-basic economic development, including Hospital/Wellness Centers, which are a low priority.

#### **Recommendation:**

The Commission should follow established protocol and policy when awarding grants to ensure grant applications are fairly and consistently evaluated.

#### **Interim Executive Director's Response:**

*The Commission routinely follows its established policies and protocols when awarding grants to ensure fair and consistent evaluation of applications; however, on rare occasions and under exigent circumstances, it exercises the ability to respond within its statutory authority to urgent emerging economic development needs and opportunities. Under the Commission's current Strategic Plan, projects that expand access to healthcare are now an identified objective while wellness centers remain a Low Priority. The motion regarding the funding package for the dental clinic was made by the Committee chair, which is within his prerogative as a Commission member, properly seconded, and approved by majority vote of the Commission in a public session, as documented in the January 10, 2012 meeting minutes. In this particular case, the \$400,000 grant was made for a project also supported by \$1.6 million of other state and federal funds, resulted in the creation of eight healthcare jobs and will serve 2,400 residents annually.*

#### **OSIG Response**

The above response confirms our finding. We will consider the issue resolved provided that such actions are taken only in "rare occasions and under exigent circumstances."

### **Issue #4—Appearances of Conflicts of Interest**

In the following two instances, Commission members did not recuse themselves or abstain from voting on matters presented to the Commission or the respective committee:

- The Commission Chairman voted in the May 2, 2013 Executive Committee meeting on a matter presented by the Executive Director of Scott County's Economic Development Authority, who was also his brother, and
- The Commission Vice-Chairman is also a director of a not-for-profit entity that applied for a grant. He voted to award the grant in the Commission meeting on September 20, 2011.

The Conflict of Interest Act (*Code* § 2.2-3100 et seq.) provides the legal standard for defining a conflict of interest. Although the Act does not specifically prohibit the above, training information supplied by the OAG encourages the avoidance of an appearance of a conflict of interest. The appearance of a conflict of interest, even when technically allowed, compromises the confidence of citizens in the operation of their government.

**Recommendation:**

Commission members should take significant care to avoid even the appearance of a conflict of interest in order to maintain integrity and accountability when conducting Commission business.

**Interim Executive Director's Response:**

*Commission staff schedules Conflict of Interest Act and Freedom of Information Act training for all new Commissioners, along with periodic refresher training. The Commission's legal counsel provides advice on Conflict of Interest Act matters to Commissioners as needed, such instances sometimes arising during the course of the grant process or meetings as Commissioners raise the potential of a conflict or apparent conflict of interest. Indeed, there are several instances noted in Commission meeting minutes where Commissioners recused themselves from voting on a particular matter due to a potential conflict of interest. The Commission heeds the admonition that the Conflict of Interest Act sets forth minimum standards of conduct. None of the referenced situations are violations of the Conflicts of Interest Act, nor reflect instances where a Commissioner or his/her family members benefitted financially from the action taken by the Commission.*

**OSIG Response**

The above response confirms our findings regarding conflicts of interest and resolves the issue, provided Commissioners avoid taking future actions that give the appearances of conflicts of interest.

**Issue #5—Non-Compliance with TROF Grant Program Guidelines**

As discussed in the background section, the TROF is a unique Commission program that provides performance-based monetary grants to localities in Virginia's tobacco-producing regions. The grants assist in creating new jobs and investments, whether through new business attraction or existing business expansion. The *TROF Grant Program Guidelines* state that the four persons

specifically empowered by the Commission to vote on TROF requests are the Commission Chairman, the Chairs of the two Economic Development Committees, and the Executive Director. The TROF guidelines also indicate that the Commission requires repayment by the locality of the full or pro-rated grant amount if the performance agreement is not met. The TROF Performance Agreement specifies that the grantee obligation to repay the Commission shall not be contingent upon successful collection of any amount from the company benefitting from the grant.

During our review of TROF grants and related Commission meeting minutes, we noted the following:

- The TROF Committee currently consists of the Commission Chairman, Vice-Chairman, the Southside Economic Development Committee Chairman, and the Executive Director. The Vice-Chairman is improperly serving in place of the Southwest Economic Development Chairman.
- At the beginning of our review, the four TROF Committee members did not meet and were voting on approval of the grant via email. Note: The approval of the grant occurred only when three or more votes cast were in favor of the approval. This condition changed during the course of our review as the TROF Committee held its initial (in person) meeting in July 2013.
- For one of the two closed TROF grants we reviewed, the beneficiary company did not attain the employment and capital investment goals specified in the performance agreement and the locality was not required to repay the Commission.
- Neither the TROF Committee nor the Commission staff verifies the validity of the locality's vetting of the beneficiary company's proposal or performs a due diligence review. In some cases, the Commission will make an exception and forgive the locality's repayment obligation, which results in a loss of TROF money.

JLARC's report from June 2011 included a recommendation that the Commission develop a clear policy for TROF repayment exceptions, but the Commission elected not to develop one. The Executive Committee continues to allow itself the ability to hear appeals and make any exceptions.

**Recommendation:**

The TROF Committee should continue to meet regularly (in person) and the Chairman should adjust the makeup of the TROF Committee to include the chairman from the Southwest Virginia Economic Development Committee. Additionally, as recommended by JLARC, the Commission should establish a policy for TROF repayment exceptions. If repayment by the localities continues to be waived, the Commission should perform due diligence in verifying the validity of the locality's vetting process.

### **Interim Executive Director's Response:**

*The TROF grant process in place prior to July 2013 was based on prior advice of counsel from the Office of the Attorney General from more than a decade ago and was well known by Commissioners. In August 2013 the Commission approved a new policy for TROF grants, setting out a formula for TROF grants, and requiring that any TROF grants that exceed the approved formula-generated amount must be approved by the full Commission.*

*We do note that under the Commission bylaws, the Chairman makes the assignments of Commissioners to the various Committees, which was the case when the Vice Chairman was appointed to serve on the TROF Committee. The membership of the TROF Committee was stated to and affirmed by the Commission at its May 2013 meeting. The TROF program information on the Commission website will be revised to reflect the current process and Committee membership by June 30, 2014.*

*All requests for forgiveness of TROF repayments are discussed and approved in public session by the Commission's Executive Committee. Forgiveness is only granted upon presentation of evidence that repayment would place an undue hardship on a fiscally-stressed locality. Commission staff is currently exploring alternatives for Executive Committee consideration regarding the forgiveness of TROF repayments and the underlying ability of private beneficiaries and local governments to meet their repayment obligations.*

### **OSIG Response**

The above response confirms our findings and the issue regarding the TROF Committee makeup will be resolved once such information on the website is updated for consistency. However, the issue of establishing a policy as recommended by JLARC for TROF repayment exceptions remains unresolved.

### **Issue #6—Award Exceeded Calculated Estimate**

The Commission staff makes recommendations as to the amount of a grant award. In cases of the TROF grants, the staff uses a model to estimate the recommended award amount. We found one instance involving a proposal for a natural gas pipeline for which the Commission staff calculated the need at \$6.5 million. However, that amount was not explicitly discussed during the May 17, 2012 Executive Meeting, and the amount requested by the applicant—\$10 million for the first year—was awarded to build a natural gas-based power plant. Additionally, contingent awards of \$10 million for each of the following two years were also passed.

### **Recommendation:**

The Commission should ensure that it obtains and considers the staff's recommended award amount, and if an award exceeds the recommended amount, the Commission should justify the excess.

### **Interim Executive Director's Response:**

*The entire Commission discussed all material elements of the natural gas pipeline project at its January 2012 meeting, after which the full Commission approved the grant. The Commission considered the TROF grant an infrastructure investment critical to the project in obtaining approximately \$1 billion in private capital investment.*

### **OSIG Response**

The above response confirms our finding and resolves the issue, provided future award amounts recommended by the Commission staff are appropriately considered by the Commission, and any increases are justified.

## **Issue #7—Reimbursement of Ineligible Expenditures**

Grantees were reimbursed for ineligible project expenditures in four instances:

- The grantee was reimbursed \$7,656 for a utility deposit. The expenditure was considered ineligible as the deposit will either be refunded or credited back to the account holder at some point in the future after the project is completed.
- The grantee received an ineligible reimbursement for two invoices totaling \$56,293 because the dates of the invoices preceded the award date of the grant. However, the amount could have legitimately been paid under a prior grant award.
- The grantee was reimbursed \$476.41 for supplies and materials. The expenditures were considered ineligible as there was no approved budget in the grant for this type of expenditure.
- The grantee was reimbursed \$4,098.43 for six invoices associated with research and development. The expenditures were considered ineligible as the dates of the invoices preceded the award date of the grant. However, this was 2.1% of a \$191,280 reimbursement that contained a large number of supporting invoices.

We also noted that the Commission staff generally had a large number of reimbursement requests to review and approve and overall they were diligent in approving reimbursements. The staff was more focused on whether the expenditures were appropriate for the purpose of the project instead of whether lesser technical aspects of the expenditures, such as the expenditures occurring prior to the grant award date, were overlooked.

### **Recommendation:**

In the future, Commission staff should consider the timing of the expenditure as important as the nature of the expenditure when approving reimbursement requests. As the Commission staff has already taken action to recover the amounts, no further recommendation is made.

### **Interim Executive Director's Response:**

*In the January 2011 through March 2013 timeframe studied by OSIG staff:*

- *Commission staff reviewed 372 grant proposals;*
- *The Commission approved 276 grant awards; and*
- *Commission staff processed 1,868 reimbursement payments that totaled \$235.8 million.*

*Verifying the timing of project expenses is an important, albeit routine, task conducted while assessing the eligibility of reimbursements, and is consistent with the Commission's implemented guidelines and policies addressed in further detail in Issue #2 – Policies and Procedures.*

*Certain of the described payments occurring prior to the award date of the grant have been revised to be an advance of grant funds until new eligible expenses could be submitted consistent with such advanced amounts. In addition, minor adjustments to the project budget that are not considered material changes to the scope of the approved project are within the authority of the Commission to approve.*

### **OSIG Response**

The above response confirms our findings and resolves the issue.

### **Issue #8—Matching Requirements Were Not Verified**

We identified six of 13 projects for which matching funds were not verified as detailed below.

- For a construction project, a not-for-profit organization's match of \$7.5 million was not verified, but its website said that it would contribute up to \$8 million toward the project.
- For a renovation project, the proposed matches totaling \$782,475 were not verified.
- For a wireless communications project, the intent of a wireless company to participate in the project was not verified prior to granting the award.
- For a construction project, the performance agreement did not specifically state the matching requirements of the grantee and although many participating grantors were involved, matching funds were unknown and could not be verified.
- For a research and development project, the performance agreement for the grant did not specifically state the matching requirements and as a result such requirements could not be verified. However, the Regional Grant Coordinator did verify matching funds on two invoices.
- For a workforce education grant, the 20% funding promised by the company providing the training was not verified.

### **Recommendation:**

The Commission staff should require documentation of matching funds when the grant application is submitted and when reimbursement requests are filed. Total project expenditures should be reported by the grantee so the Commission staff can verify that matching funds are actually being spent by the grantee.

### **Interim Executive Director's Response:**

*Since the early days of the Commission it has required all grant applicants to list the source, amount and use of proposed matching funds on all grant applications. However, due to the timing of funding cycles by other sources of project funds (e.g. other state, federal and private funding agencies) it is impractical to "require documentation of matching funds when the grant application is submitted" because oftentimes the other funders have not yet announced their own funding decisions. In some cases Commission awards are made contingent on the approval of other matching funds, and in all cases the minimum required matching funds are documented at grant close-out. Grant applications, if approved, are referenced and appended to the Commission standard grant agreements, and the approved budget is included as Exhibit B in all grant agreements as of May 2013. The grant agreement templates now also include a statement that the grantee must provide satisfactory documentation of matching funds to the Commission. Staff verifies matching funds during the grant application review process and requires reporting on matching funds with annual and final grant reports.*

*However, Staff acknowledges that more complete documentation of matching funds "when reimbursement requests are filed" would provide earlier evidence that sufficient matching funds have been secured. In most of the cited projects, overall project costs far exceeded Commission funding, so the availability of required matching funds was implicitly evident even if not explicitly documented. To address this issue, Staff will revise the "drawdown summary sheet" that accompanies requests for reimbursement to now include reporting on matching funds spent to date on each project. The update drawdown summary will be sent to all new grantees by June 2014.*

*With respect to the wireless communications project, Commission staff had been previously alerted that the provider's participation in the project was confidential.*

### **OSIG Response**

The above response confirms our findings and resolves the issue of requiring documentation of matching funds at reimbursement, but it does not resolve the issue of requiring documentation of existing or proposed matching funds to be included when submitting the grant application.

### **Issue #9—Grantee Conflict of Interest**

The standard grant agreements do not prohibit the grantee from entering into contracts with individuals/entities where there is a conflict of interest. The language incorporated into the standard *Letter of Agreement* does not address potential conflicts of interest.

For one grant in our sample, the grantee organization's program director owned a business that was awarded a contract to design and build boat ramps, trail

signs, and trail mapping. The program director had disclosed his conflict of interest and purportedly did not participate in the selection or award process.

**Recommendation:**

The standard *Letter of Agreement* should be strengthened to prohibit conflicts of interest from being allowed, even when disclosed.

**Interim Executive Director's Response:**

*Commission staff was aware of the potential conflict of interest in the referenced project, and took several steps to protect against any fraud or abuse with respect to the grant. Staff will add a COI clause in the standard grant agreements by June 2014.*

**OSIG Response**

The above response confirms our finding and should resolve the issue when management action is taken.

## **Issue #10—Missing Grant Reporting Forms**

Grant agreements and the Commission's Grant Management Issues and Information for Grantees guidelines require grant recipients to complete and submit a Grant Reporting Form, due one year from the date of the Agreement and annually thereafter until the project is complete. The guidelines suggest that the grant recipient submit a final Grant Reporting Form with the final request for release of grant funds. The Commission may withhold 10 percent of the grant funds until receipt of the final report. The annual report provides the Commission with the grant recipient's self-reported description of the project's status and its use of Commission funds.

Of the 14 grant files we reviewed that required submission of an annual or final report, four of the files were missing the annual reporting forms. Additionally, the Commission staff had not contacted the grantees to request that they send in the forms.

**Recommendation:**

The Commission staff should follow through with plans for electronic reporting and follow-up with the grantees when required documentation is not filed. Consideration should also be given to withholding reimbursements when follow-up efforts do not result in a report being filed.

**Interim Executive Director's Response:**

*The Commission's form grant agreements over the last decade have provided Commission staff with the ability to withhold payments if a grantee is not in compliance with its reporting requirements. The current "one size fits all" grant report form has not been particularly effective in capturing outcome information for projects that range from education to utility infrastructure to agricultural, and Commission staff is working to align anticipated and actual program-specific outcomes to be reported electronically and captured in the GIFTS database. Staff*

*has beta-tested a process for collecting actual outcomes from grantees and will develop by December 2014 a schedule for collecting outcomes from additional grantees on a phased and ongoing basis that recognizes the universe of 1,700 grants to date and limited staff resources to gather and populate data in GIFTS.*

#### **OSIG Response**

The above response confirms our findings and should resolve the issue once management action is taken.

### **Issue #11—Outcome Monitoring**

All grant programs should have established clearly defined, expected outcomes whereby progress can be measured. These outcomes should be integrated into every phase of the life of the grant including the initial application, periodic reporting, performance monitoring, and final assessment of the performance of individual grants and overall grant program.

Of the six closed grants we reviewed, three lacked clearly defined and expected outcomes. In all three cases, outcome monitoring had not been established for the related type of grant, and the grant awards were made either prior to or just after the JLARC report date. The Commission staff has only been able to develop a preliminary performance monitoring methodology for the Research and Development grants. Outcomes for TROF grants are specified in each Performance Agreement and the TICR staff independently verifies the beneficiary's employment statistics and capital investment.

The lack of established, clearly defined outcomes was also noted in the June 2011 JLARC report. In response to this report, the Commission added a staff position to address the issues.

#### **Recommendation:**

The Commission needs to continue to develop their monitoring methodology for the remaining types of grants. All grants should have measurable goals and objectives stated in the grant agreement to facilitate this monitoring.

#### **Interim Executive Director's Response:**

*Program specific outcomes, such as academic credentials granted, new farm income reported, etc., have been added to the online grant application forms in the past two years, and efforts are underway to require that program-specific outcomes be reported electronically and captured in the GIFTS database in order to improve reporting and aggregation of project results. Staff has beta-tested a process for collecting actual outcomes from grantees and will develop by December 2014 a schedule for collecting outcomes from additional grantees on a phased and ongoing basis that recognizes the universe of 1,700 grants to date and limited staff resources to gather and populate data in GIFTS.*

### **OSIG Response**

The above response confirms our findings and should resolve the issue once management action is taken.

### **Issue #12—Legal Counsel**

The *Code* [§ 3.2-3105 \(C\)](#) requires the OAG to provide legal counsel to the Commission.

The Tobacco Commission did not have legal representation from the OAG for a period of 18 months. When counsel was needed for transactional matters, the OAG allowed the use of outside counsel. The attorney on retainer by the Commission passed away, leaving the Commission without representation. The Commission staff contacted the OAG and asked for counsel but none was provided. The Executive Director had been working with the OAG for at least a year to secure counsel. This situation hindered the Commission's work and decision making process on matters requiring legal counsel.

In the Executive Committee meeting on January 7, 2013, the Commission was informed that the OAG; the Commission; and the law firm of Christian & Barton, LLP entered into a retainer agreement for the firm to serve as counsel to the Commission.

#### **Recommendation:**

The OAG should continue to provide or make arrangements for another law firm to provide legal counsel to the Commission as required by the *Code*.

No response was necessary from the Commission's Interim Executive Director to this recommendation.

### **Issue #13—Salary and Expenses of Deputy Secretary**

In March 2010, the Governor appointed Virginia's first Deputy Secretary of Commerce and Trade for Rural Economic Development. The Deputy Secretary's salary and expenditures are paid by the Tobacco Commission. Although she has been tasked as the liaison to rural parts of the Commonwealth focusing on rural economic development, not all rural areas of Virginia are within the designated Tobacco Region.

Based on funding restrictions in *Code* [§ 3.2-3108](#), the Tobacco Commission should only fund the portion of salary and expenditures of the Deputy Secretary of Commerce and Trade for Rural Economic Development that relate to her work in the designated Tobacco Region in Southwest and Southside Virginia.

#### **Recommendation:**

Supplementary funding for a portion of the salary and expenditures that is paid to the Deputy Secretary of Commerce and Trade for Rural Economic

Development for work performed that is unrelated to the Tobacco Region should be sought.

**Secretary of Commerce and Trade's Response:**

*The Deputy Secretary for Rural Development, while representing all of rural Virginia, spends the vast majority of her time, over 95%, in the traditional Tobacco growing region of Virginia. Both her home and daily work office are located in the region. She attends Tobacco Commission meetings as the Secretary of Commerce and Trade's designee, and also generally attends even when the Secretary is present. When she is not in the region or in Richmond, she is often still working on issues important to the region.*

**OSIG Response**

The above response confirms our finding and should resolve this issue once funding for the remaining five percent of the Deputy Secretary for Rural Development's salary and expenses is identified and transferred from other sources by the Secretary of Commerce and Trade.

**Issue #14—Improper Use of Restricted Funds**

The bond indenture agreement for restricted funds provides for the proceeds of non-taxable bonds to be spent on capital expenditures. Further, the Commission's Eligibility and Funding Policy disallows expenditures for "staff support or fees for administration or management to implement the project, including indirect charges." Finally, the general rule per the standard grant agreement is that the funds are to be used within 36 months of the award.

The Commission has expended \$545,989 for a proposed medical school (King School of Medicine) in Southwest Virginia under a grant initially established in 2009 without any building ever being built. Of that amount, \$71,604 of restricted funds was spent on non-construction related activities. These activities consisted of:

- Employment expenses for the medical school's CEO totaling \$62,439.
- Expenses for the CEO and other individuals affiliated with the medical school totaling \$9,165 including:
  - Travel expenses for appearing before the TICR Committee.
  - Expenses at high-end coffee shops for coffee consumed during meetings in the Bristol area by various individuals associated with the School of Medicine.
  - Cell phone bills.
  - Mileage reimbursements of \$3,722 for the CEO and an advisor.
  - Lunch for three individuals, including the CEO and a person who is not part of the school or its trustees, who were on a trip exploring a clinical partnership.

**Recommendations:**

(1) The Commission should not use restricted funds to fund non-construction activities or activities related to the King School of Medicine's staff support and administrative expenses.

(2) The Commission should also evaluate whether the proposed medical school will become a reality considering that the grant was initially awarded four years ago.

**Interim Executive Director's Response:**

*Federal tax law requirements regarding the use of restricted funds may in certain circumstances allow for a small portion of bond proceeds to be used for non-capital expenditures. Further, as the entire grant award is for a capital project, these initial expenses might be considered as startup expenses and therefore an element of the overall capital cost of the project were the entire grant disbursed and the project built and placed in service as contemplated. Efforts to implement the project continue as of this date, as provided below.*

*The minutes from the May 2012 meeting of the Southwest Economic Development Committee as well as subsequent meeting minutes reflect that the use of restricted funds for non-capital expenditures was known and approved by the Committee. The Committee continues to meet prior to each Commission meeting to assess progress on implementation of the project, and the Committee is scheduled to meet again in January 2014 for a similar report.*

*As previously stated, Staff released restricted funds for the cited project as directed by the Commission and within IRS guidelines. Since 2006, the Commission has used tax-exempt bond proceeds to award 362 grants totaling over \$340 million. One hundred percent (100%) of those grants include an express written opinion from bond counsel that the grants were for eligible purposes under the bond indenture and IRS rules, including the grant in favor of King College. Subsequent to the approval of the grant and the corresponding opinion by counsel, the Commission agreed in May 2012 to allow King College to use up to \$1 million of grant proceeds for "non-construction expenses consistent with the construction project." It has not been determined whether or not the Grantee's actual expenses to date are eligible for reimbursement using restricted funds, but for the avoidance of doubt, the funding source for the grant has been changed from restricted to unrestricted as of today. No further action on this issue is anticipated.*

*OSIG has subsequently clarified its additional concern that this operational funding for KSOM (King School of Medicine) was contrary to the Commission's policies that state that funds should not be used for "staff support and fees for administration or management to implement the project." Commission staff notes that the program Committees have generally been open to considering requests (particularly in the Education program) to provide start-up operational costs for new or expanding projects (i.e. salaries for newly-created faculty and operational positions etc.), as is the case with the approved KSOM project expenses. Conversely, great effort has been made to avoid the use of Commission funds for less critical project costs that are allowed by some other funding agencies, such as a grantee's indirect/overhead, or for a grantee's staff and facilities that are already fully-funded by the grantee or another source (such as salaries/benefits of existing positions on the grantee's staff) to*

*implement a project. The issue of start-up operational funding will be presented to the Commission when it revises its Strategic Plan, and the General Funding Policies therein, in 2014.*

#### **OSIG Response**

The above response confirms our findings and resolves the use of restricted funds, but does not resolve the issues of using funds for activities related to the King School of Medicine's staff support and administrative expenses and whether the proposed medical school will become a reality.

### **Issue #15—Lack of Sufficient Time to Review Committee Recommendations**

Commission members do not have sufficient time to review Committee recommendations when a Committee meeting is held the day before, or the day of, the Commission meeting. The Deputy Executive Director explained that information packets detailing grant requests and committee recommendations are mailed to Commission members about a week prior to the Commission meeting. However, when a committee meets the day before or the day of the Commission's session, no information from that committee is included in that packet. Instead it is provided just before the Commission meeting. This situation occurred for one grant we reviewed that was recommended for funding by the Special Projects Committee at its September 26, 2012 meeting and was approved by the Commission on September 27, 2012. Additionally, the Commission website shows three committees met to review grant proposals on September 26, 2012 or September 27, 2012. The Commission awarded 16 grants totaling \$22,412,113 based on the recommendations received from these three committees on September 27, 2012.

One of the Commission members expressed similar concerns at the May 23, 2013 Commission meeting. As indicated in the minutes, a member stated:

*"... I know that we talked about a lot of things in the Education meeting, and it's pretty difficult when you have a committee meeting the day before and the commissioners don't really get an opportunity to review what's in here, since we're getting ready to vote right now. I hope in the future we can try to schedule these meetings so we could at least have time to evaluate what these proposals are before we have to vote on them."*

#### **Recommendation:**

In instances where committees meet the day before the Commission meeting, the Commission staff should include information in the Commission's briefing books on the applications being reviewed by the committees to ensure all Commissioners have ample opportunity to review those projects that could be potentially funded by the grant awards.

**Interim Executive Director's Response:**

*Grant applications are posted to the Commission website, generally about seven to ten days after submission to the Commission, and the applications and related materials are available upon request to the Commissioners and the public alike. Commission staff consistently and diligently attempts to schedule committee meetings two weeks prior to Commission meetings so that Committee recommendations can be included in the Commission meeting material packets; however, Committee meeting times are subject to the call of the Committee chairman, availability of Committee members and other conflicting events. In those rare cases when a Committee meets the day before or day of a Commission meeting, Commission staff provides a printed list of Committee recommendations and/or the Committee chairman reads the list of Committee recommended applications into the record. Based on OSIG's recommendation, any pending funding requests that are scheduled to go through Committee review immediately prior to the Commission meeting will be included in the Commission meeting material packets.*

**OSIG Response**

The above response confirms our findings and should resolve the issue once management action is taken.

## Endnotes

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<sup>1</sup> <http://www.tic.virginia.gov/mastersettlement.shtml>

<sup>2</sup> JLARC Report, June 2011

<sup>3</sup> FMS Bonds Inc January 29, 2013.

[http://www.fmsbonds.com/News/bond\\_article.asp?id=434](http://www.fmsbonds.com/News/bond_article.asp?id=434)

<sup>4</sup> Email statement by Evelyn Whitley, Director of Bond Finance, Treasury

<sup>5</sup> Code of Virginia. § 3.2-3101

<sup>6</sup> the Commission 2012 Annual Report

<sup>7</sup> Auditor of Public Accounts Report #7093 dated October 3, 2012

<sup>8</sup> November 23, 2010 press release from the US Attorney's Office

<sup>9</sup> Virginia Business, December 29, 2010