



City of Chattanooga

INTERNAL AUDIT

City Hall

Chattanooga, Tennessee 37402

Stan Sewell
Director

Ron Littlefield
Mayor

April 2, 2008

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

RE: 21st Century Waterfront, Audit 07-11

Dear Mayor Littlefield:

Attached is the Internal Audit Division's report on 21st Century Waterfront. We thank the management and staff of the Chattanooga Downtown Redevelopment Corporation (CDRC) and RiverCity for their cooperation and assistance during this audit.

You may note that regarding our first objective and the related conclusion, we state that it appears the CDRC was not required to follow City procedures for the procurement of the management agreement (entered into with RiverCity). We do feel strongly that the State Code required the agreement to be competitively bid. However, we did not state this in our report because the City Attorney's position is that the agreement was exempted as a "single source of supply." It is our general policy to accept the opinion of the City Attorney on legal issues. I have just recently reviewed the details of this procurement with the State's Director of Municipal Audit. It is his "firm" opinion that the service should have been competitively bid.

Sincerely,

Stan Sewell, CPA, CGFM
Director of Internal Audit

cc: Dan Johnson, Chief of Staff
Daisy Madison, President of CDRC
Paul Brock, President of RiverCity
Mike McMahan, City Attorney

CDRC
21st Century Waterfront
Audit 07-11
February 13, 2008

CDRC
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Auditor



Auditor



Audit Director

CDRC
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INTRODUCTION

The 21st Century Waterfront Plan called for a complete transformation of the riverfront, including the creation of Ross's Landing Park, the creation of the Front Street Steps, which connects the Bluff View Art District and Market Street, and the creation of the Renaissance Park and extension of the Coolidge Park Experience. The Plan incorporated 83 acres of open space and infrastructure and 46 acres of new mixed-use development on both the north and south side of the Tennessee River. It was a \$120 million dollar public/private initiative centered on the north and south shores of the Tennessee River in downtown Chattanooga.

In 2002, the City of Chattanooga sold bonds financed by the City's Hotel/Motel Tax to finance the public portion of the 21st Century Waterfront. The Chattanooga Downtown Redevelopment Corporation (a non-profit corporation formed by the City of Chattanooga to carry out business of the City) was responsible for executing qualifying projects on behalf of the City and submitting request for payments of such projects through the City Finance Officer for payment from the Riverfront Projects Capital Fund. However, the Board of Directors of CDRC (which consists of the Mayor or his or her designee, the Chairman of the City Council or his or her designee, the City Finance Officer or his or her designee and two to four directors which shall be appointed by the Mayor) authorized the RiverCity Company to act as agent of the CDRC for the 21st Century Waterfront Development Plan, subject to the City's policies on purchasing and expenditure of budgeted funds. A Management Agreement was also developed, at a later date.

STATEMENT OF OBJECTIVES

This audit was conducted in accordance with the Internal Audit Division's 2007 Audit Agenda. The objectives of this audit were to determine if:

1. The Management Agreement was properly procured per the City's guidelines.
2. RiverCity was in compliance with guidelines specified in the Development Management Agreement.
3. Competitive bids were obtained, when applicable, and all proper channels were followed per the City's purchasing policies and procedures.
4. Contracts were approved by the CDRC, when required.
5. All 21st Century Waterfront projects were completed properly.

6. RiverCity's total expenditures tie to the City's total expenditures.
7. Land purchases/transfers were reasonable and proper.

STATEMENT OF SCOPE

Based on the work performed during the preliminary survey and the assessment of risk, the audit period will cover the operations of the 21st Century Waterfront project from July 1, 2002 to June 30, 2007.

Source documentation was obtained from RiverCity, the City of Chattanooga Attorney's office, City's Real Estate office and the City Finance office. Original records as well as copies were used as evidence and verified through physical examination.

STATEMENT OF METHODOLOGY

Auditors worked with personnel from RiverCity, City Attorney's office, City's Real Estate office and City's Finance office to collect data by interviewing, reviewing documents and research. Auditors verified the status of projects by performing walkthroughs of the 21st Century Waterfront properties.

To achieve the audit's objectives, reliance was placed on computer-processed data contained in both RiverCity's and the City's financial systems. The City's financial system was previously determined to be reliable and no additional work was necessary. A reconciliation of RiverCity's financials to the City's financials was made and they were deemed reliable. Based on these assessments and tests, we concluded the data was sufficiently reliable to be used in meeting the audit's objectives.

The sample size and selection were statistically generated using a desired confidence level of 90 percent, expected error rate of 5 percent, and a desired precision of 5 percent. Statistical sampling was used in order to infer the conclusions of test work performed on a sample to the population from which it was drawn and to obtain estimates of sampling error involved. Also, when appropriate during the audit, the entire population was tested for certain areas.

STATEMENT OF AUDITING STANDARDS

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to afford a reasonable basis for our judgments and conclusions regarding the organization, program, activity, or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. We believe that our audit provides a reasonable basis for our conclusions. In addition, we abide by the standards of professional practice established by the Institute of Internal Auditors.

AUDIT CONCLUSIONS

Based upon the test work performed and the audit findings noted below, we conclude that:

1. Although the Management agreement was not procured per City guidelines, it does not appear the CDRC's Bylaws or Charter require the City's policies or code be followed.
2. Other than some instances where RiverCity failed to maintain complete and detailed records, it appears RiverCity was in compliance with guidelines specified in the Development Management Agreement.
3. Competitive bids were not obtained in some instances, as required by the City's purchasing policies.
4. Some contracts were not approved by the CDRC, as required.
5. It does not appear that all 21st Century Waterfront projects were completed properly.
6. RiverCity's total expenditures agreed to the City's total expenditures.
7. Some of the land purchases and transfers do not appear reasonable and proper, as noted in findings below ("Appraisals not Performed" and "No CDRC Board Approval").

While the findings discussed below may not, individually or in the aggregate, significantly impair the operations of CDRC Board, they do present risks that can be more effectively controlled.

POLICIES AND PROCEDURES NOT ADHERED TO

A resolution approved by CDRC dated October 17, 2002 states, "RiverCity Company is authorized to act as agent of the Corporation for the 21st Century Waterfront Development Plan, subject to City of Chattanooga policies on purchasing and expenditure of budgeted funds." Auditors tested fifty-two expenditures and discovered eight expenditures (15%) did not adhere to the City's policies and procedures. Some expenditures did not have proper supporting documentation, some were not competitively bid and some were not properly approved. These are all violations of the City's purchasing policies and procedures.

RECOMMENDATION 1

Auditors recommend the CDRC ensure RiverCity adheres to all of the City's purchasing policies and procedures as long as the 21st Century Waterfront Management Agreement is active. In the future, the CDRC should monitor third parties that have been entrusted with the responsibility of following specific guidelines. In addition, the CDRC should seek legal counsel to determine the possibility of recouping funds from RiverCity due to their failure to competitively bid some contracts.

AUDITEE RESPONSE

We will continue to follow this recommendation with regard to purchasing policies and procedures and monitoring third parties. Nothing in the audit establishes a basis for recouping funds from RiverCity. The RiverCity Development Agreement did not require RiverCity to follow the practices and procedures of the City. While there may have been isolated instances where City practices were not followed, RiverCity generally adhered to the City's purchasing practices and procedures. At such time as there is any indication that any failure by RiverCity has damaged the CDRC, this recommendation would then be reconsidered.

AUDITOR COMMENT

The Development Agreement is not mentioned in this finding and clearly is not relevant. Our finding clearly states that RiverCity was acting as an agent for CDRC with a requirement that City Policies be followed. Competitive bidding for expenditures in excess of \$10,000.00 is a City Policy. The practice of competitive bidding by the City of Chattanooga and other entities (governmental and private) is a common practice utilized to reduce costs. The failure of RiverCity to competitively bid some expenditures (as stated in our finding) may have resulted in excessive expenditures. Such excess expenditures may be construed to be the result of a breach of fiduciary responsibility on the part of RiverCity.

We do not purport to be experts in the field of law. Hence, our recommendation that the CDRC seek legal counsel on this issue. We would further comment that while we do not question the integrity of the City Attorney, the City Attorney's office appears to have had extensive involvement with the 21st Century Waterfront project. Therefore, for the purposes of appearance, we would recommend the CDRC seek legal counsel independent of the City Attorney's office. We reaffirm our finding and recommendation.

APPRAISALS NOT PERFORMED

In reviewing the documents for all the land purchases and exchanges, it was discovered that three land transactions did not have an appraisal and/or a RFP performed during the 21st Century Waterfront project. Although, the City and State codes do not specifically (to our knowledge) require appraisals to be performed when property is purchased, as a matter of good business practice, an appraisal should be completed when purchasing or exchanging property to determine fair market value and ensure there are no undue benefits.

RECOMMENDATION 2

As a matter of good business practice and to ensure compliance with Article II, section 29 of the State Constitution, Auditors recommend that the CDRC have appraisals performed on all land purchases and exchanges before the settlement is performed or transaction is closed.

AUDITEE RESPONSE

It is normally a good government practice to obtain appraisals; however, there are exceptions. Appraisals and/or RFPs were obtained with regard to all sixteen property transactions with the exception of three parcels: the McDonald property at 18 Market St (First Street frontage), the Huckabee property at 501 Cherry Street, and Parcel 8(C) on Walnut Street. The City itself is authorized pursuant to City Code §2-567 to negotiate a negotiated or private sale of property where such appears advantageous to the City. These parcels were critical to the 21st Century Waterfront Plan and were negotiated with willing sellers to avoid eminent domain. The option on 8C was for the same price per square foot as the adjacent property.

AUDITOR COMMENT

We fail to see any relevance to our finding and recommendation in the auditee response. While the transactions mentioned in the response may (or may not) have been advantageous to the City/CDRC, we fail to see any reasoning in the auditee response that would prevent or provide a logical basis for omitting the step of obtaining an appraisal (as was done for other transactions and as is a standard practice for the City of Chattanooga). We reaffirm our finding and recommendation.

DETAILED RECORDS

As mentioned in a previous finding, some expenditures did not have proper supporting documentation. In addition, there appeared to be poor organization of information pertaining to the land transactions involved with the 21st Century Waterfront project. The project involved numerous land purchases and exchanges. During test work for land purchases and exchanges, Auditors were unable to obtain a comprehensive listing and detail of land purchases/exchanges. Auditors expended a great amount of time composing a list of all land transactions and gathering documentation for the land transactions from RiverCity, the City Attorney's office, City's Real Estate office and several other sources. According to the Management Agreement with RiverCity, they shall maintain a complete and detailed set of financial books, records and accounts relating to the project. Due to the amount spent on the 21st Century Waterfront and the numerous, extensive and complex transactions involved, comprehensive organized records are important.

RECOMMENDATION 3

CDRC should keep complete detailed and organized records of all land purchases/exchanges. In addition, CDRC should determine if RiverCity, as required by the Management Agreement, has kept a complete set of detailed records. In the future, the CDRC should monitor third parties that have been entrusted with the responsibility of following specific guidelines. Further, the CDRC should not rely on a third party to maintain important documents.

AUDITEE RESPONSE

These transactions are well documented but we will continue to implement procedures to improve on the process for any future project.

AUDITOR COMMENT

As stated in our finding, some expenditures did not have proper supporting documentation and land transactions did not appear to be well organized. We made specific requests for documents that could not be located or were not well organized. Therefore, **all** transactions were not well documented. We reaffirm our finding and recommendation.

NO CDRC BOARD APPROVAL

Auditors were not able to locate Board approval allowing RiverCity to keep a portion of the Berry property. In addition, no approval was given to enter into an Option to Purchase agreement with RiverCity which stated that a redevelopment plan must be provided within one year for Lot #1 of the Berry property. The CDRC Board authorized the purchase of the property at 99 Walnut (Berry property) in the October 17, 2002 minutes for \$2,000,000. On November 1, 2002, acting as an agent for the CDRC, RiverCity purchased the James Berry property for \$2,000,000. On the same day RiverCity sold/transferred Lot #2 of the Berry property to the CDRC and kept Lot #1 which appears to be without written or otherwise documented approval from the CDRC Board. However, this portion of the Berry property was returned to the CDRC in 2005 when the Berry property was sold.

RECOMMENDATION 4

All such contracts or agreements should be reviewed and discussed in full detail with the CDRC's Board prior to the completion of the transactions. In addition, CDRC management should not donate, sell, purchase or swap real estate without the prior approval of the Board of Directors.

AUDITEE RESPONSE

We have been advised that this item relates to Lot 1 at 99 Walnut Street (Berry property) also known as 115 First Street. While we generally agree with first recommendation, it is inapplicable to this transaction. RiverCity undertook to arrange this transaction at the request of the Mayor. This was done before the CDRC had been assigned responsibility for the 21st Century Waterfront or RiverCity had been employed to manage that development. RiverCity is a non-profit entity that supports development activities of the City of Chattanooga. RiverCity undertook this activity at its own risk. Once the 21st Century Waterfront project was funded, the option was assigned to the CDRC to exercise. There was no improper or questionable financial gain or other advantage arising from these transactions, and the governmental purpose was fulfilled.

AUDITOR COMMENT

We fail to see the relevance to our finding and recommendation in the auditee response. CDRC was assigned the responsibility of the 21st Century Waterfront in September 2002, per resolution #23536 and a charter amendment adopted September 26, 2002. RiverCity was authorized to act as agent for the 21st Century Waterfront on October 17, 2002. Both of these acts occurred before the purchase of the Berry property. We have provided the above information to ensure readers are not misled by the auditee response. Our finding is valid regardless of when CDRC took on the responsibility of the 21st Century Waterfront or when RiverCity became the agent for the 21st Century Waterfront. The relevant fact is RiverCity withheld a portion of the property without approval of the CDRC board. Further, there was no board approval given to enter into an Option to Purchase agreement with RiverCity pertaining to the Berry Property. We reaffirm our finding and recommendation.

PROPERTY UNDER REPAIR

Although all projects have been paid in full, Auditors noted during a walkthrough of properties completed, the "Passage" was closed for major repair. After meeting with City Officials, it was noted there were multiple problems with the 21st Century Waterfront including improper wiring, underwater fixtures not grounded, pump motors not properly grounded, grinder pump not working, as well as extensive masonry, structural and irrigation system problems.

RECOMMENDATION 5

Internal Audit recommends that CDRC further investigate to determine if contract work was properly completed and if RiverCity properly managed all projects. In addition, CDRC should seek legal counsel to determine if contractors and/or RiverCity should be held liable due to poor construction.

AUDITEE RESPONSE

The CDRC has been aware of problems arising from the construction of the waterfront since May 14, 2007, at which time it authorized some initial repairs. The board subsequently directed the Department of Public Works and the City Attorney to investigate construction related issues and bring forth a comprehensive plan for corrective action. of the situation.

The CDRC Board authorized at its meeting on Monday, March 31, 2008, the retention of a consultant to further investigate these matters. If it appears from the results of that investigation that some entity has been negligent with respect to the project, then further action will be pursued

REPORT ADDENDUM

The standard format of reporting by Internal Audit is to list the audit objectives, provide our conclusions regarding those objectives, and provide findings that support our conclusions. We then provide auditees the opportunity to respond to those findings. Auditee responses are never edited or modified by Internal Audit (they are presented as received). Because our conclusions are supported by the findings (and the auditee provides a response to those findings and recommendations), there is generally no perceived need for the auditee to respond to the actual conclusions. However, in this instance, CDRC management has provided responses to our conclusions. We have included those responses below. As with auditee responses to our findings and recommendations, where we feel the auditee is stating irrelevant, misleading or incorrect information, we have provided auditor comments.

Auditee Response to Conclusion #1:

We agree with this assessment. The 21st Century Waterfront Project was entrusted to the CDRC and RiverCity to provide a stream-lined management for the project. Such a major and time-sensitive project would have over-burdened the City's departments and most likely delayed development of the waterfront. Although, the CDRC is required to follow the Municipal Purchasing Act, T.C.A. §29-20-101, *et seq.*, with regard to use of municipal funds entrusted to its management, CDRC's by-laws and charter do not require that the CDRC comply with or follow City Code or policies.

Auditor Comment:

Because the auditee has raised the issue of the requirements of Tennessee's Municipal Purchasing Act, we feel it is prudent that our opinion on this issue be included here. As stated above, the CDRC is required to follow (comply with) the Act. Although not stated in our conclusion, it is our opinion that CDRC was required to competitively bid the management agreement that was ultimately entered into with RiverCity. Because the services were not bid, it is our opinion that CDRC violated the requirements of the Municipal Purchasing Act.

Auditee Response to Conclusion #2:

We concur.

Auditee Response to Conclusion #3:

We concur in part and disagree in part. Although the CDRC is required to follow the Municipal Purchasing Act with regard to expenditures of city funds, it was not required to follow all of the City's practices or procedures.

We have been advised that this item relates to the following payments: American Campbell, TRC, and Brian Hackett.

The American Campbell procurement was subject to the Municipal Purchasing Act. These expenses were incurred over the expanse of over 2-1/2 years and covered five separate construction/demolition projects. Of the \$38,242.86 expenditures, \$12,700 was offset by contractor reimbursals. When it became apparent that these expenditures would exceed \$10,000 in any single year, we acknowledge that there should have been a competitive bid.

TRC provided professional services related to compliance with a cultural resource analysis that was required to be obtained by state and federal agencies. Bids are not required for professional services pursuant to T.C.A. §12-4-106. The original terms of the TRC agreement was for an hourly rate to be billed monthly. Upon realization that the costs of services provided by TRC were exceeding \$10,000 a proposal was submitted to and approved by the CDRC board on 02/11/04 in compliance with Section 2.1.7 of the Development Management Agreement.

Brian Hackett provided personal services related to demolition oversight at the GE Roper site. Mr. Hackett was uniquely qualified for providing these services both by his accreditation by the Academy of Certified Hazardous Materials Managers, and by his history of approximately 5 years of related work at the subject site. Mr. Hackett's qualifications were discussed and the related expenditures approved by the CDRC board on May 11, 2004.

Auditor Comment:

The fact that the CDRC is not required to follow all of the City's practices or procedures is not relevant. RiverCity, acting as an agent for CDRC, was required to follow **all** of the City's policies and procedures with regard to purchases and expenditures. This is clearly stated in the introduction section of our report and in our first finding titled "Policies and Procedures not Adhered to."

We are unaware of who has “advised” CDRC management of the items related to this conclusion. However, the advice is not correct. We took into consideration Mr. Hackett’s certification and status as a “Professional” and removed his requirement for competitive bids from our analysis. The auditee was informed of this during an exit interview prior to providing auditee responses. Likewise, the TRC payments were not included in our analysis as having a competitive bidding requirement. The auditee was also informed of this during an exit interview prior to providing auditee responses.

This conclusion is related only to the issue of competitive bidding. Because the auditee has raised the issue regarding failure to obtain CDRC board approval for TRC expenditures, we will address that particular issue here. TRC payments tested totaled over \$10,000 in May 2003 and should have been approved by the Board prior to that time. In February 2004 (when approval was finally obtained), payments to TRC already totaled \$17,391.37.

As discussed in our report section titled “Statement of Methodology,” we utilized statistical sampling to infer conclusions to the entire population. Specific items identified as exceptions are only those tested in our (relatively small) statistically generated random sample pulled from the entire population of transactions. When extrapolated to the entire population, a few specifically noted exceptions indicate multiple errors.

Auditee Response to Conclusion #4:

We concur. We have been advised that this item relates to the payment of invoices from Miller and Martin LLP. Although bidding of professional legal services contracts is not required, the CDRC Board should have approved the retention of Miller and Martin

Auditor Comment:

Conclusion #4 does not only apply to the contract with Miller and Martin LLP. There were other vendors that did not get Board approval when required as found in our test work (some of which the auditee has noted in the above response to conclusion #3). We would further direct the reader to our above comment regarding statistical sampling. It is important to note that we only tested a small portion of transactions.

Auditee Response to Conclusion #5:

It is our opinion that this audit comment reaches a premature and unsubstantiated conclusion concerning a complex set of issues. The 21st Century Waterfront projects were generally completed on time and within budget. Furthermore, these construction projects were duly accepted as being substantially completed. Some post-acceptance issues such as the settling of a portion of the riverwalk have been identified and are being addressed by the CDRC.

Subsequent issues related to the Passage including delamination of the cladding, electrical wiring and lighting have arisen. These matters are being duly investigated by consultants retained by the CDRC Board. A corrective plan of action will be developed and appropriate actions taken based on the findings of the investigation to ensure that responsible parties are held accountable.

Auditor Comment:

Our conclusion states that it does not **appear** that all of the projects were completed properly. Considering our finding titled "Property Under Repair," we feel this is a reasonable statement. The auditee states in their own response above and in their response to our finding that there are "issues" and that they have requested City personnel "investigate construction related issues." The auditee further states they have retained "a consultant to further investigate these matters." We believe these statements alone provide sufficient support for our statement that there "appear" to be problems with the proper completion of some projects.

Auditee Response to Conclusion #6:

We concur and are pleased that all funds have been properly accounted for.

Auditee Response to Conclusion #7:

We disagree. We have been advised that this conclusion relates to certain land transactions at 99 Walnut Street involving the purchase of property approved by the CDRC board on October 17, 2002. The property had been appraised at \$2.5 million, but optioned by RiverCity at \$2 million. Subsequently, the option was assigned to the CDRC which exercised the option. There may have been a failure to fully document the transfer of a small portion of that transaction (a small parcel valued at \$9,400) by RiverCity while it still owned the land to RiverPark Properties, LLC. However, this was clearly anticipated to be a part of the transaction as shown by the option contract contained in the CDRC minutes material of the January 15, 2003, meeting. The \$9,400 has been fully accounted for.

Auditor Comment:

This response to our conclusion is not relevant. Again, we are unaware of who has "advised" CDRC management of these details. Our conclusion is based on more than the 99 Walnut Street Property. However, since this is the only issue the auditee has addressed we will respond accordingly. Neither of our findings in regards to our conclusion takes consideration of the transfer of the small piece of property valued at \$9400. This piece of property was not a factor or relevant to our conclusion or finding. Please see auditor comment to recommendation 4 above.