

Office of Internal Audit

Performance Audit 20-01: Nonprofit Appropriations

August 2020

City Auditor

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OFFICE OF INTERNAL AUDIT

Stan Sewell, City Auditor

August 19, 2020

To: Mayor Andy Berke
City Council Members

Subject: Nonprofit Appropriations (Report #20-01)

Dear Mayor Berke and City Council Members:

The attached report contains the results of our audit of Nonprofit Appropriations. Our audit found the Department of Finance & Administration's Office of Management & Budget Analysis is generally doing a good job managing the Nonprofit Appropriations process. However, we found there is value in exploring opportunities for improvement.

In order to address the noted areas for improvement, we recommended actions to amend the ordinance to clarify the assignment of authority and responsibility for overseeing nonprofit appropriations, as well as the filing of required documentation. We also recommended the development of a verification process to ensure compliance with the documentation requirements.

We thank the management and staff of the Department of Finance & Administration's Office of Management & Budget Analysis for their cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE
City Auditor

Attachment

cc: Audit Committee Members
Kerry Hayes, Chief of Staff

Maura Sullivan, Chief Operating Officer
Daisy Madison, Chief Financial Officer
Tanikia Jackson, Deputy Chief Financial Officer
Fredia Forshee, Director of Management & Budget Analysis
Jim Arnette, Tennessee Local Government Audit

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AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit's 2020 Audit Agenda. The objective of this audit was to determine if the City is properly overseeing nonprofit appropriations.

BACKGROUND

Section 6-54-111, Tennessee Code Annotated, as amended, authorizes a municipality's governing body to appropriate funds for the financial aid of any nonprofit charitable organization that provides services benefiting the general welfare of the residents of the municipality or any nonprofit civic organization working to maintain and increase employment opportunities in the municipality. This section also provides for the Comptroller of the Treasury to establish standard procedures to assist the municipal governing body in the disposition of funds so appropriated.¹

City of Chattanooga Ordinance No. 12872 authorizes the appropriation and disbursement of municipal funds to nonprofit charitable and civic organizations. The ordinance requires each nonprofit organization to comply with Section 6-54-111, Tennessee Code Annotated, as amended. The ordinance also includes a right to audit clause.

Each year, at budget time, the City receives numerous requests from nonprofits for appropriations. For consideration, state and local law require the filing of documentation such as cover letters, budgets, charters, exempt status, audits and IRS Form 990 (Return of Organization Exempt from Income Tax). The purposes for the requests range from funding for a specific activity, to funding for general operations, to asking for funding of capital projects.

¹ State of Tennessee, Tennessee Comptroller of the Treasury, Audit Manual, Standards and Procedures, June 2019, *Auditing, Accounting, and Reporting for Local Governmental Units and Other Organizations*, APP.D-16, 5. Municipal Donations to Nonprofit Organizations.

Financial Information

External Appropriations

Fiscal 2016 Actual Amounts	\$3,541,188
Fiscal 2017 Actual Amounts	\$3,838,108
Fiscal 2018 Actual Amounts	\$5,317,268
Fiscal 2019 Actual Amounts	\$7,207,199
Fiscal 2020 Appropriations	\$8,519,200

Source: CAFR (Actual Amounts) and Budget (Appropriations)

FINDINGS AND RECOMMENDATIONS

Clarify the Assignment of Authority and Responsibility

Tennessee Code Annotated 6-54-111 (state law) and City Ordinance 12872 (city code) set forth guidelines for appropriating funds to nonprofit organizations. When they differ, state law takes precedence over a local ordinance.

When comparing state law to city code, we noted a difference in the assignment of authority and responsibility. The state law assigns authority and responsibility for nonprofit appropriations to the municipality’s legislative body and city clerk.² Whereas, the city code assigns authority and responsibility to the Mayor and Chief Financial Officer.

In addition, state law asserts the documentation shall be filed with the City Clerk, whereas the city code states the information shall be furnished to the Chief Financial Officer.

The substantive impact of these discrepancies is minimal because the City Council approves the budget, which includes the nonprofit appropriations. However, compliance with state law is mandatory and the city code should be consistent with it.

Recommendation 1:

We recommend the Chief Financial Officer initiate changes to the city code in order to clarify the assignment of authority and responsibility for overseeing nonprofit appropriations, as well as the collecting and filing of the required documentation.

² The City’s “Clerk to Council” carries out the same functions as the State’s “City Clerk”.

Auditee Response: We concur with the audit finding and recommendation.

Create a Verification Form

As previously stated, state law and city code set forth guidelines for appropriating funds to nonprofit organizations, including required documentation. The documents include cover letters, budgets, charters, exempt status, audits, and IRS Form 990 (Return of Organization Exempt from Income Tax).

During the audit, we statistically selected 28 out of 45 nonprofits for testing documentation. Ten documentation requirements were tested for each nonprofit selected, resulting in 280 separate requirements being tested. Out of these 280 requirements tested, there were 17 exceptions (6%).

Exceptions were identified when a particular document was incomplete, not found or not provided. An exception is the inability to demonstrate compliance with the documentation requirements.

Recommendation 2:

We recommend the Department of Finance & Administration's Office of Management & Budget Analysis create a verification form to certify all required documentation is on file for each nonprofit. Responsibility for ensuring the form is completed should be assigned, as a formal job duty, to a specified position/person. The City Council is responsible for oversight and should be provided the form for each nonprofit receiving funds, prior to the budget recommendations.

Auditee Response: We concur with the audit finding and recommendation.

APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS

Based on the work performed during the preliminary survey and the assessment of risk, the audit covers nonprofit appropriations from July 1, 2019 to June 30, 2020. When appropriate, the scope was expanded to meet the audit objectives. Source documentation was obtained from the Department of Finance & Administration's Office of Management & Budget Analysis. Original records as well as copies were used as evidence and verified through physical examination.

To evaluate the oversight of nonprofit appropriations, we compared state law to city code and selected a sample of fiscal year 2020 awards to test for compliance with requirements.

To develop our recommendations, we reviewed industry best practice documents and discussed certain issues with the Tennessee Comptroller of the Treasury – Division of Local Government Audit.

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. When appropriate, judgmental sampling was used to improve the overall efficiency of the audit.

We conducted this performance audit from February 2020 to July 2, 2020, in accordance with generally accepted government auditing standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

City of Chattanooga Fraud, Waste, and Abuse Hotline

Internal Audit's Fraud, Waste, and Abuse Hotline gives employees and citizens an avenue to report misconduct, waste or misuse of resources in any City facility or department.

Internal Audit contracts with a hotline vendor, NAVEX GLOBAL, to provide and maintain the reporting system. The third party system allows for anonymous reports. All reports are taken seriously and responded to in a timely manner. Reports to the hotline serve the public interest and assist the Office of Internal Audit in meeting high standards of public accountability.

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