



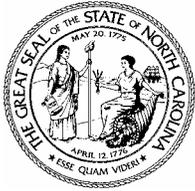
STATE OF NORTH CAROLINA

PERFORMANCE AUDIT

**NORTHEASTERN NORTH CAROLINA REGIONAL ECONOMIC
DEVELOPMENT COMMISSION
AND
NORTH CAROLINA'S NORTHEAST PARTNERSHIP, INC.**

MARCH 2006

**OFFICE OF THE STATE AUDITOR
LESLIE W. MERRITT, JR., CPA, CFP
STATE AUDITOR**



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April 11, 2006

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Secretary Jim Fain, Department of Commerce
Mr. Jack Runion, Chairman, Northeastern North Carolina
Regional Economic Development Commission and
North Carolina's Northeast Partnership, Inc.

Ladies and Gentlemen:

We are pleased to submit this performance audit entitled *Northeastern North Carolina Regional Economic Development Commission and North Carolina's Northeast Partnership, Inc.* The objective of the audit was to determine whether the resources provided by the State were used in a prudent business manner for their intended purpose of furthering economic development in the northeast region of North Carolina. Chairman Runion has reviewed a draft copy of this report. His written comments are included after each audit finding and in an appendix to the report.

We wish to express our appreciation to Chairman Runion and the Boards of Directors and staffs of both organizations for the courtesy, cooperation, and assistance provided us during the audit.

Leslie W. Merritt, Jr.

Respectfully submitted,

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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Summary

North Carolina and other states are faced with the challenge of how to increase economic development within their states. In partial response to that challenge, North Carolina's General Assembly provides funds for seven designated regions of the State to market their regions. The seven regions were provided \$20.9 million in State appropriations during the three-year period ending June 30, 2005, with an additional \$8.5 million authorized for the year ending June 30, 2006. Northeastern North Carolina Regional Economic Development Commission (Commission) is the regional entity designated to market the northeastern area of the State.

The Commission formed a private non-profit partnership, North Carolina's Northeast Partnership, Inc. (Partnership), in an effort to carry out its mission of marketing the northeastern part of North Carolina to business and industry. The majority of the State funds provided to the Commission are passed to the Partnership for this purpose. During the three-year audit period ending June 30, 2005, \$4.08 million in economic development funds have been provided by the State to the Commission and the Partnership.¹

The State has provided minimal regulatory guidance regarding the use of these funds except that the funds should be used for economic development in the region. The objective of this audit was to determine whether the resources provided by the State were used in a prudent business manner for their intended purpose of furthering economic development in the region. The scope of this audit encompassed the operations associated with the efforts of the Organization to further economic development in its designated region.

RESULTS IN BRIEF

The Organization's president has created a conflict of interest and has created a situation in which his decisions, however inconsequential, could be questioned as to their motivation. There has been significant controversy and legitimate questions have been raised by citizens and from officials within the region's economic development community. These issues have caused extensive adverse media attention and heightened public skepticism that could cause the Organization's mission and focus to suffer.

The Partnership has made significant bonus payments without any pre-determined criteria on which to justify the payments. Bonus payments of \$572,000 were paid to the Organization's employees, employees of the North Carolina Department of Commerce, and to several of the Organization's independent contractors without any documented basis for the payments.

The Organization paid consultants in excess of \$889,000, yet the Organization's process of selecting contractors does not provide assurance that the Organization contracted with the most qualified and at the best possible price.

¹ As more fully described in the appendices to this report, the Commission and the Partnership are so intertwined operationally and financially that it would be cumbersome and unnecessary to discuss the issues in this report in the context of two separate entities. Therefore, the two entities will hereafter be referred to jointly as "Organization" when the topic under discussion equally applies to both entities.

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Many of the employment and consulting contracts entered into by the Organization contain terms that could adversely affect the Organization's operations and/or finances and they do not include other terms that would protect the Organization's interest. The Organization could be required to pay certain employees and even some independent contractors the equivalent of the employee's annual salary or the contractor's annual retainer even if the Organization had good cause for severing its relationship with the employees or contractors.

There was no documented evidence in the financial records that two contractors that had been paid \$50,340 had provided specific services to the Partnership.

The Partnership is reporting financial information incorrectly on Internal Revenue Service Form 990. Compensation of key employees has not been reported correctly. Failure to accurately report required data could mislead the public and lead to an inaccurate assessment of an organization's operations.

There are internal control weaknesses in the Organization's operations. There are no written policies and procedures on reimbursement of expenditures for Organization and North Carolina Department of Commerce staff and there is inadequate separation of duties.

The Commission did not seek clarification from the Attorney General regarding the Commission's status and obligations as "an agency of North Carolina" or whether the substantial delegation of the Commission's responsibilities to the Partnership was at odds with its authority.

The Commission and Partnership Boards of Directors have not sufficiently exercised their fiduciary responsibilities to monitor operations and ensure funds are used in the most effective and efficient manner in furtherance of economic development in the region. The failure of the Boards to properly act in a timely manner to major issues confronting the Organization could hurt the Organization's goal to improve the economic conditions of the region.

ORGANIZATION'S RESPONSE

The Organization's responses are included after each audit finding and in an appendix to the report.

Introduction

BACKGROUND

The counties of North Carolina are organized into seven regional partnerships for economic development. The seven partnerships work on a regional basis to serve North Carolina's 100 counties in promoting economic development marketing strategies and opportunities. North Carolina's regional partnerships compete for new investment and devise economic development strategies based on regional opportunities and advantages. The seven regions were provided \$20.9 million in State appropriations during the three-year period ending June 30, 2005, with an additional \$8.5 million authorized for the year ending June 30, 2006.

The Northeastern North Carolina Regional Economic Development Commission was created in 1993 by General Statute § 158-8.2 as a public agency designed "to facilitate economic development in Beaufort, Bertie, Camden, Chowan, Currituck, Dare, Gates, Halifax, Hertford, Hyde, Martin, Northampton, Pasquotank, Perquimans, Tyrrell, and Washington Counties." The Commission formed a private entity named North Carolina's Northeast Partnership, Inc. to carry out its mission of marketing the northeast region through tourism and business/industry recruitment and expansion. The Commission is provided State funds from the annual State appropriation but then passes the majority of the funds to the Partnership. During the three-year audit period ending June 30, 2005, \$4.08 million in economic development funds have been provided by the State to the Commission and the Partnership.

North Carolina's Northeast Partnership, Inc. promotes economic development, travel, and tourism for its region. The Partnership provides no cost, confidential assistance to companies considering relocation or expansion in the region. The Partnership also supports efforts to increase visitor awareness of the natural, historical, cultural, and recreational opportunities in North Carolina's northeast.

The Northeastern North Carolina Regional Economic Development Commission and North Carolina's Northeast Partnership, Inc. share the same mission and goals, which is "to increase the standard of living for citizens in the sixteen county region through industrial, business, tourism, and retirement development as well as improve economic conditions in Northeast North Carolina by marketing the region's excellent business, tourism, and quality-of-life amenities."

OBJECTIVES, SCOPE, AND METHODOLOGY

With the recent questions raised regarding the use and administration of State funds by the Northeastern North Carolina Regional Economic Development Commission and North Carolina's Northeast Partnership, Inc., the State Auditor determined that there was a need to review their operations. The objective of this audit was to determine whether the resources provided by the State were used in a prudent business manner for their intended purpose of furthering economic development in the region.

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The scope of this audit encompassed the operations associated with the efforts of the Commission and the Partnership to further economic development in its designated region. Unless otherwise described, our audit covered primarily the three-year period ending June 30, 2005.

To accomplish our objective, we interviewed organization staff, contractors, board members, Department of Commerce staff, and personnel from other economic development organizations. We reviewed the General Statutes and the North Carolina Administrative Code relating to economic development and the Organization's policies and procedures. We reviewed internal control, performed compliance testing, and examined financial records and documentation as related to the audit objectives.

This report contains the results of the audit including conclusions and recommendations. Specific recommendations related to our audit objectives are reported. Because of the test nature and other inherent limitations of an audit, together with the limitations of any system of internal and management controls, this audit would not necessarily disclose all weaknesses in the systems or lack of compliance.

We conducted the fieldwork from November to December 2005. We conducted this audit under the authority vested in the State Auditor of North Carolina by Section 147-64.6 of North Carolina General Statutes and according to generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

1. THE PRESIDENT/CEO CREATED A CONFLICT OF INTEREST WITH HIS INVOLVEMENT IN THE PARTON ENTERTAINMENT PROJECT

The Organization's president has created a conflict of interest and has created a situation in which the motivation for his decisions could be questioned. The president is in a position to direct the Organization's efforts and State-provided resources for the benefit of an organization that has offered him employment. This, by any reasonable person's definition, is a conflict of interest and we believe clearly violates the president's employment contract and the Partnership's own definition of a conflict of interest. Can the Organization, the State, and its citizens be assured that the president, if circumstances required it, would withhold or modify the Organization's efforts or make a decision that would adversely impact the Parton² Project?

The Partnership's Ethics and Conflict of Interest Policy defines a conflict of interest, in part, as a relationship in which an employee's private financial interest conflicts with public duties and responsibilities:

“A conflict of interest involves any situation in which the private interest, usually of a financial or economic nature, of any director, officer or employee of the corporation, conflicts or raises a reasonable question of conflict with such directors, officer's or employee's public duties or responsibilities.

This definition even labels those situations where one's private economic or financial interest “raises a reasonable question of conflict” as a conflict of interest. More directly, the president's contract with the Organization states that he is “obligated to diligently avoid a conflict of interest, or the *appearance of a conflict of interest* [emphasis added].” The president has also failed to comply with this requirement. There has been significant controversy and legitimate questions have been raised by citizens and from officials within the region's economic development community, not only about the Parton Project, but also about actual or planned personal investments by the president in businesses he has aided. These issues have caused extensive adverse media attention and heightened public skepticism that could cause the Organization's mission and focus to suffer.

According to Organization management, the president initiated and cultivated the Parton Project, primarily by establishing a personal relationship with Randy Parton and his family. Approximately a year after the relationship began, the president announced in October 2005, that he had verbally agreed to employment with the Parton Project, to begin in April of 2007. The president has also stated that he plans to invest in the Parton Project. The president has stated that his main priorities as an employee of the Organization until he departs will be the day-to-day operations of the Organization and overseeing the Parton Project for the Organization.

² The Parton Project is the Randy Parton Theater and Carolina Crossroads Entertainment District Project, a major economic development located adjacent to Interstate 95 and south of Roanoke Rapids, North Carolina. According to Organization officials, an analysis of its economic impact indicates that over a four-year period, 2005 to 2008, this venture, if successful, could provide \$225 million in increased labor income and 13,000 new jobs.

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The Organization's attorney, who also represents the Parton Project, stated that there is no conflict of interest. We acknowledge that the Organization also engaged another outside attorney who provided a similar opinion. The Organization, however, did not seek an opinion through the Attorney General's office.

Recommendation: The Commission and Partnership Boards need to consider remedial action given that the president is not in compliance with his contract and the Partnership's own Ethics and Conflict of Interest Policy. All board members should more actively involve themselves in the operations of the Organization. We believe a matter as serious as this, one in which the integrity of the Organization's operations is questioned, warrants such Board attention.

Subsequent Events: Subsequent to completion of fieldwork on this audit, several events took place regarding the president's employment with the Organization. First, on March 1, 2006, the president notified the Organization in writing that he would be resigning effective June 30, 2006. Then on March 21, 2006, the Organization and the president mutually agreed that the president's tenure with the Organization would terminate retroactive to March 1, 2006. In accordance with the president's original employment contract,³ the Organization will pay the president a year's base salary of \$165,000 and for accumulated unpaid vacation and earned commissions.

Organization's Response: While two legal opinions from highly reputable law firms, Morgan, Reeves & Gilchrest and Sanford Holshouser were obtained to guide the Boards actions relating to a conflict of interest for the President & CEO, we agree that the situation with the President/CEO's continued work with the Organization and future commitment with Moonlight Bandit Productions could give the appearance of a conflict of interest as set forth in the Commission/Partnership's Ethics and Conflict of Interest Policy.

On March 21, 2006, the Boards terminated its agreements with the President/CEO effective March 1, 2006. In subsequent meetings, the Boards for both the Commission and Partnership acknowledged the seriousness of this situation and voiced firm commitments for strict compliance with and enforcement of the Organization's Ethics and Conflict of Interest Policy to ensure that we do not distract from our mission to improve the standard of living for citizens of North Carolina's Northeast Region.

2. BONUSES HAVE BEEN PAID TO PARTNERSHIP EMPLOYEES, DEPARTMENT OF COMMERCE EMPLOYEES, AND CONTRACTORS WITHOUT DOCUMENTED CRITERIA

The Partnership has made significant bonus payments without any pre-determined documented criteria on which to justify the payments. Of the \$4.08 million in funds provided by the State during the three year period under audit, 14%, or \$572,000, of the funds were paid out in bonus payments to the Organization's employees, employees of the North Carolina Department of Commerce, and to several of the Organization's

³ See finding 4 for a discussion of employment contracts.

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independent contractors without any documented basis for the payments. The Organization's staff stated that the payments were based on what the president felt the individuals, including himself, deserved based on their performance. The amounts were then discussed and approved by the Commission and Partnership executive committees and approved (in the aggregate) by the Boards when the Organization's overall budget was considered. Individual bonus amounts were not disclosed to the Boards. In another matter, we also noted where the Partnership gave a \$3,000 bonus to a former employee who had worked less than 1 month of the 12-month period for which bonus payments were based.

* Total Bonuses Paid to Partnership Employees and Others			
Contractor	Fiscal Year 2002-2003	Fiscal Year 2003-2004	Fiscal Year 2004-2005
President/CEO	58,650	82,225	99,475
VP of Marketing/NCDOC Marketing Consultant	24,150	35,938	41,688
Finance Officer	12,363	12,535	14,490
Tourism/Finance Assistant	4,600	7,590	12,190
Administrative Assistant	4,600	6,440	3,000
Front Desk Clerk	0	500	5,400
NCDOC Retention & Expansion Specialist	6,500	8,100	8,600
NCDOC Regional Assistant	9,500	10,600	12,600
NCDOC Heritage Officer	3,500	6,600	0
Lead Consultant	26,000	30,850	30,600
Existing Industry Consultant	0	15,600	20,600
Minority Consultant	0	0	2,000
Total Bonuses Paid	149,863	216,978	250,643
Total Bonuses Paid During Three Years		617,484	
Amount Allocable to State Funds Based on Total Available for Bonus Payments		572,000	
* Total = Annual, Christmas, and amounts contributed to individuals' IRAs as a result of bonus payments			
NCDOC: North Carolina Department of Commerce employee			
Source: North Carolina's Northeast Partnership, Inc.			

As noted in the table, the bonus payments include \$66,000 awarded to employees of the North Carolina Department of Commerce. These are the Department of Commerce employees who are housed on partnership premises and, although answerable only to Department of Commerce supervisors, generally work in coordination with organization activities. These payments were in addition to their State salaries and, as previously discussed, were not supported by documentation to verify justification.

Without documentation of the criteria for bonuses, the State has no way of knowing if the bonuses were deserved, reasonable, the most effective use of State resources, or whether they enhanced economic development.

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Recommendation: The respective Boards should first determine whether a bonus program is the most effective use of resources and whether it is appropriate to include Department of Commerce employees and independent contractors. If the bonus program is continued, management should base bonus payments on a documented set of measurable performance criteria that are related to the Organization's mission and goals. While the Organization's job is multi-faceted, including education and marketing of the region, we believe a strong component of the performance criteria should be based on the ultimate goals of the Organization, that of bringing in new investment, new jobs, and increased economic activity. Also, individuals eligible for bonuses should be made aware of the performance criteria prior to the beginning of the established performance review period. Documenting the bonus payments against a set of established criteria provides information to better assess justification.

Additionally, the Organization should be advised that a proposed rule amendment to the North Carolina Administration Code addresses the payment of bonuses to State employees. If accepted, the rule would not allow State employees to "receive compensation above the employee's base salary from the State or from any source for performing the duties of the employee's position except as authorized by this chapter."

Organization's Response: The Boards are in the process of developing a written performance bonus program incorporating the recommendations of the State Auditor that will be based on written performance criteria relating to the mission and goals of the Commission and Partnership. This plan, when complete, will be presented to the full boards of the Organization for consensus. No future performance bonus payments will be made until this plan is approved.

Previous performance bonus payments have always been based on specific accomplishments criteria; however, written documentation for these criteria was not maintained. The Organization did not routinely provide salary increases, except for changes in duties and responsibilities. Performance bonuses were only provided for outstanding achievements in meeting the goals and objectives of the Organization.

3. CONTRACTORS WERE CHOSEN UNDER A POORLY FORMULATED SELECTION PROCESS

The Organization's process of identifying and selecting contractors does not provide sufficient assurance that the most qualified provider of services at the most economical cost is obtained. The Organization does not have any systematic, documented process in place for selecting contractors. We found no applications on file for any of the contractors or any other information regarding contractor credentials, qualifications, and experience or general information about the contractor. For the period under audit, consultant payments exceeded \$889,000; however, in the absence of sufficient documentation, we cannot be assured that the Organization contracted with the most qualified and at the best possible price.

We were told that the primary method of identifying potential contractors came from leads provided by the president or board members. Typically, the Organization's process would

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begin with the president seeking out and making direct contact with a candidate. Once the Organization's choice is identified, a background check, primarily consisting of obtaining Dun and Bradstreet information and/or calling references, may then be performed. The Organization does not advertise with the regional media and does not always investigate or seek price quotes. The first candidate contacted could be, and often is, the only one ever approached, without any further investigation of others.

Prudent business practices require that a more substantive search be done. Without better search procedures, the Organization is uncertain whether another consultant would have been a better match for its needs.

Recommendation: The Board should establish a consultant hiring process. The selection process should be documented each time it is employed and, at a minimum, should include decisions made regarding the extent and type of advertising, the evaluation process, price quote comparisons, approvals. The search should include advertising or some other reasonable and prudent method of gauging the market for the desired services. The selection decision should not rest with one individual and may include the entire Board in matters involving key services or large sums.

Organization's Response: The Boards of the Organization are in the process of establishing a consultant hiring process that will incorporate acceptable procurement standards and written documentation with full involvement by the Boards in the final selection decisions.

Consultant hires may have not followed a formulated selection process; however, these hires have always been based on sound judgment and references from individuals and organizations familiar with the proposed consultant's capabilities. Additionally, it has always been the practice of the Commission and Partnership to utilize the services of individuals and firms from within the Northeast Region.

4. THE ORGANIZATION AGREED TO POTENTIALLY HARMFUL CONTRACT TERMS

Many of the employment and consulting contracts entered into by the Organization contain terms that could adversely affect the Organization's operations and/or finances and they do not include other terms that would protect the Organization's interest. A clause contained in 11 of the 15 employment contracts and consulting contracts requires the Organization to pay the equivalent of the employee's annual salary or the contractor's annual retainer even when the Organization has good cause for severing its relationship with the employees or contractors. On termination of these contracts "with or without cause," the Organization would be obligated to pay amounts ranging from a low of \$10,625 to a high of \$165,000 depending on the contractor.

Another contract term requires the Organization to give very long advance written notice if termination of an employee or contractor is desired, possibly resulting in the Organization's inability to change course in a timely manner. We notice that the employee or contractor was not required to reciprocate under an equally demanding advance written notice requirement.

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Contract Terms		
	Clause 1	Clause 2
Employee/ Contractor	Termination of this contract by the Organization requires 365 days advance written notice to the contractor; however, the contractor is required to give a 4-month notice if he/she decides to terminate the agreement.	The Organization may immediately terminate the agreement, with or without cause; however, it would require a lump sum payment to the contractor of his/her current annual base salary or annual retainer.
President *	Contracts include clause as stated above	Contracts include clause as stated above - salary of \$165,000
Vice-President *	Contracts include clause as stated above	Contracts include clause as stated above - salary of \$95,000
Lead Consultant *	Contracts include clause as stated above	Contracts include clause as stated above - retainer of \$120,000
Existing Industry Consultant *	Contracts include clause as stated above	Contracts include clause as stated above - retainer of \$80,000
Finance Officer *	Not applicable	Contracts include clause as stated above, except payment required would be 1/4 of his/her current annual base salary, or \$10,625
International Business Consultant	Not applicable	Contract includes clause as stated above - retainer of \$10,800
* This individual has a separate contract with each organization.		
Source: Northeastern North Carolina Regional Economic Development Commission and North Carolina's Northeast Partnership, Inc.		

The Organization could find itself in a position where it could not freely and in its best interests remedy an adverse situation. With limited options, the Organization would be forced to choose between tolerating an adverse situation with potentially disastrous impact on its mission or expending partnership/State funds to eliminate a bad situation created by an employee or a contractor. We believe the terms as currently formulated are not in the best interest of the Organization or the State.⁴

Compounding the potential for problems with contractors, the Organization failed to include in many of the contracts certain other terms that would serve to protect its interests. Of the 15 contracts let by the Partnership and the Commission, nine did not have a non-compete clause, three did not have a conflict of interest clause, and ten failed to require disclosure of financial relationships. The presence of these clauses would help

⁴ See finding 1 and its discussion of subsequent events related to the president's employment contract.

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the Organization guard against questionable business/financial relationships and would protect the Organization's competitive position were a contract terminated.

Recommendation: The Organization should modify the contracts to limit its liability and allow for more timely engagement of needed changes should termination of an employee or contractor is desired. The Organization should include terms in its contracts that better protect its interests, such as non-compete and conflict of interest clauses, and should require disclosure of financial relationships.

Organization's Response: Because it is critical to the future success of the Organization, the Boards are developing written Contract Review Procedures to ensure full Board understanding and consensus of existing and proposed contracts and terms. These Procedures will include an annual review of all contracts, including contract terms and performance, any modifications needed to ensure that non-compete and conflict of interest clauses are present, and that the level of contract performance is commensurate with the terms of the contracts. A Contract Review Committee will be appointed at the next meeting of the Boards to implement this review.

5. CONTRACTORS RECEIVED PAYMENTS WITHOUT PROVIDING SUPPORTING DOCUMENTATION

There was no documented evidence in the financial records that two contractors, who had been paid \$50,340 over the last three fiscal years, had provided specific services to the Organization. Without adequate documentation and proper oversight, a contractor could receive payment for services not provided. The contracts require the contractors to submit time/activity logs or invoices for services rendered.

Management stated that appropriate services had been provided and payment to these contractors occurred as a result of the president's authorization.

Recommendation: Management should require contractors to submit adequate documentation, as required by their contracts, before payments are authorized.

Organization's Response: It has always been the Organization's standard requirement that all Contractors provide detailed, written time and activity reports as documentation for payment for services rendered. Two contractors employed by the Organization failed to provide these reports to the President & CEO, as required by their contract. One of the consultants has subsequently provided full written documentation of activities in performance of her contract with the Organization. In the future, management will ensure that detailed time and activity reports are received prior to making payments under any contract for services.

6. THE PARTNERSHIP IS REPORTING FINANCIAL INFORMATION INCORRECTLY

Compensation of key employees has not been reported correctly on Internal Revenue Service Form 990, a key financial report available to the public. The Partnership either completely omitted or partially listed information on salaries, bonuses, commissions, and employee benefit plans. Since the form is an integral source of information for the public

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on the financial position and operations of the Partnership, failure to accurately report required data could mislead the public and lead to an inaccurate assessment of an organization's operations.

For Fiscal Year	Employee	Total Compensation Which Should Have Been Stated on 990s	Total Compensation Stated on 990s	Total Compensation Understated
2003-2004	President/CEO	256,039	123,878	132,161
	VP of Marketing	143,783	75,836	67,947
2002-2003	President/CEO	196,128	189,785	6,343
2001-2002	President/CEO	287,495	189,750	97,745
Compensation includes Commission and Partnership salaries, annual and Christmas bonuses, commissions on fund raising, and benefits.				
Source: North Carolina's Northeast Partnership, Inc.				

Recommendation: Management should ensure that Form 990 is completed correctly and should be aware that it is ultimately responsible for its accuracy.

Organization's Response: The Organization's multi-departmental classifications inadvertently led to underreporting of information in the 990's by the CPA Firm. The CPA Firm has received clarification from the IRS in reporting information for the 990's, and is in the process of amending all reports for the Organization to ensure that full and accurate reporting is accomplished.

7. INTERNAL CONTROLS ARE WEAK IN SOME AREAS

We noted internal control weaknesses in the Organization's operations:

- There are no written policies and procedures on reimbursement of expenditures to partnership or Department of Commerce employees. According to an Organization official, current practice is to reimburse the expense if the employee has a receipt or reimburse without a receipt if the value of the purchase is minimal; and
- There is inadequate separation of duties. The finance officer approves and authorizes her own pay, including overtime. Over the last three fiscal years, she has been paid \$12,845 in overtime pay.

Recommendation: Management should document in writing its reimbursement policies and procedures and they should be communicated to all employees. Each employee's

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supervisor should approve the employee's attendance records and/or other records as needed for payroll.

Organization's Response: The President/CEO and Treasurer have always reviewed proposed expenditures with the Treasurer initialing invoices before payments being made. The Organization has prepared a written Expense Reimbursement Policy to guide the reimbursement of expenditures to Partnership and Department of Commerce Employees. While employees' supervisors have always approved employee attendance and payroll records in the past, the Organization will ensure that written documentation of approval is maintained for these items.

8. CLARIFICATION OF THE COMMISSION'S LEGAL STRUCTURE WAS NOT OBTAINED

The Commission did not seek clarification of a 1999 Attorney General advisory opinion that presented questions about the Commission's legal structure and the operational environment the Commission had created for itself. Although the opinion was issued to respond to one question, that of the applicability of the Public Records Act to the Partnership, the opinion contained several conclusions that warranted follow-up and action by the Commission's Board.

The opinion stated that the Commission "is unquestionably an agency of North Carolina government. The Commission is located administratively in the North Carolina Department of Commerce...although it is required to exercise its statutory powers and duties independently of the Department." The Attorney General's opinion continues by calling into question certain actions taken by the Commission's Board. On July 27, 1994, the Commission held a special meeting at which it declared that it would no longer "be affiliated with the Department of Commerce" and would begin operating on its own, to which the Attorney General's opinion declares, "The Commission had no evident authority to disassociate itself by vote from the Department of Commerce in 1994." The question which follows: as "an agency of North Carolina" is the Commission subject to some or all the rules governing State agencies, such as purchasing and contract requirements and State laws on competition, conflict of interest rules, personnel and pay regulations, allowable uses of State funds?

A second question arises when the opinion refers to the incorporation of the Partnership. On September 16, 1994, the Partnership was incorporated and, according to the opinion, "the Partnership's articles of incorporation and bylaws indicate that it assumed the duties and functions of the Commission associated with economic development and tourism development." The Attorney General's opinion took exception and declared, "There is nothing in § 158-8.2 that grants the Commission the authority to divest itself of its statutory powers and duties in the areas of economic and tourism development." The opinion makes note of the annual funding which flows through to the Partnership and the requirement that these funds be used for public purposes.

In response, the Commission signed a memorandum of understanding with the Partnership establishing certain guidelines and principles for the use of its funds. We question

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whether this action was sufficient to rectify this issue raised by the Attorney General's opinion. Most of the funds provided to the Commission by the State are immediately transferred to the Partnership and the use of the funds would therefore be at the behest of the Partnership's Board.

Recommendation: The Commission Board should ask the Attorney General of North Carolina for an opinion clarifying the Commission's status and obligations as "an agency of North Carolina," the State rules and regulations, if any, it is required to comply with, and whether the substantial delegation of the Commission's responsibilities to the Partnership is at odds with its authority.

Organization's Response: The Organization has requested an opinion from the North Carolina Attorney General for clarification of the Commission's status and obligations as "an agency of North Carolina" and its authority to enter into a Memorandum of Understanding with North Carolina's Northeast Partnership, Inc., a private, non-profit corporation. A copy of this request is attached hereto.

9. THE COMMISSION AND PARTNERSHIP BOARDS OF DIRECTORS HAVE NOT PROVIDED ADEQUATE OVERSIGHT

The Commission and Partnership Boards of Directors have not sufficiently exercised their fiduciary responsibilities to monitor operations and ensure funds are used in the most effective and efficient manner in furtherance of economic development in the region. We saw very little evidence of in-depth discussion or very little action taken in regards to some major outlays and operational issues, some of which have become controversial. The Boards have relinquished too much authority and responsibility to their executive committees. While some matters are appropriate for an executive committee, others should not be delegated. We believe the following items, some of which have previously been discussed, represent areas in which the Boards have been slow to act or not acted on at all:

- We believe the Boards have not sufficiently acted nor responded in a timely manner to some highly publicized and controversial matters, in particular, the status of the Organization's president and his future employment plans with a client;⁵
- There is very little evidence that board members were aware of or considered the details of the Organization's contractor agreements, the outlays for which approached \$889,000 over the three year audit period;
- Amounts paid to independent contractors are large. However, the Boards have not established a process that would ensure the selection of the most qualified candidates at the best prices;

⁵ See audit finding 1 for discussion of events that took place subsequent to completion of fieldwork on this audit.

FINDINGS AND RECOMMENDATIONS

- The Boards did not involve themselves in a detail analysis and discussion of bonus payments to employees and others, another significant expenditure item; and
- There is no evidence that the Boards recognized the possible difficulty and the impact on finances from unfavorably formulated contract terms⁶ – a problem which would arise were the Organization faced with non-performance of a key employee or contractor.

The failure of the Boards to properly act in a timely manner regarding major issues confronting the Organization could adversely affect the Organization, as it could jeopardize funding, diminish confidence of the State and its citizens, diminish the willingness of corporate entities to associate with an organization embroiled in controversy, and ultimately hurt the Organization's goal to improve the economic conditions of the region.

Recommendation: Each board member should be provided detailed information about Organization expenditures and operations, such as salaries, bonus payments, contract terms and agreements, as well as contractor selection and performance. Each board member has the responsibility and fiduciary duty to engage in active consideration of these and other significant issues of Organization operations. The Board's exercise of its oversight responsibilities provides some of the checks and balances needed to better ensure prudent spending of funds.

Organization's Response: We recognize the importance of Board understanding and support of the activities of the Organization in improvement of economic conditions of the Region. Boards will be provided full and detailed information regarding expenditures, operations, salaries, performance compensation, and employee and contractor selection/performance for the Organization. The Organization has always maintained an open-door policy for Board Members with any and all information available to Members at anytime.

⁶ As discussed in findings 1 and 4, the Organization paid the president the equivalent of his annual salary upon agreement to terminate his employment with the organization.

APPENDICES

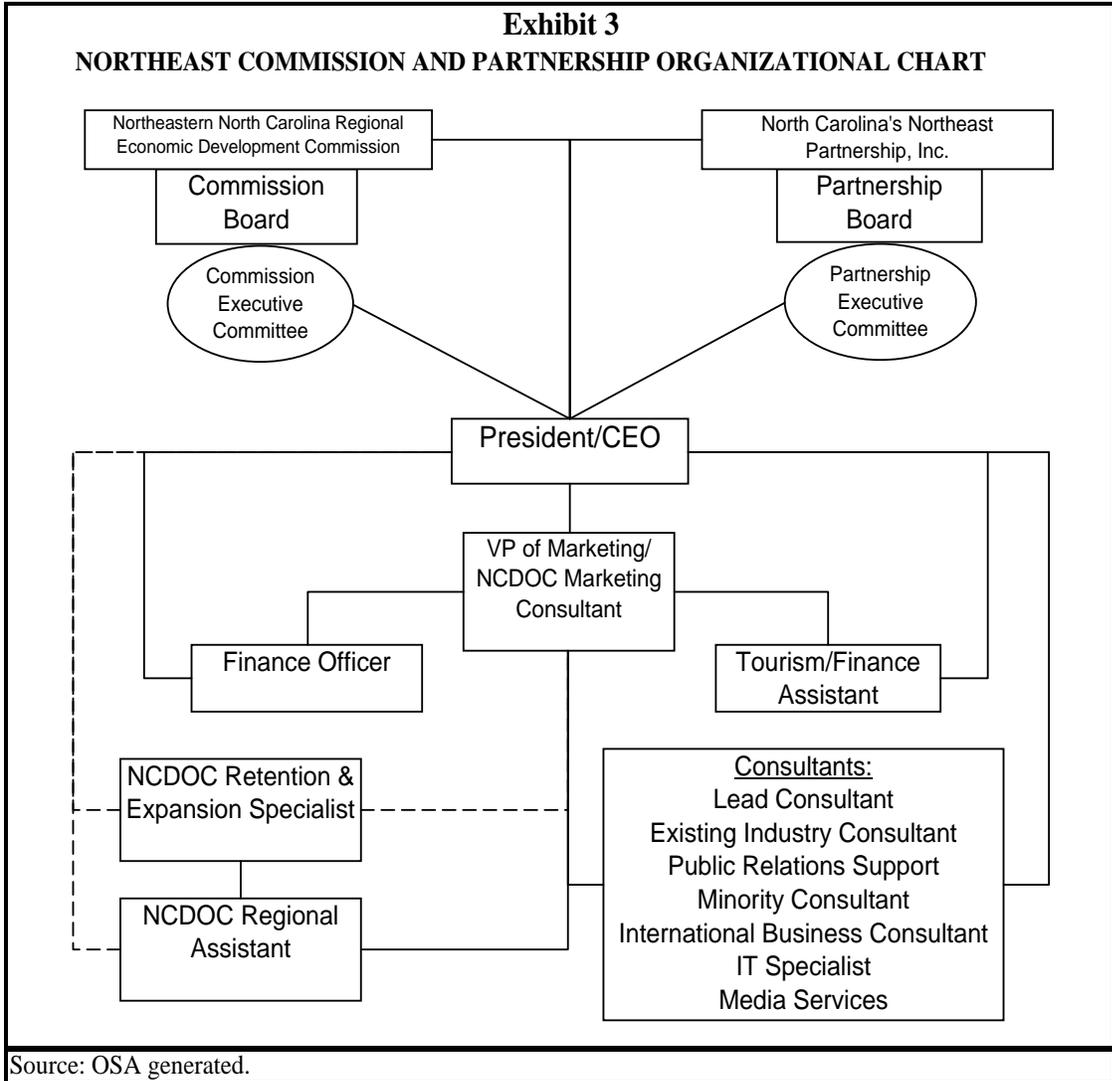
ADMINISTRATIVE STRUCTURE

The Northeastern North Carolina Regional Economic Development Commission was established by the General Assembly to serve the northeastern region. Its Board is made up of nineteen members who are the Secretary of Commerce or his designee and appointments by the Governor, the Speaker of the House, and the President Pro Tempore. The Commission receives the yearly allocation of State funds provided to the northeastern region for economic development. North Carolina's Northeast Partnership, Inc. is given a large percentage of the funds and operates under a memorandum of understanding on behalf of the Commission to carry out the economic development efforts for the region. The Commission's executive committee is given financial and funding decision-making responsibility. Decisions made by the executive committee are reviewed and voted on by the Commission's Board.

The Partnership's Board includes the chair and treasurer of the Commission, the president, the immediate past commission chair, four chairs from the Partnership's sub-committees or related entities, and three at large directors that are chosen by the president. The Partnership also has an executive committee that has the primary responsibility for financial and funding decision-making. Decisions by the Partnership's Board may be passed on to the Commission if required. Most decisions by the Partnership Board do not require further approval.

The president serves as president for both the Commission and the Partnership. The president supervises or leads most of the decision-making efforts within the Commission and the Partnership, especially matters concerning financial data and compensation. The Commission's and Partnership's executive committees typically review major financial decisions.

APPENDICES



APPENDICES

BUDGETING AND FUNDING

State allocations are issued to the Commission and the Commission provides a portion of the funds to the Partnership to carry out its mission in economic development. The State allocations received by the Commission and Partnership for the last three fiscal years are shown in the exhibit below.

The Partnership also receives some private funding through North Carolina's Northeast Committee of 1000, Inc. and North Carolina's Northeast Economic Foundation, Inc., two affiliated non-profit corporations, by way of the same type of memorandum of understanding that it has with the Commission. Other sources of funding include other government grants along with private and miscellaneous types of income.

Type of Funds	Fiscal Year 2004-2005	% of Fund to Total Funds	Fiscal Year 2003-2004	% of Fund to Total Funds	Fiscal Year 2002-2003	% of Fund to Total Funds
State Allocation Granted to the Commission	1,269,368		1,443,557		1,341,845	
Funds to Partnership						
State Allocation Passed from the Commission to the Partnership	1,494,096	66%	1,250,000	70%	1,336,338	69%
Other Government Grants	600,801	26%	410,285	23%	558,124	29%
Private Funding	150,000	7%	106,000	6%	0	0%
Miscellaneous Income (Interest, sales tax refunds, etc.)	20,442	1%	10,734	1%	40,474	2%
Total Funds to Partnership	2,265,339		1,777,019		1,934,936	
Source: Northeastern North Carolina Regional Economic Development Commission and North Carolina's Northeast Partnership, Inc.						



April 7, 2006

Mr. Leslie W. Merritt, Jr., CPA, CFP
State Auditor
Office of the State Auditor
2 South Salisbury Street
Raleigh, NC 27699

RE: Response to March 2006 Performance Audit of Northeastern North Carolina Regional Economic Development Commission and North Carolina's Northeast Partnership, Inc.

Dear Mr. Merritt:

Thank you for the opportunity to respond to the Confidential Draft of the Performance Audit of the Northeastern North Carolina Regional Economic Development Commission and North Carolina's Northeast Partnership, Inc. We have moved quickly to address the findings and recommendations of the State Auditor's office and a special Oversight Committee has been created to assist the Boards in reviewing and responding to the Report, as well as developing long-term solutions and actions that will ensure efficient and effective use of State resources in support of economic development in North Carolina's Northeast Region.

As this is a Performance Audit, we feel strongly that the tremendous accomplishments of the Commission and Partnership should be included in this Audit Report. We would like to reiterate the successes of the Commission and Partnership in the past ten years in meeting its mission to "improve the standard of living for citizens in North Carolina's Northeast Region." Specifically, we would like to point out the following achievements by the Organization since 1996

- Named as one of the "Top 10 Economic Development Organizations" in the United States and Canada by *Site Selection Magazine*.
- The activities and initiatives of the Organization have supported the creation of over \$3.7 billion in new and expanding business/industry investment and over 18,000 new jobs in North Carolina's Northeast Region.
- The activities and initiatives of the Organization have supported a 59% increase in tourism revenues for North Carolina's Northeast Region.
- Identified over \$112 million in federal, state and private grant funds to support economic and tourism development in North Carolina's Northeast Region.
- Supported value-added economic development as follows:
 - Every \$1 of Commission/Partnership funds spent generated \$313.82 in new investment
 - Every \$1 of Commission/Partnership funds spent generated \$693.31 in tourism revenues

The Boards of the Commission and Partnership have always worked in the spirit of the State Auditor's recommendations. We appreciate these recommendations, as we believe the Organization's actions in response to them will only strengthen our ability to meet our goals and objectives and better serve the economic development needs of the Northeast Region.

NORTHEASTERN NORTH CAROLINA REGIONAL ECONOMIC DEVELOPMENT COMMISSION
NORTH CAROLINA'S NORTHEAST PARTNERSHIP, INC.

119 West Water Street - Edenton, NC 27932 – Toll Free 888-872-8562 – Fax 252-482-3366

E-Mail: info@ncnortheast.com - Web Page: www.ncnortheast.com and www.visitncne.com

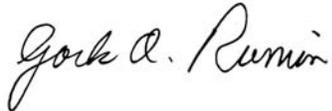
Mr. Leslie W. Merritt, Jr.

April 7, 2006

Page 2

After reviewing our responses, please do not hesitate to contact us if you have any questions or require additional information.

Sincerely,

A handwritten signature in cursive script that reads "Jack A. Runion". The signature is written in black ink and is positioned below the word "Sincerely,".

Jack A. Runion
Chairman

Regional Accomplishments Since 1996
**Northeastern North Carolina Regional Economic
Development Commission**
North Carolina's Northeast Partnership, Inc.



- In 1998, Site Selection Magazine named North Carolina's Northeast Partnership as one of the "Top 10 Economic Development Organizations" in the United States and Canada. Site Selection Magazine hailed North Carolina's Northeast Partnership for its "value-added" services and programs to benefit prospective new firms and existing companies, as well as economic development leadership, problem solving innovation and cooperation."
- Provided representation to counties in tourism and economic development efforts and initiatives where there is no full-time staff person to ensure that opportunities for these counties are not missed.
- Developed combined marketing strategies and priorities for regional economic development which highlights business recruitment and expansion, tourism and retirement opportunities.
- Provided assistance and technical support in the development of four new industrial parks and four new shell industrial buildings.
- Provided staff assistance and technical support in the formation of the US Highway 158 Corridor Development Association to spearhead the multi-laning of the 158 corridor.
- Provided assistance and support to the multi-laning efforts for US Highway 17 underway cooperatively between North Carolina and Virginia.
- Provided technical support and assistance to the sixteen counties in documenting and cataloguing heritage tourism resources.
- Provided technical support and staff assistance in the organization of the Northeast Film Advisory Board to promote increased opportunity for major film production in the Region.
- Provided computer technology support and multimedia enhancements for the 16-county economic development and tourism offices.
- Developed the capacity to implement computerized marketing including weekly updates of regional calendar of events, sites and buildings and other marketing materials, including web site enhancement and updating.
- Developed state of the art client tracking database
- Established the Northeast Committee of 1000, Inc., made up of business and community leaders in Northeast North Carolina which private funding for tourism and economic development efforts.
- Supported and participation in nine (11) job fairs to assist new and expanding companies in the recruitment of workers.

- Supported the location of a major mega project, Nucor Steel: \$425 million investment; 350 jobs (announced investment)
- With private funding support, held “Northeast Showcase” events in 1996 (Perquimans County), 1998 (Beaufort County) and 2000 (Halifax County) to showcase North Carolina’s Northeast to business and industry representatives and tourism development professionals.
- Worked closely with the Albemarle Pamlico Energy Corporation (APEC) in their work toward construction of natural gas lines to serve fourteen unserved Eastern North Carolina counties as well as the construction of fiber optic conduit along the route of natural gas lines constructed
- Working with Sprint, expedited the deployment of DSL Broadband Internet Service to the Northeast Region.
- Worked collaboratively with the Martin County Economic Development Corporation and the Town of Williamston, the Education & Training Task Force, and assisted in the development of the Northeast Technology & Business Center, one of five telecenters funded by the NC Rural Internet Access Authority.
- Continued partnership with the North Carolina Department of Commerce in the Internet-based buildings and sites database, NCSITSEARCH. Partnership staff maintains the information on available buildings and industrial sites in the Northeast Region. Additionally, the Northeast Partnership maintains its complete inventory of available buildings and sites at www.ncnortheast.com.
- Installed state-of-the-art videoconferencing equipment enabling both domestic and international videoconferences.
- Supported the nominations of several winning NC Economic Developers Association (NCEDA) Service Awards:
 - Economic Developers of the Year: Bill Early (Hertford County) & Gary Brown (Northampton County); Johnnie Rogers
 - Allies of the Year: Ben Berry (Gateway Bank & Trust), Brenda Daniels, Electricities; and Jon Hamm, Sprint
 - Volunteers of the Year: Stan Crowe (Martin County); Fred Yates (Mayor of Winfall), R.V. Owens (Outer Banks), and Bob Spivey (Windsor/Bertie County)
- Implemented regional business and industry services program to reach out to existing business and industry in our sixteen-county region. Each and every major employer in the County will be visited by Partnership representatives, in collaboration with the local economic developer and Commerce’s Regional Existing Industry Representative to make sure these businesses have knowledge of and access to the same level of support and services that are used to recruit new business to this region.

- With funding from Elizabeth City State University and our economic development allies, supported the certification of seven “Certified Industrial Sites” in 2004. These sites are locally-owned and controlled properties where environmental and geotechnical studies and other analyses have been completed to document the properties are “ready-to-build.” Six additional sites are underway.
- Spearheaded the introduction of HR 2925 for designation of Northeast North Carolina as a National Heritage Area.
- Since 1996, the Partnership’s efforts have supported the creation of over 18,000 new jobs and over \$3.7 billion in new and expanding industry investment in Northeast North Carolina.
- Since 1996, the Partnership’s efforts have supported a 59% increase in tourism revenues for Northeast North Carolina and a 27% increase in tourism-related jobs..
- Since 1996, the Partnership’s efforts have secured over \$112 million in state, federal, private and other grant and loan programs to support economic development
- Spearheaded development of regional tourism web portal
- Spearheaded development of a regional buyer-supplier network to provide an avenue for businesses in Northeast North Carolina to do business with each other
- Established a minority business assistance program to support the growth and development of minority businesses in North Carolina’s Northeast Region
- Completed a Regional Economic Development Vision plan to guide the region’s economic development activities over the next five years and continued business cluster development
- Worked collaboratively with Northampton County for location of Advanced Vehicle Research Center, an automotive proving ground and vehicle test track, to be located near Interstate 95. The NC General Assembly approved \$7.5 million for this project in 2005 and Golden LEAF has awarded \$1 million for construction of the test track
- Worked collaboratively with the City of Roanoke Rapids in developing a world-class tourist destination in Halifax County –Carolina Crossroads Music & Entertainment District, which represents a potential 250+ million investment and over 2,500 new jobs for Phase I
- Development of a biotechnology and life sciences business development initiative for the Region

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