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March 9, 2007

Honorable Mayor and Members of the
City Council
City of Memphis
125 Main Street
Memphis, TN 38103

Ladies and Gentlemen:

We have completed our investigative audit of selected records of the Memphis Intermodal Transit Facility. The purpose of the investigative audit was to (1) assist the District Attorney General in his inquiry, (2) evaluate the internal controls in place, and (3) determine the extent of the entity's compliance with grant agreements as well as with certain laws and regulations.

Our review consisted primarily of making inquiries, examining selected documents and financial records, and performing tests and other procedures as deemed necessary.

Background

In 2001, the City of Memphis and Shelby County began the formal process of attracting a National Basketball Association (NBA) team to Memphis by forming a not-for-profit entity, the New Memphis Arena Public Building Authority (PBA). The PBA was to oversee the development and construction of a basketball arena facility that met the minimum standards set out by the NBA. Those minimum standards included an adjacent parking garage. The arena project to construct what is now the FedEx Forum was primarily funded through a bond issue. However, former Governor Don Sunquist's administration also committed to provide funding for the construction of the sports facility in Memphis. Federal Highway Administration (FHWA), Tennessee Department of Transportation (TDOT) and local officials crafted a \$20,000,000 federally funded mass transit project. The primary element of the project was an "intermodal transfer facility" (ITF) which was essentially a public parking garage. When combined with other associated components in accordance with a detailed parking plan, the project would

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theoretically support and encourage mass transit use. Because the recipient of these particular federal funds had to be a government with mass transit capabilities, neither the PBA, nor Shelby County qualified¹, leaving the City of Memphis as the only eligible recipient of the grant funds. Ultimately, the city agreed to “construct and operate ... an intermodal transfer facility,” to promote transit use and also serve as NBA-mandated improvements for the FedEx Forum project. According to an e-mail from the former city attorney, the grant was to be administered by the city attorney’s office.

To satisfy requirements of FWHA, PBA officials enlisted the support of the Memphis Area Transit Authority (MATA). MATA officials to that point had not been involved in the selection of the location or the planning and design of the parking garage. However, they submitted a Transit Operations Plan proposing how MATA would utilize the structure.

The federal grant ultimately paid for a parking garage, the relocation of a state road, the reconstruction of another road², an entry plaza³, construction of a bus marshaling area⁴, and a MATA ticket office⁵. The project was completed in October 2004.

Following an investigation by his internal audit division, TDOT Commissioner Nicely informed Memphis Mayor Herenton in a letter dated June 1, 2006, that FHWA had determined that the parking garage as constructed and operated was ineligible for federal funding as an intermodal transfer facility. All federal funds were removed from the project and replaced with state funds. As a result, the requirements that attached to the project due to the federal funding no longer applied. Also, as a result of the internal audit, TDOT recovered \$6,277,141 from Memphis in ineligible project costs and terminated the grant agreement.

¹The PBA was not a government, and Shelby County had no transit operations.

²The reconstructed road was Beale Street Alley. MATA’s Transit Operations Plan declared that about 74 buses per day would use this road. However, MATA officials acknowledged to auditors that the road was too narrow for regular bus traffic. Therefore, MATA runs no bus routes through Beale Street Alley.

³This served as an entry plaza for the FedEx Forum arena. Without bus routes on Beale Street Alley, the justification for including this component in a transit project is unclear.

⁴This area was never actually used as a bus marshaling area. Instead, the area is utilized for restricted and special use parking for the FedEx Forum.

⁵MATA officials told auditors that, in a meeting with Grizzlies representatives on August 26, 2005, they were told that 1) all parking spaces had been sold, 2) the operating agreement with the city and county did not mention either MATA or intermodal parking, and 3) MATA would be required to enter into a lease agreement that included upkeep costs, such as insurance, janitorial and employee parking. MATA officials told auditors that they had understood the office space and parking was to be made available at no cost. MATA never occupied this space.

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There were several factors that contributed to the ultimate failure by the city to comply with the grant agreement⁶:

Incompatible contract elements

The City of Memphis entered into two agreements that were incompatible – each contract could not be fulfilled without potentially breaching the other. The first agreement (operating agreement) entered into on June 29, 2001, between the City of Memphis, Shelby County, and HOOPS, LP (owners of the Grizzlies NBA team), guaranteed to HOOPS all revenue from HOOPS use of the as yet built arena complex, including the parking garage. In addition, that agreement gave to HOOPS naming rights and any associated revenue for the arena and parking facility. The operating agreement clearly did not contemplate a governmental use of the parking garage.

On October 30, 2002, the City of Memphis entered into a grant agreement with the State of Tennessee to construct and operate an intermodal transfer facility and parking garage on the arena site. The grant contract required that, once the garage was built, the city and TDOT enter into an operating agreement. However, as noted previously, the city had already guaranteed the use and revenue privileges of the parking garage to HOOPS, LP. Therefore, by entering into this contract with the state, city officials established and become party to conflicting contracts. The city could not fulfill the terms of one contract without potentially breaching the other.

Failure to adequately oversee applicable construction aspects of the project

The City of Memphis failed to adequately oversee the construction aspects of the federally funded portion of this parking garage project. Oversight for the overall arena project was competently and efficiently provided by the PBA. However, the contract with TDOT made the City of Memphis responsible for the construction and operation of the intermodal transfer facility. The city failed to assume project oversight responsibilities for that applicable portion.

Failure to ensure compliance with the grant contract or the intermodal transfer facility operations plan

City officials did not ensure compliance with the grant contract or other agreements entered into in order to secure the grant. The grant contract between the city and TDOT indicated that the city was to build and operate an intermodal transfer facility. According to notes of meetings between PBA, TDOT, and FHWA officials, a critical step in qualifying for federal

⁶Although the Tennessee Department of Transportation apparently failed to adequately monitor and enforce compliance with the grant agreement, city officials are not absolved of their responsibility to ensure city compliance.

funds was to demonstrate the eventual operation of the project through the development of a parking plan. The PBA retained a consulting firm, Walker Parking Consultants, to formulate a detailed parking plan that met the approval of federal officials. That plan stated, "The goal of the ITF is to promote transit usage in the downtown area by giving preference in parking facility use to transit users." The plan goes on to describe various aspects of the operation of the public-owned parking facility, including both designated parking areas and free parking for transit users. Based on various draft copies of the plan, it appeared that the plan was tailored to gain approval of the project from federal officials and thereby obtain the related federal funding. Although the project was completed in October 2004, city officials failed to make any productive effort to fulfill the promises made in the parking plan. Although the physical structure was built, the operational phase was never initiated. As a result, the project failed to meet the grant requirements.

The city's failure to comply with the requirements of the \$20,000,000 grant contract apparently went unnoticed by both city and state officials until April 2005, when representatives of FHWA began questioning certain aspects of the project.

Recommendations

Based on the results of our investigative audit, we have developed the following recommendations:

- **Prior to acceptance of a prospective grant, require that the city attorney's office certify that there are no preexisting contracts that would cause a conflict.** Prior to accepting future grants, have the city attorney's office sign off that there are no preexisting contracts or covenants that would prevent or hinder compliance with the grant.
- **During the grant period, assign oversight of the grant to an appropriate city division.** Grants which the city is a party to must have city supervision, even in cases such as this in which the project is being administered by a third party.
- **During and after the grant period, monitor compliance with the grant agreement using a designated independent compliance officer.** The compliance officer should not have supervising responsibilities for the project. They should be independent of the initiation, performance, or completion of the grant.

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City officials should take immediate corrective action to reduce the risk that future grants awarded to the city must be repaid. In addition, city officials should consult their city attorney's office to identify what remedial action, if any, should be taken.

Very truly yours,

A handwritten signature in black ink, appearing to read "Dennis F. Dycus". The signature is fluid and cursive, with a large initial "D" and "F".

Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

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