REPORT TO

UTAH STATE LEGISLATURE

Report No. 98-03

A Performance Audit
of the
Utah Technology Finance Corporation

June 1998

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Digest of a
Performance Audit of the
Utah Technology Finance Corporation

Questions regarding mission compliance and the adequacy of existing controls resulted in the Legislature requesting this audit of the Utah Technology Finance Corporation (UTFC). UTFC, created in 1983 by the Utah Legislature, has defined goals in the **Utah Code**. The organization has sought to identify its purpose and the means to measure its effectiveness within the written definition of the **Utah Code**. We believe this to be inherently difficult given the mission as stated by the Legislature as well as the Legislature's informal directive to become self-sufficient. In our opinion, the mission and this informal directive result in conflicting goals for UTFC---to be self-sufficient and to support high-risk, start-up businesses. UTFC has attempted to address both goals. Despite these attempts, UTFC remains dependent on continued state financial support. Further, a broadening of their mission interpretation may be pulling UTFC away from high-risk, start-up companies. In addition to what appears to be conflicting UTFC goals are UTFC's problems with insufficient oversight by its board and non-compliance with some internal administrative controls.

UTFC's Effectiveness May Be Declining. The effectiveness of UTFC to meet its original legislative purpose appears to be declining in selected measures of industry performance. In our 1993 audit report on UTFC, we expressed concern that UTFC was beginning to take an approach that was moving it away from its legislative purpose of providing early-stage capital to high technology companies. We believe UTFC may be continuing to lose sight of these primary aspects of its original legislative mission. We continue to be concerned with UTFC's movement away from early-stage business aid and add to that concern the possibility that UTFC is moving away from funding high-technology companies. This movement away from primary aspects of UTFC's legislative mission means that UTFC's current practices may not be addressing UTFC's goals as originally set and understood by the Legislature. Finally, UTFC's cost efficiency appears to be declining. As a result, the cost per loan in fiscal year 1997 was $26,590 while in fiscal year 1994 the cost per loan was $14,001.

Some Controls Were Not Working Properly at UTFC. UTFC's administrative control systems were not functioning adequately and resulted in approximately $106,000 of additional agency costs between fiscal years 1996 and 1997. UTFC's Executive Committee, which is charged with approving all staff compensation and benefits, may not have been aware of specific employee benefits at UTFC. First, we could not find nor could UTFC provide documentation authorizing certain staff benefits, in particular those offered to the former Executive Director. Second, some members of the Executive Committee do not remember discussing and approving these benefits. As a result, it is possible that UTFC's former Executive Director and some staff received approximately $90,000 of benefits which were not approved by the committee. The Executive Committee was also unaware that some internal policies and procedures had been ignored by the former Executive Director and had cost the organization approximately $16,400. Finally, some administrative processes, such as the employee hiring process, were poorly documented. Upon learning of these weaknesses, UTFC's acting Executive Director and the board took immediate action to rectify the problems.

Investigation of Allegations Yielded Mixed Results. A number of allegations of inappropriate activities have been made concerning UTFC and its former executive director. For example, it was alleged that the former Executive Director performed private consulting work using UTFC time and assets and that UTFC payed for a friend of the former Executive Director to attend conferences. Many of the allegations have some merit and stem from a lapse in controls, either from the organization's policies and procedures or from oversight by the organization's board. We believe that UTFC should work to tighten up its management controls relating to private consulting, travel expenditures, conflicts of interest, board member assets and use of corporate credit cards.

Chapter I
Introduction

Questions regarding mission compliance and the adequacy of existing controls resulted in the Legislature requesting this audit of the Utah Technology Finance Corporation (UTFC). UTFC, created in 1983 by the Utah Legislature, has defined goals in the **Utah Code**. The organization has sought to identify its purpose and the means to measure its effectiveness within the written definition of the **Utah Code**. We believe this to be inherently difficult given the mission as stated by the Legislature as well as the Legislature's informal directive to become self-sufficient. In our opinion, the mission and this informal directive result in conflicting goals for UTFC---to be self-sufficient and to support high-risk, start-up businesses. UTFC has attempted to address both goals. Despite these attempts, UTFC remains dependent on continued state financial support. Further, a broadening of their mission interpretation may be pulling UTFC away from high-risk, start-up companies. In addition to UTFC's mission problem are UTFC's problems with insufficient oversight by its board and non-compliance with some internal administrative controls.

Current UTFC management, unlike past management, does not believe that its legislatively defined goals are in conflict. Rather, UTFC management, with the support of its legal counsel, believes that the organization's mission definition wording allows a broad approach to UTFC operations. Most noticeably, in highlighting loans to situationally innovative businesses rather than solely to high-technology companies. UTFC believes that, because **Utah Code** changes have not been made, the Legislature has given passive approval to UTFC's current direction.

UTFC has received over $18,000,000 of state support since the organization's inception in 1983. On average, $ 1.6 million in support has been appropriated per year since fiscal year 1993; even though UTFC committed to obtaining self-sufficiency after a 1993 legislative audit. Self-sufficiency has not been obtained nor has UTFC presented the Utah Legislature with suggestions for re-codification that would allow self-sufficiency or defined reasons for continued state support. Rather, UTFC has become involved in programs that have been questioned regarding their legality (i.e., the Foundation associated with UTFC) and their possible distancing of the organization from its statutory responsibility.

UTFC is again in a state of change---attempting to address legislative and financial concerns. Programs are being terminated and/or altered; new, more rigid controls are being placed over operations; and, administrative costs are being reduced. These actions were deemed necessary by UTFC's board of trustees who found that administrative costs had dramatically increased in recent years and that a lack of board oversight over UTFC's former executive director's spending and administrative actions had existed in the past.

Issues Have Not Changed Since the 1993 Legislative Audit

UTFC is a substantially different organization today than it was in 1993. Operations have grown as have management controls and corporate policies, but the major issues have not changed. A 1993 audit of UTFC by the Legislative Auditor General identified two difficulties that we believe still exist: (1) meeting the corporation's divergent goals set by the Utah Legislature; and, (2) the difficulty in measuring the effectiveness of UTFC's operations. That audit pointed out that UTFC was only one component of Utah's system supporting emerging technology companies. In addition, success in the growth of technology-based industries was due to the entire system, not just one component. UTFC was founded on an idea that cannot be quantified in real terms but can be supported in abstract terms.

The 1993 audit also found that UTFC had an identity problem after the court ruled it could not take equity positions in the companies it supported. Following the court ruling, UTFC opted to grant funds to companies with the stipulation that the funds be paid back at three times the grant if the product became successful. Left in a near dormant state while awaiting the ruling, UTFC had a limited staff and needed to rely heavily on the expertise of its board of trustees to do much of the work for its grants. Allegations of too much trustee interaction and interference, combined with high losses from unpaid grants, resulted in a change of direction to a staff operated, loan-based program. The 1993 audit found no major problems with the trustee actions but the board was changing from a managing board to an oversight, advisory board, able to make policy but not interfere with daily operations.

At the time of the 1993 audit, state funding made up the majority of UTFC's revenues. However, in fiscal year 1997 state funds were significantly less. Specifically, in fiscal year 1993 state funds accounted for 63 percent of UTFC's revenue; but in fiscal year 1997, state funding accounted for only 50 percent. Figure I shows a historical breakdown of the sources of UTFC's revenues.

Figure I Available UTFC Revenue by Source Fiscal Years 1993-1997					
Fiscal Year	**State Appropriations**	**Federal Grant**	**Interest on Investments**	**Operating Revenue***	**Total**
93	$1,400,000	$ 277,990	$190,715	$ 352,982	**$2,221,687**
94	888,000	508,708	101,650	634,787	**2,133,145**
95	2,047,000	1,049,318	134,038	1,275,158	**4,505,514**
96	1,984,000	1,218,914	218,067	1,174,237	**4,595,218**
97	$2,130,500	738,068	244,675	1,143,306	**4,256,549**

***** Operating revenue is made up of interest and other income from loans, royalties and fee income. In FY97, over 78% of operating revenue was interest income.*

In spite of the fact that state funds provided in fiscal year 1997 were 52 percent higher than those provided in fiscal year 1993, state funding, as a percentage of total revenues, fell in 1997 relative to 1993. This percentage drop is primarily the result of increasing operating revenues and UTFC's increasing emphasis on obtaining federal funds in an effort to achieve self-sufficiency.

UTFC Has Greatly Expanded Its Field of Operations

Because UTFC has aggressively sought federal funding, the number of loan programs administered by UTFC has grown significantly. In fiscal year 1993, UTFC administered six loan programs. By fiscal year 1997, UTFC administered ten loan programs. The following list identifies each loan program and briefly describes it:

- **Phase I Program -** The purpose of this program is to fund technology-based, high growth Utah businesses. Generally, money in this program is loaned for product development. This program is funded entirely with state money.

- **Phase II Program -** The purpose of this program is to fund technology-based, high growth Utah businesses. Money in this program is loaned for market introduction of a recently developed product. This program is funded entirely with state money.

- **Bridge Program -** The purpose of this program is to fund technology-based, high growth Utah businesses. This money is loaned to provide short-term financing based

  on purchase orders or accounts receivable. This program is funded with state money and loan revenues.

- **Utah Revolving Loan Program -** The purpose of this program is to enhance permanent job creation and stimulate private investment in local businesses. This money is loaned for working capital, machinery and equipment acquisition, and inventory maintenance or expansion. Evidence must be presented that this financing will result in the creation of new jobs for local, low-to-moderate income persons. This program is funded with federal, state, and local monies.

- **Participating Loan Program -** The purpose of this program is to provide meritorious companies with working capital. If a small technology-based Utah company has need of working capital but a bank does not consider them completely loan worthy, then UTFC will participate in the loan. This program is funded with bank and state monies.

- **Converted Royalty Program -** The purpose of this program is to convert former UTFC royalties into loans. This program is funded with state money.

- **Micro-loan Program -** The purpose of this program is to assist women, low-income, and minority entrepreneurs in operating successful business concerns and to assist small business concerns in those areas hampered by a lack of credit due to an economic downturn. This money is loaned for fixed assets and working capital. This program is funded with federal money from the Small Business Administration.

- **Rural Loan Program -** The purpose of this program is to provide loans to small businesses in rural areas. Recipients are to use the funds for the establishment of new businesses, the expansion of existing businesses and/or the creation of employment opportunities. This money may not be used for agricultural purposes. The recipients must, to the maximum extent possible, use the labor of low-income persons, farm families, or displaced farm families and, in addition, be innovative in their services and/or products. This program is funded with federal money from the Farmers Home Association.

- **Defense Conversion Loan Program -** The purpose of this program is to help alleviate the problems caused by the downsizing of the defense industry in Box Elder, Davis, Tooele, and Salt Lake counties by assisting businesses and individuals in defense conversion activities. UTFC will make capital available to meritorious businesses that involve displaced defense workers or involve the conversion of business operations to the private sector. This program is funded with federal money.

- **Salt Lake County Revolving Loan Program -** The purpose of this program is to enhance permanent job creation and stimulate private investment in local businesses. Preference is to be given to products or services that are technology-based. Further, evidence must be presented that this financing will result in the creation of additional jobs for local residents. This program is funded by federal money. It should be noted that Salt

Lake County applied for and received these federal monies. UTFC administers the fund for the county.

Primarily, because of the addition of the latter four loan programs listed, significantly more money was loaned to Utah companies in fiscal year 1997. For a historical breakdown by loan program of monies loaned see Figure II.

Figure II
Amount of Dollars Loaned by Loan Category
Fiscal years 1993 - 1997
(,000's omitted)

		Fiscal Year				
Program	**Funding Source**	**93**	**94**	**95**	**96**	**97**
Phase I	State	$ 876	$ 232	$ 150	$ 115	$ -0-
Phase II	State	353	255	75	625	1,100
Converted Royalty	State	123	87	55	-0-	-0-
Bridge	State/Revenue	262	719	1,400	1,900	1,300
Participation	State/Private	583	1,100	1,600	275	588
Utah Revolving	Fed/State/Local	536	447	1,100	375	530
Micro-loan	Federal	n/a	112	260	257	268
Rural	Federal	n/a	n/a	265	577	385
Defense	Federal	n/a	n/a	250	1,900	1,100
Salt Lake Revolving	Federal	n/a	n/a	540	180	265
TOTAL		**$2,700**	**$2,900**	**$5,600**	**$6,200**	**$5,500**

As can be seen, $2.8 million additional dollars was loaned in fiscal year 1997 as compared to fiscal year 1993. On the other hand, the number of loans made did not increase significantly over time. Figure III shows the historical breakdown of the number of loans made in each loan program.

Figure III
Number of UTFC Loans by Loan Category
Fiscal Years 1993 -1997

		Fiscal Year				
Program	**Funding Source**	**93**	**94**	**95**	**96**	**97**
Phase I	State	17	5	2	3	0
Phase II	State	7	4	1	3	7
Converted Royalty	State	2	1	1	0	0
Bridge	State/Revenue	7	7	14	16	13
Participation	State/Private	13	15	15	4	7
Utah Revolving	Fed/State/Local	8	5	9	3	4
Micro-loan	Federal	n/a	7	14	14	12
Rural	Federal	n/a	n/a	4	6	3
Defense	Federal	n/a	n/a	2	11	9
Salt Lake Revolving	Federal	n/a	n/a	4	3	3
TOTAL		**54**	**44**	**66**	**63**	**58**

Although the number of loans made in fiscal year 1997 was not significantly different from the number made in fiscal year 1993, the amount of money loaned was. This difference is because the average loan size increased from $50,000 in fiscal year 1993 to $95,000 in fiscal year 1997.

In our opinion, all of these programs appear to be meritorious. However, as can be seen from the program descriptions, not all of these programs focus on emerging, high-technology companies, and this focus is what we believe to be UTFC's primary concern. As a result, it is possible that some of these additional programs, while adding to available loan monies, are pulling UTFC from its primary objective. In addition, it is possible that some of these programs have the potential to overlap, in a small way, with the Industrial Assistance program within the Department of Community and Economic Development. In the 1993 audit, we made a recommendation that UTFC's goals and objectives be re-clarified in statute since we believed that UTFC was beginning to drift from its mission. However, the statute was not re-clarified. We are still concerned that UTFC is drifting from its mission, and we still believe that UTFC's goals and objectives need to be re-clarified.

UTFC's current direction has lead to what appear to be more stable loans in a variety of different loan arenas. The diversity of these loans (see Figure III) may allow for greater self-sufficiency but do appear to drift from UTFC's original leaning toward high-technology business-aid in its Phase I and Phase II loans of 1993. We, unlike current UTFC management, do not believe this change follows original legislative intent.

Audit Scope and Objectives

This audit was requested by President R. Lane Beattie. President Beattie was concerned as to whether UTFC was meeting its mission and was appropriately controlled. Not only did President Beattie want these questions answered, UTFC did as well. UTFC felt its reputation had suffered from the legislative hearings on quasi-governmental organizations. UTFC and its former executive director cooperated fully with the audit.

In addition to the above concerns, we were asked to review three allegations and determine if they had merit. It should be noted that during its history, UTFC has been the subject of many allegations. In fact, the 1993 legislative audit was initiated as a result of allegations of board misconduct which were found to be without merit. Concern over UTFC was further heightened as a result of a misleading answer provided by the former Executive Director to a legislative sub-committee formed to study quasi-governmental organizations. We reviewed the three allegations as well as others which surfaced during the course of the audit. As a result of these concerns, our audit addresses the following questions:

1. Is UTFC effectively meeting its statutory mission?

2. Does UTFC have effective internal controls?

3. Do the allegations made against UTFC have merit?

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Chapter II
UTFC's Effectiveness May be Declining

The effectiveness of the Utah Technology Finance Corporation (UTFC) may be declining along certain measures related to the original legislative purpose. In our 1993 audit report on UTFC, we expressed concern that UTFC was beginning to take an approach that was moving it away from its original legislative purpose---providing early-stage capital to high technology companies. We believe UTFC may be continuing to lose sight of these primary aspects of its original legislative mission. We continue to be concerned with UTFC's movement away from early-stage business aid and add to that concern the possibility that UTFC is moving away from funding high-technology companies. This movement away from primary aspects of UTFC's legislative mission means that UTFC's current practices may not be addressing UTFC's goals as originally set and understood by the Legislature. Finally, UTFC's cost efficiency appears to be declining.

UTFC was created in 1983, a time when Utah was in an economic downturn. During this time there was concern that those graduating from college were moving outside Utah to get better-than-average-paying jobs. As a result, Utah was bearing much of the cost of education without receiving the benefit of increased tax revenue when those graduates became employed in Utah. Further, there was an interest in providing Utah's children the opportunity to make a good living in Utah. As a result, the Legislature was interested in encouraging the growth of better-than-average paying jobs by funding small, start-up and early-stage, high technology companies. UTFC was created to help accomplish this purpose.

UTFC May Be Moving Away From Primary Aspects of its Legislative Mission

UTFC's focus on funding high-technology companies has declined. In addition, the age of companies receiving state funding through UTFC is increasing. As a result, UTFC's focus on start-up and early-stage companies may be declining. UTFC may have moved away from these primary aspects of its mission because of pressure from the Legislature to become self-sufficient and to fund more rural businesses.

Before beginning our analysis of legislative mission adherence, it should be noted that UTFC does not believe that its primary focus was to be on start-up or early stage, high-technology companies. Instead, UTFC believes that it was to focus on any company which had some technological and innovative feature. UTFC believes that all loans which it has given meet UTFC's mission. Further, UTFC recently requested an opinion from its legal counsel regarding the scope of its authorized activities. This opinion reached the following conclusion:

> *Based on the history and the plain language of the enabling act, it is clear that UTFC's primary purpose is to create jobs throughout the state by assisting the development of companies that are most likely to create new jobs. To accomplish that purpose, the [L]egislature gave UTFC broad discretion to determine which companies qualify as technological and innovative and what actions can be taken to provide assistance.*
>
> *Nothing in the pertinent statutes or the legislative history mandates a narrow interpretation of what counts as "technological" and "innovative". On the contrary, such an interpretation would prevent the corporation from fulfilling its purpose outside the Wasatch Front, which would directly conflict with express provisions in the corporation's enabling act. ...To do its job effectively, the corporation must have the discretion to determine what qualifies as technological and innovative on a case by case basis.*
>
> *..., it is our opinion that UTFC is acting in compliance with law whenever it provides any authorized form of financial assistance to any entity that the officers and trustees of the corporation believe in good faith has technological and innovative characteristics and a relatively good likelihood of creating new jobs in the community where it will operate.*

Based on this opinion, it appears to us that UTFC believes, given the broad terms used in the enabling language (small, emerging, developing technological, and innovative) and given the fact that UTFC's board considers these terms when approving UTFC loans, that all loans given by UTFC meet the legislative mission.

While it is possible that the Legislature may share this opinion, we are uncomfortable with this broad definition of UTFC's legislative mission. As a result, we attempted to identify the primary interests to the Legislature at the time UTFC was created. We do believe that this question over legislative intent is noteworthy and indicative of the fact that the statute pertaining to UTFC's mission needs clarification.

To better understand the Legislature's specific intentions regarding UTFC, we reviewed the debate surrounding the creation of UTFC. During the debates it was noted that the Joint Economic Committee of Congress had issued a report stating that Utah was in a good position to attract high-technology industry to the state. High-technology industry was made a priority because the jobs created tended to be comparatively higher-paying. Further, a Depart ment of Commerce study indicated that for every one high-technology job created, eight support jobs were created. Thus, high-technology companies had the potential to create a number of better-than-average paying jobs, exactly what the Legislature was interested in accomplishing. High-technology was also viewed as a labor intensive, clean industry, another positive benefit.

In addition to a focus on high technology, UTFC was also to focus on helping get new companies off the ground. In other words, it appears that the Legislature intended to concentrate on start-up and early-stage companies. It was not the Legislature's intention for UTFC to become another Small Business Administration (SBA) program. Rather, Utah was going to create better-than-average paying jobs by centering on small, start-up and early stage, high technology companies. Based on legislative discussion, it appears that the Legislature's goal was to create another Silicon Valley in Utah. Presentations to the Legislature claimed the following five criteria needed to be met:

- Government had to demonstrate a strong interest in high-technology
- A funding mechanism for high-technology had to exist
- Innovation centers had to exist
- Research parks had to exist
- Technical training had to be available in the state

The Legislature believed that Utah was in a good position but needed to improve in two areas of the established criteria: funding and innovation centers. The Centers of Excellence program was established to meet the innovation center criteria and UTFC was established to meet the funding criteria. In defining UTFC's mission, the **Utah Code** 9-2-704.(2)(a) states that UTFC is to take all action necessary or desirable to encourage and assist in the research, development, promotion, and growth of emerging and developing technological and innovative small businesses throughout Utah. The term "small business" is defined in **Utah Code** 9-2-702.(1) as one which meets the definition as per the United States Small Business Adminis- tration; however, the other terms are not defined in the statute. In addition, UTFC has not formally defined these terms either.

Based on a complete reading of relevant **Utah Code** sections and also from listening to the debates surounding UTFC's formation, we defined emerging and developing businesses as primarily start-up or early-stage businesses and developing technological businesses as primarily high-technology businesses. These definitions were used in our 1993 audit and were not challenged. We do not mean to imply that these definitions are anything more than selected measures for testing UTFC's success in meeting primary aspects of its legislative mission.

It should be mentioned here that UTFC believes that one of the most significant effectiveness measures is the loan default rate. UTFC maintains that companies which are unable to repay loans are probably also unable to pay wages. As a result, these companies probably do not create and maintain jobs. We agree that the loan default rate is an important measure. However, in order for us to make an analysis of this measure, we would have wanted to do a trend analysis using approximately five years of historical default rates. Since UTFC's loan program did not significantly get started until 1992 and since loan terms are generally five years, there was not enough information to make an analysis. As a result, we were unable to report on trends in UTFC's loan default rates. However, we would certainly be interested in doing this analysis in the future.

In the tests of UTFC that we did conduct, we found all the businesses receiving funding to be small, so we have no concerns with the application of this criterion. However, we do have concerns regarding UTFC's effectiveness at addressing emerging businesses in high technology fields.

UTFC's Emphasis on High-Technology, Emerging Businesses Appears to Be Declining

UTFC's efforts at making loans to high-technology companies has declined over time from two perspectives: (1) the percentage of loans made to high technology companies; and , (2) the percentage of loan dollars going to high technology companies. (We also looked at UTFC's efforts from the perspective of the percentage of high technology companies receiving loans. This perspective showed the same trends as the above two, and so we did not report on this additional measure). Both of the above declines are surprising given the substantial growth in high-technology industries since 1992. In addition, the age of companies receiving funding is increasing over time. As a result, UTFC may be losing its focus on the types of companies---high-technology start-up and early-stage---that the Legislature primarily intended to fund.

At the time of our analysis, UTFC did not have in place a working definition of high technology. As a result, it was necessary to develop a definition of high-technology before continuing our testing. We determined that the Bureau of Economic and Business Research (BEBR) had developed such a definition. BEBR's definition has two criteria and a company is identified as high-technology by meeting either. First, a company is considered high- technology if it is involved in software development in Utah. Second, a company is considered high-technology if it devotes three percent or more of its gross revenues to research and development in Utah.

From these criteria, BEBR selected 27 Standard Industry Code (SIC) descriptions that best describe high-technology. Because of the second criteria, BEBR determined the definition of high-technology is not limited to computer-related industry. Examples of other industries BEBR determined to have high technology elements are:

- Agricultural chemicals
- Paints and allied products
- Petroleum refining
- Medical instruments, and

- ♦ Guided missiles and space vehicles

As noted above, UTFC did not have a definition of high-technology at the beginning of this audit so we used BEBR's definition. BEBR's definition is also used by the Department of Workforce Services. Later in the audit, UTFC developed its own high-technology definition which was also deemed reasonable by BEBR.

UTFC's Efforts Towards High-technology Appear in Decline. The percentage of loans made to high-technology companies and the percentage of loan dollars going to high- technology companies have declined. This decline is from both an overall funding source perspective (i.e., federal money, state money, local money) as well as a specific loan funding source perspective (i.e., state money).

Percentage of Loans. The percentage of loans going to high-technology companies has declined. We reviewed all UTFC loan activity, regardless of funding source, of companies within BEBR's identified high-technology SIC's. We determined that high-technology lending decreased from 54 percent in fiscal year 1993 to 39 percent in fiscal year 1997. Since the percentage of loans to high-technology companies has declined, we believe it can be said that UTFC's efforts towards high-technology have declined. This belief is based on the assumption that all loans require the same effort to process. Specifically, it was reported to us that the same amount of effort is used to approve a $75,000 loan as a $175,000 loan. Thus, if one high technology company received three loans, we would consider that as three efforts made for high-technology.

Second, UTFC loan activity involving state money was analyzed by UTFC officials. In fiscal year 1993, UTFC reported that 80 percent of the loans made were to high-technology companies. In fiscal year 1997, UTFC reported that 52 percent of the loans made were to high technology companies. UTFC's analysis differed from ours. Upon seeing our analysis, UTFC officials developed their own definition of high technology. UTFC did not use SIC's in their analysis. Instead, all companies involved in computer software, computer hardware, biomedical technology, laser technology, composite materials, and telecommunications were considered to be high-technology companies. This definition was also deemed appropriate by BEBR. Rather than apply this definition to all loans UTFC had made, UTFC focused on companies which had received state funding. As can be seen, UTFC's own analysis indicates that efforts made toward high-technology companies has declined. Figure IV shows the historical trend for all loans and state-funded loans.

Figure IV
UTFC Loans to Companies Meeting High-Technology Criteria
Fiscal year 1993 - Fiscal year 1997

Year	Percent of All Loans	Percent of "State Funded Only" Loans
1993	54%	80%
1994	48	77
1995	50	73
1996	49	71
1997	39	52

While the two methodologies are different, the conclusion is the same. The efforts made toward high technology appear to be declining. Another way to look at UTFC's efforts is through the percentage of loan dollars going to high-technology companies.

Percentage of Loan Dollars. The percentage of UTFC funding going to high-technology companies has fluctuated since fiscal year 1993 and declined rapidly in fiscal year 1997. In fiscal year 1993, 68 percent of total UTFC loan dollars went to high-technology companies; while in fiscal year 1997, 50 percent of the loan dollars went to high-technology companies.

While the above analysis looked at all UTFC loan funding, including state and federal monies loaned by UTFC, a similar analysis was also done focusing on state-funded UTFC loans. Based on the analysis done by UTFC loan officials, 82 percent of the state money loaned in fiscal year 1993 went to high-technology companies as opposed to 61 percent in fiscal year 1997. Figure V shows these percentages by year.

Figure V
UTFC Funding of High Technology Companies
Fiscal year 1993 - Fiscal year 1997

Year	Percent of Total Loan Funding to High Technology Companies	Percent of State-only Funding to High Technology Companies
1993	68%	82%
1994	65	73
1995	65	77
1996	73	78
1997	50	61

Both methodologies indicate fluctuations followed by a decline in the percentage of loan dollars going to high-technology companies. Thus, from both a loan dollar percentage perspective as well as from a loan percentage perspective, UTFC's efforts towards high technology appear to be declining.

UTFC's Emphasis on Start-Up and Early-Stage Companies May Also be Declining. In addition to focusing on high-technology companies, UTFC's legislative mission also states that UTFC will focus efforts on emerging companies. However, an increasing percentage of older companies are starting to receive funding from UTFC. As a result, UTFC may be losing its focus on the types of companies (start-up and early-stage) that the Legislature primarily intended to be funded.

Start-up and early-stage companies appeared to be primary concerns of the Legislature because companies in these stages were perceived to have few, if any, sources of funding available. Specifically, banks and non-bank lenders generally will not loan to a company until the company has five years of operating history. Further, venture capitalists may not loan during this time frame if the amount of money needed is too small. As a result, an inadequate supply of capital existed for start-up and early-stage companies. Because of this capital gap, UTFC identified the product development stage and the product-to-market-introduction stage as UTFC's primary market segment. Phase I money is used to fund product development, and Phase II money is used to introduce the product to the market. Both Phase I and Phase II loan programs are funded exclusively with state money.

UTFC did not have a definition of a start-up or emerging company. We used company age as our definition since age seems to be a primary component in defining the boundaries of the capital gap. As a result, we used the point at which banks are willing to consider giving a loan (five years) as a general measure of when a company might be coming out of the start-up or emerging phase. In making our assessment, we reviewed Phase I and Phase II loans. In fiscal year 1993 there were 24 Phase I and Phase II loans. We sampled 11 of the companies or 46 percent of the total. In fiscal year 1997, there were seven Phase I and Phase II loans. We reviewed all seven.

In fiscal year 1993, the average age of companies in our sample was 4.7 years while in fiscal year 1997 the average age rose to 9.14 years. Thus, the companies in fiscal year 1993 appeared, on average, to be in the start-up or emerging phase while the companies in fiscal year 1997, on average, appeared to be past the start-up or emerging phase.

In addition to an increasing average age, a smaller percentage of companies were younger than five years while a higher percentage were older than 10 years in fiscal year 1997. In fiscal year 1993, 80 percent of our sample companies were five years or younger while 57 percent were five years or younger in fiscal year 1997. In addition, no companies in our fiscal year 1993 sample were older than 10 years while 29 percent were older than 10 years in fiscal year 1997. In fact, one company was 42 years old.

If the Legislature intended UTFC to focus primarily on start-up or early-stage companies, this data indicates that UTFC may be moving away from that focus. However, UTFC may be moving away from primary aspects of its mission in response to legislative pressure.

Legislative Pressure May Have Initiated UTFC's Movement Away From Mission

For a number of years the Legislature has gone on record as desiring UTFC to become self-sufficient. In so doing, the Legislature may have encouraged UTFC to fund less risky, more stable companies rather than fund the more risky, start-up and emerging companies. In addition, recently the Legislature has informally encouraged UTFC to make more loans to companies in rural areas of the state. Both of these directives may, in part, account for UTFC's movement away from its statutory mission of helping start-up or early-stage, high-technology companies. The Legislature should reconsider specifically what it wants UTFC to accomplish and then amend the statute accordingly.

Pressure to Become Self-Sufficient. In our 1993 audit of UTFC, we reported that the informal directive toward self-sufficiency was in conflict with UTFC's mission of providing funding to high-risk, start-up businesses. As a result, the 1993 audit reported that, in order to become self-sustaining, UTFC was beginning to fund more stable companies and was moving away from making higher-risk investments to legislatively mandated high-technology businesses. We believe this trend is continuing.

In addition, we believe the goal of becoming self-sustaining may be a difficult one for UTFC to achieve. In 1993 we reported that we were unable to find a state-supported, self-sustaining organization which engaged exclusively in high risk, debt financing. The goal of becoming self-sustaining is perhaps more easily realized with equity financing. Since UTFC has been challenged on the legality of taking an equity position in companies, it must become self-sustaining using debt financing. Thus, as we reported in 1993, UTFC may be pressured into funding more stable companies which are more likely to repay their loans. In addition, we believe that UTFC faces pressure to maximize the amount of money loaned out at any given period of time. This pressure may conflict with the statutory requirement to be discriminating as to what types of companies may qualify for funding.

As a result of this latter pressure, UTFC may have broadened the criteria for qualifying companies. Of particular concern is the appearance that UTFC does not require all four conditions (small, emerging, high technology and innovative) to be present for a company to be considered for a loan. Using UTFC's own analysis, only 52 percent of the companies receiving state funding in fiscal year 1997 were high-technology companies. The remaining 48 percent were granted loans apparently based on the remaining three criteria. By not requiring all the criteria to be met, UTFC may not be focusing on what the Legislature intended.

In addition to broadening the criteria, UTFC also appears to have broad definitions of key words. For example, a 42-year-old fur ranch was identified to us as a start-up company. The reason given was that UTFC financing was used to restart the business after it had suffered the loss of its mink stock from disease. It should be noted that loss of stock from disease is not an uncommon problem in the mink industry, and agricultural loans are available to deal with this problem. This interpretation is very broad for the term "start-up" and may not follow legislative intent for the program. As another example, a seven-year-old company was described to us as an early-stage company because this company was in the process of changing its business model from one relying on government research grants to one producing and selling its product commercially. It is not uncommon for companies to refocus or redefine their markets and by so doing these companies do not start over financially. UTFC's broad interpretation of the term "early-stage" may not follow legislative intent for the program.

By broadening the criteria and key definitions, UTFC appears to have significantly increased the available number of companies qualifying for UTFC financial support. The more companies that can qualify for loans, the more loan money UTFC can put out and the greater the chance that UTFC can become self-sufficient. However, UTFC may be sacrificing legislative mission focus for self-sufficiency.

Pressure to Loan in Rural Areas. In addition to the pressure to become self-sufficient, UTFC has, in recent years, felt informal political pressure to increase loans to companies in rural areas. UTFC has complied with this informal directive; however, this compliance has sometimes been at the expense of UTFC's legislative mission. For example, in our sample we identified two fiscal year 1997 loans to rural areas which did not meet all the statutory criteria laid out in the **Utah Code**. The first loan, cited previously, was to a 42-year-old mink farm. This company received a Phase II loan to purchase new breeding stock after the loss of the old stock from disease. In UTFC's analysis of this loan, UTFC indicated that this company was not high technology nor was it innovative. Further, it is debatable whether it is emerging. However, as noted above, UTFC believes this company to be a start-up company. Regardless of this debate, this company does not meet two of the four criteria. We believe this company was funded because it was in a rural area.

The second loan, also a Phase II loan, was to a ten-year-old holding company. Among its holdings was a painting company in Arizona and a family fun center in southern Utah. This company was planning to build another family fun center in Idaho at the time of the loan. In its analysis of this loan, UTFC indicated that there was no technology involved. However, UTFC considered the concept of family fun centers (activities like go-carts, video arcades, golf driving ranges and miniature golf in a single facility) to be innovative. In addition, UTFC considered the company early-stage because the concept of family fun centers was fairly new. While these latter two justifications may be debatable, UTFC did indicate that there was no technology involved. A further concern might be that the project under consideration by this company is out of state. The reason the company was funded was because it was off the Wasatch Front. Further, jobs in real estate development, human resources, and marketing were going to be created.

UTFC may be sacrificing mission focus to comply with the informal directive to fund more companies outside the Wasatch Front. While we do not oppose loans to rural areas, we believe these loans, if governed by UTFC, still have to meet the criteria established in the **Utah Code**. UTFC's legal counsel appears to agree. In his written opinion he states that there is a clear legislative implication that any business receiving assistance from UTFC must have some technological and innovative features.

In addition to our concern regarding UTFC's possible legislative mission drift, we are also concerned that compliance with some of UTFC's directives is potentially at risk under current practices. One of UTFC's primary directives is to increase the number of high technology jobs in Utah. UTFC appears to be moving away from funding high-technology companies and, perhaps as a result, we found the job creation data to be inconclusive. Another of UTFC's directives is to provide capital in lending niches not served by the private lending industry. However, UTFC's possible movement away from funding start-up companies may increase the likelihood of UTFC competing with the private lending industry.

UTFC's Compliance With Directives is Potentially at Risk Under Current Practices

Perhaps as a result of UTFC's decline in focus upon high-technology companies, UTFC's effects on high-technology job growth is inconclusive. In addition, UTFC's changing loan focus may make possible competition with the private lending industry more likely.

UTFC's Impact on High Technology Job Growth is Inconclusive

UTFC was created primarily to encourage job growth. Small and emerging businesses were targeted because the Legislature found that these types of businesses create new employment opportunities at a substantially greater rate than large and mature businesses. High technology companies were targeted because, according to a Department of Commerce study at the time, for every one high-technology job created, eight more jobs are created in the community. In addition, high-technology jobs tend to be better-than-average paying jobs.

Due to a lack of control over variables, we have attempted to measure high-technology job growth at a gross level. In addition, since high-technology jobs were sought because of their high wage rates, we also collected information about wage growth. It must be noted that measuring job creation which is attributable to a single variable (in this case UTFC funding) is extremely problematic. For example, did a UTFC funded company create more jobs than a non-UTFC funded company because of the funding, or because of a stronger marketing team, or a better product? In addition, it was beyond the scope of this audit to determine how many support jobs were created by these additional high-technology jobs.

In conducting this test, we selected a sample of 15 companies (41% of total companies) which had received state funding (i.e., Phase I, Phase II, Participating Loans, and Participating Leases) from UTFC in fiscal year 1993. We selected fiscal year 1993 because we wanted to measure long-term rather than short-term job and wage growth. To get job and wage growth data, we requested the Department of Workforce Services supply 1992 to 1997 employment statistics for the sampled companies. We compared our sample's job and wage growth to the job and wage growth in Utah's small, high-technology market over the same time period. To gather this comparative market data, we again used the Standard Industry Codes (SIC) defined by the Bureau of Business and Economic Research (BEBR) and adopted by the Department of Workforce Services as representative of high-technology industries. In addition, we requested that the Department of Workforce Services report on companies having 300 employees or less. It was our expectation that our sample of companies receiving UTFC's assistance would perform at least as well as the market did in both job and wage growth.

In fact, the market created more jobs than did our sample for the time period under observation. In the market there were 61 percent more high-technology jobs in the third quarter of 1997 than in the third quarter of 1992. This percentage increase equals 11,000 new jobs in the market. In our sample of UTFC loan recipients, there were 42 percent more high-technology jobs in the third quarter of 1997 than in the third quarter of 1992. This percentage increase equals 50 new jobs in our sample. Figure VI identifies cumulative job growth for the market and for UTFC companies.

Figure VI
Job Growth Comparison
(3rd Quarter 1992 - 3rd Quarter 1997)

Year	Number of Jobs (Market)	Percent Change	Number of Jobs (UTFC)	Percent Change
1992	17,969	---	118	---
1993	17,773	(1 .0%)	157	33.0%
1994	17,713	(0 .3)	215	33.9
1995	19,972	12.8	266	23.7
1996	26,476	32.6	250	(6.0)
1997	28,979	9.5	168	(32.9)

While the market had more job growth than our UTFC sample, our sample compared favorably to the market in terms of wage growth. In the market, the average quarterly wages grew from $7,643 in 1992 to $9,676 in 1997, a 27 percent increase. In our UTFC sample, the average quarterly wages grew from $4,706 in 1992 to $9,630, a 105 percent increase. Thus, in this five year period, the wages in our sample increased at such a rate that in 1997 the sample wages became equal to the market wages. Wage increases by year for both the sample and the market are shown in Figure VII.

Figure VII
Quarterly Wage Growth Comparison
(3rd Quarter 1992 - 3rd Quarter 1997)

Year	Market	UTFC Sample
1992	$7,643	$4,706
1993	7,937	5,009
1994	8,328	5,808
1995	8,671	7,659
1996	9,506	8,920
1997	9,676	9,630

In our opinion, this data is inconclusive as to UTFC's impact. On one hand, job growth did not match the market. On the other hand, wage growth was comparable to the market. Whether or not UTFC's impact in the high-technology market meets legislative expectations depends, ultimately, on the Legislature's weighting of job creation and wage growth and whether the Legislature believes that UTFC-funded companies should keep up with the market in terms of job and wage growth.

In addition to creating high-technology jobs, another of UTFC's directives was to do what the private lending industry would not do---specifically, UTFC is to provide capital where the private lending industry will not. Thus, UTFC's activities should not be competing with the private lending industry. It is possible that UTFC's movement away from start-up companies is increasing the likelihood that UTFC may compete with the private lending market.

UTFC's Potential for Competing with the Private Sector May Be Increasing

As UTFC lending focus changes, the potential for competition with the private lending industry may also increase. Specifically, private lenders generally do not lend to start-up companies (companies with less than five years operating history). However, UTFC sometimes loans to companies with more than five years of operating history. In addition, three independent reviewers representing the banking perspective indicated a slight possibility that a small percent of UTFC Phase I and Phase II loans are bankable. We believe that UTFC should provide assurance that its loans do not compete with the private lending industry by requiring lender turn-down letters from loan applicants.

UTFC May Be Increasing the Possibility of Competition With Private Lenders. Private lenders, as a general rule, do not lend to start-up companies. We talked with six private lenders and four stated that they will not lend to a company with less than three to five years of operating history. Two stated that they have occasionally lent to start-up companies but that generally they do not.

Three of the companies contacted were aware of UTFC and indicated that since UTFC funded start-up companies, there was no possibility of competition between them. However, as discussed earlier, the companies receiving UTFC Phase I and Phase II loans are getting older. In fiscal year 1993, 20 percent of the companies receiving Phase I and Phase II loans were older than five years while in fiscal year 1997, 43 percent were older than five years.

Certainly, age is not the sole determinant of a companies ability to obtain a loan from a private lender. However, it is one criterion for which there is a very clear line separating what a private lender will and will not consider. As long as UTFC loans to companies with five years or less of operating history, there is virtually no chance of competition with private lenders. However, once UTFC lends to companies with more than five years of operating history, the possibility of competition with private lenders is increased.

There is a Slight Possibility that Banks Could Make Some UTFC Loans. By looking at the riskiest section of UTFC's loan portfolio, we attempted to determine if some UTFC loans could be made by banks. Even in UTFC's Phase I and Phase II loans, the most problematic of all UTFC activity, a small percentage of these loans has a slight chance of receiving a bank loan.

We had two current loan officers and one banking consultant independently review the same sample of eighteen fiscal year 1993 and fiscal year 1997 Phase I and Phase II loans. All 18 loans were funded entirely with state money. We asked each reviewer to make an assess- ment of each company's ability to qualify for a bank loan at the time the UTFC loan was applied for using the information contained in the UTFC loan files. This task was completed by each reviewer.

It is possible that as much as 6 percent of the Phase I and Phase II loans could have received a bank loan. Specifically, one company in the sample of eighteen was identified by one reviewer as being bankable. It is also possible that no loans are bankable. We asked three reviewers to look at the same sample because we were expecting to see consistency among the reviewers; however, we did not see this. The reviewers did not agree among themselves as to which companies were bankable. Specifically, two reviewers believed that no loans were bankable, while one reviewer believed that one company was bankable. If the latter reviewer is correct, then one, or 6 percent, of the companies reviewed could be bankable.

Although the percentage of projected bankable loans is very small, it still represents a potential for competition with the private lending industry. In addition, the loans reviewed were UTFC's riskiest loans. It is possible that loans made under other UTFC loan programs may have a higher bankability percentage.

Further, it may be the Legislature's belief that no loans involving state money should be bankable. Currently, UTFC does not require proof (i.e., turn-down letters) that a company is not bankable. Depending on the Legislature's belief, UTFC may want to require turn-down letters from companies applying for financing.

In summary, we believe that UTFC may have moved away from some primary aspects of its original mission. As a result, UTFC may not be having the expected market impact and may be increasing the potential for competition with the private lending industry. In addition, UTFC's efficiency may also be declining.

UTFC's Cost Efficiency May Be Declining

UTFC's operating expenses have increased significantly since 1994, while the number of loans made has increased only moderately. As a result, the cost per loan made in fiscal year 1997 was $26,590 while in fiscal year 1994 the cost per loan made was $14,001. In particular, full-time employees and, correspondingly, their total salary costs have increased at a faster rate than have increases in the number of loans made. Increases in programs not directly related to producing loans are one reason UTFC's salary costs have grown disproportionally to yearly loans made. UTFC's present executive director agrees that UTFC's salary costs are too high and has developed a personnel restructuring plan which is estimated to save $275,000 annually. In addition to increasing operating costs, UTFC's productivity appears to have declined.

UTFC's Operating Expenses Have Increased Significantly

UTFC's operating expenses have increased 150 percent since 1994. However, loans made per year have increased by only 32 percent during this time period. As a result, the cost per loan made is significantly higher in 1997 than in 1994. We should note that UTFC believes that an accurate comparison can only be made by using 1988, the beginning of UTFC's grant program, as a starting point. We do not believe it is appropriate to compare a grant program to a loan program. As a result, we did no analysis with a starting point past 1992, the beginning of UTFC's loan program. For a historical expense and loan activity comparison, see Figure IX.

Figure IX
Historical Comparison of Operating Expense and Loan Activity
Fiscal year 1994 - Fiscal year 1997

Year	Operating Costs	Number of Loans	Cost per Loan
1994	$ 616,025	44	$ 14,001
1995	1,016,605	66	15,403
1996	1,333,596	63	21,168
1997	1,542,246	58	26,590

A significant portion of operating expense is salary cost. In fact, in 1997, 65 percent of the operating expense was salary cost. Since 1994, salary expense has increased 177 percent, and the number of full-time employees has increased 149 percent. Again, however, the number of loans made per year has only increased 32 percent during this same time period. Figure X shows a historical comparison between the number of employees and their resulting salary expense and the number of loans.

Figure X
Historical Comparison of Employees to Loan Activity
Fiscal year 1994 - Fiscal year 1997

Year	Salary Expense	FTE's	Number of Loans	Loans per FTE's
1994	$ 364,801	9.67	44	4.55
1995	703,748	19.17	66	3.44
1996	864,688	25.29	63	2.49
1997	1,009,155	24.11	58	2.41

According to the current Executive Director, one reason for high overhead costs are increasing costs which are not directly related to making loans. At UTFC, many programs and projects have been added which do not directly affect loans made. Some examples of these programs and projects are: (1) the Market Research Center which does marketing analysis for small, start-up businesses; (2) the Export Import Bank program which helps companies secure financing if they need to export their product to expand their market; (3) the Private Placement project which provides information to companies on how to secure other forms of financing; and, (4) various UTFC Foundation projects which have generally addressed the constitutional concerns surrounding the foundation.

Another reason for the increase in overhead is the increase in the number of loan programs. In fiscal year 1993, UTFC had six different loan programs. In fiscal year 1997, UTFC has ten different loan programs. While these additional programs required increased overhead, they do not appear to have generated enough loans to compensate for the increased overhead. In other words, the cost per loan has continued to increase.

The current Executive Director agrees that some UTFC programs are not specifically focused on UTFC's mission. In addition, he further agrees that UTFC has too many staff. As a result, the current Executive Director has revised UTFC's staffing plan and is in the process of implementing. UTFC estimates that this implementation will save UTFC approximately $275,000 in salary costs a year. A $275,000 cost reduction would have reduced the fiscal year 1997 operating costs per loan to $21,849. We believe that this is a good first step. In addition, we also believe that UTFC should look at loan officer productivity and determine what steps need to be taken there.

UTFC's Productivity Is Declining

Loan officer productivity appears to be declining at UTFC. Since 1994, the number of full-time employees devoted specifically to making loans has increased 141 percent. However, the average number of loans maintained per loan officer has declined 17.5 percent while the number of new loans made per officer has declined 45.6 percent. These historical comparisons are shown in Figure XI.

Figure XI Historical Comparison of Loan Productivity Fiscal year 1993 - Fiscal year 1997			
Year	**Loan Officers (FTE's)**	**Average Loans Maintained per FTE**	**Average New Loans per FTE**
1993	3.00	23.7	17.7
1994	2.75	24.0	16.0
1995	4.47	23.0	14.8
1996	6.04	19.4	10.4
1997	6.63	19.8	8.7

As can be seen, the productivity of the loan officers has dropped during the past five years. In addition, the number of loans maintained by UTFC loan officers is low when compared to loans maintained by loan officers in private banks. The lowest average number of loans maintained reported to us by private bank officials was between 30 to 50 loans per loan officer. Other reported averages ranged between 50 to 250 loans per loan officer.

It is likely that loans made by UTFC require more work than conventional bank loans. For example, UTFC loan officers report using considerable time in educating a business as to how to make an acceptable loan application. In addition, they also provide business education to companies and considerable assistance on preparing acceptable business plans to facilitate loan approval. Further, UTFC loan officers also handle loans in all parts of the state, making loan application and loan monitoring time consuming. In spite of these factors, we still expected UTFC loan officer productivity to be closer to bank productivity than it is, and, in fact, they were closer in 1994. Further, these factors do not explain the internal decline in UTFC's productivity. UTFC's only explanation is that in fiscal year 1997, the loan officers were sent for training at the Export Import Bank to learn how to help secure financing for companies that would need to export to expand their markets. In our opinion, UTFC needs to determine why productivity has been dropping for the last four years. It is possible that UTFC is simply not receiving the volume of loan requests to justify the current number of loan officers.

In summary, we believe UTFC is moving away from some primary aspects of its mission. Specifically, UTFC has moved away from funding start-up or early-stage, high-technology companies. Perhaps as a result of this movement, UTFC's impact on high-technology job growth is inconclusive. Further, UTFC may have moved out of its primary market segment where a capital gap existed and, as a result, may have increased the possibility for competition with the private lending industry. UTFC may have moved away from primary aspects of its mission as a result of legislative pressure. The Legislature needs to consider what UTFC's mission should be and then make the necessary changes and clarifications to the **Utah Code**. Finally, UTFC's efficiency appears to be declining. We believe that UTFC has taken an appropriate first step in re-evaluating its programs and resulting staffing plan. We believe that UTFC needs to continue its analysis and specifically look at loan officer productivity.

Recommendations:

1. We recommend that the Legislature clarify UTFC's mission in the **Utah Code**.

2. We recommend that UTFC analyze the productivity of its loan officers and implement any necessary changes

3. We recommend that UTFC continue to analyze its operating costs and implement any necessary changes.

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Chapter III
Some Controls Were Not Working Properly Within UTFC

Some of UTFC's administrative control systems were not functioning adequately and resulted in approximately $106,000 of additional agency costs between fiscal years 1996 and 1997. UTFC's Executive Committee, which is charged with approving all staff compensation and benefits, may not have been aware of specific employee benefits at UTFC. First, we could not find nor could UTFC provide documentation authorizing certain staff benefits, in particular those offered to the former Executive Director. Second, some members of the Executive Committee do not remember discussing and approving these benefits. As a result, it is possible that UTFC's former Executive Director and some staff received benefits which were not approved by the committee. The Executive Committee was also unaware that some internal policies and procedures had been ignored by the former Executive Director and had cost the organization. Finally, some administrative processes, such as the employee hiring process, were poorly documented. Upon learning of these weaknesses, UTFC's acting Executive Director and the board took immediate action to rectify the problems.

UTFC is a quasi-governmental organization outside many state control systems. As a result, UTFC needs to develop strong internal control systems of its own. As its primary control, UTFC relies on oversight by a Board of Trustees (the board). Membership on this board consists of no fewer than seven and no more than eleven members appointed by the Governor and approved by the Senate. The board assumes full fiduciary authority and responsibility for all UTFC expenditures and activities. To carry out its oversight responsibilities, the board created the Executive Committee (the committee) as a subset of the full board. As the Chairman of the Board indicated, there should be nothing of importance going on at UTFC of which the committee is unaware. In addition to the control exercised by the committee, we believe UTFC should have in place sufficient and reasonable policies and procedures to control everyday activities.

The following sections review control weaknesses in the following areas:

- ♦ Annual Leave
- ♦ Personal Use Days
- ♦ Insurance Benefits
- ♦ Additional Pay for Tax Purposes
- ♦ Vacation Accrual
- ♦ Credit Card Use
- ♦ Expense Documentation
- ♦ Hiring Procedures
- ♦ Consulting Practices

Committee May not Have Realized Specific UTFC Benefit Practices

Specific benefit practices within UTFC may not have been realized by the Executive Committee. According to UTFC's 1995 policy and procedure manual, the Executive Committee is charged with approving all staff compensation and benefits. However, we could find no written documentation authorizing certain staff benefits, in particular those offered to the former Executive Director. In addition, some members of the Executive Committee do not remember discussing and approving these specific benefits. As a result, it is possible that UTFC's former Executive Director and some staff received benefits totaling approximately $90,000 which were not fully realized by the committee.

To carry out its oversight responsibilities, the board created the Executive Committee as a subset of the full board. The committee consists of the Chairman of the Board and both the First and Second Vice Chairpersons as elected by the board. In addition, the President/ Executive Director sits on the committee as an ex-officio or non-voting member. The committee is required to meet at least twice a quarter and, in fact, appears to meet once a month. The committee was authorized by the board to assume general on-going oversight responsibility for UTFC operations working with and through the President/Executive Director. It is specifically noted in UTFC's 1995 policies and procedures manual that the committee will recommend to the board the appointment and election of the President/ Executive Director and fix the appropriate salary and approve all salary increases and other staff benefits. According to current members of the committee, they are responsible for approving all staff compensation and particularly the Executive Director's compensation package.

UTFC's Executive Committee now maintains that some of the benefits discussed in this section were approved by the Executive Committee because they were included in UTFC's budget which was approved by the committee. It is correct that two of the four benefits discussed in this section (increased insurance payments and increased tax liability payments) were included, in an aggregate figure, in UTFC's fiscal year 1997 budget. One benefit (annual leave cash-out) was reported in the budget; however, we do not believe it was fully reported. The last benefit (personal leave days) was not reported in the budget.

It is also correct that the Executive Committee reviewed and approved UTFC's fiscal year 1997 budget. However, we are concerned that benefits can be included in this budget for which we can find no authorizing documentation. In addition, we are concerned with a possible lack of depth in the compensation budget review. We believe it is informative that the current Executive Director stated that it was not until he became acting Executive Director that he realized how much the former Executive Director made. In our opinion, the details in the compensation budget could be improved so as to enable the committee members to have a better understanding of employee compensation by source, particularly the Executive Director's. As noted above, while two of the four benefits were reported in the fiscal year 1997 budget in an aggregate amount, it is unclear to us if the committee members understood what made up this aggregate amount and that this amount was assigned exclusively to the former Executive Director.

As noted above, for the years 1996 and 1997, UTFC employees received approximately $90,000 compensation possibly without the committee's specific knowledge or approval of the particular benefit. We have outlined four situations that contributed to this additional and perhaps unnecessary compensation.

- First, entire annual leave balances could be cashed-out by UTFC employees at anytime.
- Second, the former Executive Director and a second member of management were granted personal leave days which were sometimes cashed-out.
- Third, UTFC increased payments for a life and disability policy for the former Executive Director.
- Fourth, UTFC increased payments for the taxable consequences of the former Executive Director's benefits.

The concern over these benefits lies in the fact that the committee was possibly unaware of each benefit specifically. As a result, the committee may not have been fully aware of staff compensation, particularly the former Executive Director's compensation. Further, some of these benefits are in violation of state personnel policies and practices. There is some evidence that UTFC is not exempt from the state Personnel Management Act. Specifically, UTFC was not formally exempted from this act in the **Utah Code**. On the other hand, UTFC was also created as an independent organization and the board was given the power to hire and set salaries. We believe the Legislature should examine the statute and make any necessary changes to the exemptions listed.

UTFC Employees Cashed-out Annual Leave Possibly Without Committee Knowledge

In fiscal years 1996 and 1997, a total of $73,000 of annual leave was cashed-out at UTFC, possibly without the specific knowledge and approval of the Executive Committee. These cash-outs did not occur at termination of employment; instead, cash-outs by employees occurred throughout the year. This is a significant benefit to the employee; however, we are unsure that the committee authorized the benefit. First, we can find no written authorization of this benefit from the committee. Second, we can find no evidence in committee minutes that this policy was discussed and approved. Third, the Executive Committee members do not remember authorizing this benefit. In addition, this benefit is not fully reported in the compensation budget which the committee did approve. When the current Executive Director took over, the committee eliminated this benefit.

In 1996, five full-time employees took advantage of UTFC's annual leave policy and cashed-out approximately $35,000 in vacation leave. In 1997, nine full-time employees took advantage of the policy and cashed-out approximately $38,000 of annual leave. Figure XII shows the annual leave cashed-out by employee for both years.

Figure XII
Annual Leave Cashed-out by Employee
Fiscal Years 1996 - 1997

Employee	FY 1996	FY 1997
A	$12,544	$10,849
B	10,096	5,721
C	5,721	4,167
D	4,500	6,132
E	2,478	-0-
F	-0-	3,272
G	-0-	2,548
H	-0-	2,238
I	-0-	1,969
J	-0-	1,558
TOTAL	**$35,339**	**$38,454**

Note: The former Executive Director cashed-out the most annual leave in both years with cash values representing 16 percent (1996) and 13 percent (1997) of his base salary.

The ability to cash-out annual leave is a significant benefit to the employees. Since the Executive Committee is responsible for approving employee compensation and benefits, this committee should have specifically approved this benefit and exercised some level of oversight over the use of the benefit. However, we found no written authorization that the committee approved this employee benefit. In addition, we reviewed all the Executive Committee

minutes since July 1994 and saw no specific evidence that the cash-out policy was brought to the Executive Committee for approval.

Since the written records were not complete, we talked with members of the Executive Committee. We discovered that they are not clear as to the annual cash-out policy or their role in creating the policy. Two committee members indicated that they do not remember this policy being brought to the attention of the Executive Committee. The third member indicated that he was aware of the general policy but not the specifics of its implementation. Based on the lack of written documentation and the memories of the committee members, we are unsure that the committee authorized this benefit.

In addition, budget documents supplied to the committee did not fully report the yearly annual leave cash-out liability. As a result, the committee did not have the information necessary to monitor the on-going impact of this policy. We reviewed the fiscal year 1997 budget documents approved by the committee. While these documents show the employee annual leave liability that will be accrued for the budget year (in this case fiscal year 1997), it does not show the liability from employee annual leave balances being forwarded into the new fiscal year. For example, if an employee made $41/hour and accrued 13 hours of annual leave a month, the annual leave for the year would be $6,396. However, if that employee also had an annual leave balance of 100 hours, that unpaid liability would be $4,100. In UTFC's fiscal year 1997 budget, the former amount was reported, but the latter amount was not. As a result, we believe the annual leave liability was under-reported to the committee. Further, we are unsure that the committee members understood this account to be an annual leave cash-out liability account. Instead, it is possible that they believed the annual leave account to be a cash representation of an employee benefit.

Based on this information, it appears likely that the committee, as a whole, was unaware of this particular benefit. Further, information was not presented to the committee in a way which allowed them to see the full impact of the policy. Upon learning of the policy, the Executive Committee was not in favor of it. As a result, annual leave cannot be cashed-out at UTFC anymore. In addition, the entire leave system at UTFC has been redesigned. Vacation, sick, and compensatory time have been eliminated and replaced by personal leave time. The cashing-out of personal leave time will not be allowed.

Selected Employees Given Personal Use Days Possibly Without Committee Knowledge

Personal leave days with an approximate total benefit of $1,900 were given to certain employees beginning in fiscal year 1997. Personal leave days are essentially vacation days. As such, personal leave days are an employee benefit that should require Executive Committee approval. We found no written documentation from the Executive Committee authorizing the use of personal leave days for any UTFC employees. Further, committee members do not remember discussing and authorizing personal use days. As a result, it is possible that this benefit was given without the Executive Committee's specific knowledge or approval.

In fiscal year 1997, the former Executive Director had five personal leave days and another member of management had three personal leave days. In fiscal year 1998, in addition to these two employees, the third member of management also had three personal leave days. Personal leave days can be used for whatever the individual chooses (sick, vacation etc.) and are another type of paid employee benefit. Vacation and sick leave accrual rates were not affected by the addition of these personal leave days. Given the rates of pay for each individual, this benefit was worth approximately $1,400, $500 and $700 per year, respectively. Like vacation days, many of these days were cashed-out.

Personal leave days do not appear to have been formalized into a UTFC policy. We found no policies and procedures relating to personal leave days in either the draft 1997 Employee Manual or the 1995 policies and procedures manual. However, regardless of whether personal use days were formalized into policy, they are an employee benefit. As such, they should have been specifically approved by the Executive Committee. We could find no evidence that the use of personal leave days was either reviewed or approved by the Executive Committee. First, no written documentation from the committee authorizing personal leave days for these three employees was ever produced by UTFC. This documentation is an important control and should have been kept in employee files. Second, a review of the Executive Committee's meeting minutes found no specific reference to any discussion involving personal use days. The closest reference in time regarding fiscal year 1997 compensation issues is the following:

> *On May 21, 1996, the staff was excused from the Executive Committee meeting in order that the Executive Committee could review proposed salary increases for all UTFC personnel. These increases were recommended by the President of the organization as part of the fiscal year 1997 budget for UTFC and were reviewed by the Chairman of the Board prior to the Executive Committee meeting. All salary and benefits compensation were unanimously approved by the Executive Committee to be effective July 1, 1996, upon approval by the full Board of Trustee of UTFC.*

We examined the budget documents reviewed by the committee during this meeting and saw no evidence that personal leave days were discussed or included in the budget. Third, the three members of the Executive Committee stated that they do not remember personal leave days being discussed and approved by the committee. UTFC management maintains that the committee instructed the former Executive Director to take care of the smaller benefits to the staff. We could find no written documentation to this effect. Further, this still does not address the authorization issue of personal leave days for the former Executive Director. As a result, it again appears possible that UTFC's Executive Committee was not fully aware of employee compensation at UTFC.

Executive Director Received Increased Insurance Benefit Possibly Without Committee Knowledge

Premiums on a life insurance and disability policy for the Executive Director were increased possibly without specific committee knowledge. This increase amounted to approximately $9,000 in total additional benefits for fiscal years 1996 and 1997. The premiums were increased because the insurance coverage was increased. While this item was built into the fiscal year 1997 budget, we are concerned that a benefit could be present in the budget without specific committee authorization.

In 1996, UTFC began paying $7,560 per year ($450 for the life insurance policy and $180 for the disability policy each month) to provide insurance benefits to the former Executive Director. This is a significant increase over the $3,120 paid for the former director's insurance in 1995. As such, we expected to see this increase approved by the Executive Committee.

It is not uncommon for executive directors to have benefits provided and paid by their organizations. However, we are again concerned that this benefit was significantly increased possibly without the full knowledge and consent of the Executive Committee. First, we found no written statement from the committee authorizing the increase to this benefit. This is an important control document and should have been kept in the former Executive Director's personnel file. Without this written authorization, it is difficult for those making the corresponding payroll adjustments to be confident that this benefit was indeed authorized by the appropriate source. Second, we reviewed the Executive Committee minutes from July 1995 to January 1996. On November 9, 1995, we found a reference indicating that compensation issues were discussed. However, we found no indication that this specific issue was discussed or approved by the committee. UTFC maintains that compensation issues are discussed only during the budgetary process which occurs from March to June of the fiscal year. The minutes for this time period were unavailable for review.

Given the lack of written authorization and the lack of specifics in the minutes, we interviewed the Executive Committee members. The Chairman of the Board was aware that UTFC paid the premiums for a life insurance policy for the former executive director. Another member stated that he does not remember discussing and authorizing an increased insurance benefit. The final member indicated that, while he was unaware of this specific benefit, the Executive Committee was aware of benefits at a gross level since this committee reviews and approves UTFC's yearly budget. As a result, this member further indicated that the Executive Committee would primarily know how much they were spending for total staff compensation but not necessarily the specific amount or benefit going to the former executive director.

While it is true that this increased insurance benefit was in the fiscal year 1997 budget, we are unsure about fiscal year 1996 since documents in this time period were unavailable for review. However, we are concerned that a specific benefit item for the former Executive Director can be in the budget without supporting written documentation from the committee authorizing the benefit.

Further, we do not believe that this benefit inclusion was obvious. This benefit was included under a heading entitled "Other Benefits". The $16,317 amount under this heading was entitled disability insurance. In our opinion, it is not clear that this amount relates entirely to the former Executive Director and includes most of his benefits (i.e., his car allowance, his life and disability insurance and the tax liabilities on both these items).

Based on the lack of written documentation and also on the memories of the Executive Committee, it is unclear to us that the Executive Committee, as a whole, realized that this specific benefit was given the former Executive Director. As a result, the committee does not appear in full control of the former Executive Director's compensation package.

Executive Director Received Increased Taxable Consequences Benefit Possibly Without Committee Knowledge

Compensation covering the tax liabilities of the former Executive Director were increased in 1996 possibly without the specific knowledge of the committee. This increase amounted to approximately $6,600 in additional, total benefits received in fiscal years 1996 and 1997. While this item was built into the fiscal year 1997 budget, we are again concerned that a specific benefit for the former Executive Director could be put into the budget without documentation of specific authorization from the Executive Committee.

The 1996 taxable consequences benefit was significantly more than the 1995 benefit paid. In 1996, the taxable consequences paid by UTFC for the former Executive Director were $4,557 for the year. Since 1996, UTFC has paid the taxable consequences on both the increased life and disability insurance ($630/month) and also on the car allowance ($350/month) provided to the former Executive Director. However, in 1995, the tax consequences paid by UTFC were $1,209 for the year. In this case, UTFC paid the taxable consequences on the former Executive Director's life and disability insurance only.

Again, it is not uncommon for executive directors to have benefits provided and paid by their organizations. However, we are again concerned that this benefit was significantly increased perhaps without the full knowledge and consent of the Executive Committee. We could find no written authorization from the Executive Committee that this benefit increase was authorized. This is an important control document since it confirms to those individuals making payroll adjustments that the benefit adjustment is authorized at the appropriate level. Further, we reviewed the Executive Committee minutes from July, 1995 to January, 1996. On November 9, 1995,we found one indication that compensation issues were discussed. However, we found no indication that this specific issue was discussed or approved by the committee.

In addition, we interviewed the three Executive Committee members. One member, the Chairman of the Board, was aware that UTFC paid the taxable consequences for the former

Executive Director. Another member stated that he does not remember discussing and approving an increase in this particular benefit. The final member again added that, while he was unaware of this specific benefit, the Executive Committee was aware of benefits at a gross level since this committee reviews and approves UTFC's yearly budget. While this benefit was included in the fiscal year 1997 budget, we are concerned that a benefit specifically for the former Executive Director can be put into the budget without supporting documentation from the Executive Committee authorizing the benefit.

Also, we again do not believe that this benefit inclusion was obvious. This benefit was also included under a heading entitled "Other Benefits". The $16,317 amount under this heading was entitled disability insurance. It is not clear that this amount relates entirely to the former Executive Director and includes most of his benefits (i.e., his car allowance, his life and disability insurance and the tax liabilities on both these items).

With the lack of written authorization plus the memories of the Executive Committee members, we are not convinced that the Executive Committee, as a whole, realized that this particular benefit was significantly increased in fiscal year 1996. As a result, the Executive Committee may not have realized the former Executive Director's total compensation package.

All four issues discussed in this section (the cash-out of annual leave, the granting of personal leave days, the granting of increased insurance benefits and the granting of increased benefit tax liability payments) appear to have common control lapses. As a result, we believe that three general controls need to be strengthened. First, we believe that the Executive Committee should provide written authorization for all benefits that it approves, particularly benefits which are specific to the Executive Director. Second, we believe that the Executive Committee should be provided with more specific budgetary information on compensation, particularly regarding the Executive Director's compensation package. We believe that this information should be specific as to what benefits the Executive Director is receiving and their cash values. This information should be detailed enough so that each member of the Executive Committee knows exactly what the Executive Director is making in both taxable and non-taxable income each year. Third, we believe that the Executive Committee should review source documents (e.g., payroll histories) on a periodic basis to insure that what they think is occurring is, in fact, occurring.

While the Executive Committee is one primary control at UTFC, policies and procedures are another control.

Some UTFC Policies and Procedures Have Been Ignored

Some policies and procedures were ignored at UTFC and the oversight provided by the Executive Committee was insufficient to identify the problems. As a result, the former Executive Director and other UTFC employees received up to $16,400 which they may not have been entitled to under UTFC policy. These costs were incurred because the former Executive Director ignored UTFC policies in at least three areas identified in the course of this audit:

- First, UTFC's policy on vacation accrual was not followed.
- Second, UTFC's policy of personal expenditures on company credit cards was not followed.
- Third, UTFC's policy on documentation of business expenses was not followed.

Policies and procedures are a primary internal control. However, in order to function as a control, they must be followed. We are concerned that UTFC policies were not followed by the former Executive Director and that the oversight by the Executive Committee was insufficient to identify the problems.

It should be noted that when we requested policies and procedures from UTFC, we were provided with a copy of UTFC's 1995 policies and procedures and a copy of UTFC's 1997 draft employee manual. UTFC now maintains that during the time of our review they had no formal policies and procedures in place because the 1995 policies and procedures were never formally approved by the Executive Committee. Further, the 1997 employee manual is in draft form. As a result, UTFC management maintains that any activities UTFC engaged in, which were at variance with the 1995 policies and procedures were, in fact, in compliance with UTFC's *defacto* policies. We are very uncomfortable with UTFC's premise. Further, we believe the policies and procedures that we reviewed from UTFC's 1995 policy manual are reasonable policies and procedures. As a result, we reviewed their compliance against the 1995 policies.

Vacation Accrual Rates Exceeded Those Allowed by Policy

UTFC's vacation accrual rates established by policy were ignored. As a result, some employees accrued more vacation time than allowed by policy, and some UTFC employees received over $7,200 of possibly inappropriate, additional vacation leave in fiscal year 1997. Further, because of UTFC's vacation cash-out policy, $3,400 of this amount was cashed-out. Since vacation leave is an employee benefit, the Executive Committee should have approved these exceptions to UTFC's vacation accrual policy. However, we found no evidence of this.

In fiscal year 1997, we identified six full-time employees who were accruing vacation hours at a rate exceeding what their yearly service would support. According to UTFC's 1995 policy and

1997 draft policy, vacation accrues at the following rate: four hours of vacation per pay period (8.67 hours/month) for service through two years; five hours of vacation per pay period (10.83 hours/month)for service from the third year through the sixth year; and six hours of vacation per pay period (13 hours/month) for service of seven years or more. Finally, the 1995 policy states that the Executive Director may accrue at the highest rate upon hire or 13 hours per month. Although the required service rates are more generous, the actual accrual rates are the same as the state's. Figure XIII shows, by employee, the rate of accrual in policy compared to the rate of accrual in practice.

Figure XIII
Vacation Accrual Policy vs Practice
Fiscal Year 1997

Employee	Policy	Practice
A	13 Hrs/Month	20 Hrs/Month
B	10.83	13.33
C	10.83	12.00
D	8.67	13.33
E	8.67	10.00
F	8.67	10.00

All the employees cited in the figure are outside the accrual rate given their length of service; three are outside the maximum accrual rate allowed by the policy (13 hours/month). In particular, the former Executive Director accrued 20 hours of vacation per month, seven hours more per month than the maximum allowed by UTFC's policy. As a result of these policy violations, employees were potentially able to receive more compensation through vacation cash-out than policy allowed. Figure XIV shows the amount of additional compensation made available, by employee, above that allowed by policy.

Figure XIV
Potential Compensation Paid in Excess of Vacation Policy Allowance
FY97

Employee	Excess Compensation
A	$3,413
B	1,573
C	901
D	653
E	375
F	322
TOTAL	**$7,237**

As shown above, over $7,200 in annual leave was made available to these six employees over what the policy allowed. Only one employee, the former Executive Director, cashed out all available vacation time in fiscal year 1997. As a result, the former Executive Director, perhaps inappropriately, increased his total compensation by $3,413. Since the remaining five employees did not cash-out all their annual leave, they instead have vacation balances larger than allowed by policy. If these balances are not corrected, approximately $3,824 will be paid, perhaps inappropriately, when these employees terminate employment.

We are concerned that this policy was overridden and that the vacation leave benefit was increased for select employees without the full knowledge and consent of the Executive Committee. The 1997 draft Employee Manual is specific on this point. It states that full-time employees shall be eligible for the accrual rates stated in policy unless otherwise determined by the Executive Committee. Although this policy is in the draft manual, it is a critical control policy since annual leave could be cashed-out at UTFC. Without the committee's required approval, employees would be in a position to receive increased compensation without the knowledge and approval of the Executive Committee. As a result, we expected to see a specific reference to these increased accrual rates in the Executive Committee minutes. We reviewed the 1996 Executive Committee minutes but found no indication that this specific issue was discussed or approved by the committee.

In addition, we interviewed the three current committee members. Each stated that they do not remember discussing increased vacation accrual rates for specific employees. In particular, they did not remember discussing and authorizing the former Executive Director's increased vacation accrual rate. In fact, the Executive Committee was unaware of the rate at which the former Executive Director was accruing annual leave.

Finally, we reviewed the fiscal year 1997 budget which was approved by the committee. We found that the annual leave benefit amounts contained in the budget were inaccurate. Specifically, these amounts were reported to the committee based on the 1995 policy accrual rates, not on the accrual rates actually used in fiscal year 1997. For example, the annual leave benefit stated in the budget for the former executive director is $6,338. Based on his hourly wage, this amount assumes an accrual rate of 13 hours a month. However, in fiscal year 1997, the former Executive director accrued annual leave at the rate of 20 hours a month. Consequently, $9,751 should have been reported as his annual leave benefit, not $6,338. This under-estimate also occurred with the other employees whose accrual rates differed from those established in the 1995 policy. As a result, we believe the committee did not approve employee annual leave benefits outside the 1995 policy.

Since the Executive Committee did not authorize these accrual rates outside UTFC's policy, we believe that the $7,200 of additional vacation leave to select employees was inappropriately given. In addition, we believe that the former Executive Director's total compensation was inappropriately increased by $3,400 as a result of the unauthorized additional vacation accrual. Since the vacation benefit was inaccurately presented to the committee, they were not aware that UTFC's vacation policy was violated. As a result, the Executive Committee was not fully aware of the former Executive Director's total compensation. In addition, we believe it appears possible that the former Executive Director may have circumvented the committee's authority.

Personal Expenditures Were Put on Corporate Credit Cards

As of February, 1998, UTFC had reached, but not implemented, a settlement with the former Executive Director concerning over $9,200 of personal expenses inappropriately paid by UTFC. UTFC's policy on credit card usage states that personal expenditures are not to be put on corporate credit cards. UTFC paid for some of the former Executive Director's personal expenses because he often placed personal expenditures on UTFC's corporate credit cards.

A few other UTFC employees have put personal expenditures on UTFC corporate credit cards; however, these expenses were reimbursed to UTFC in a timely fashion. We reviewed fiscal year 1996 expenditures on the corporate cards for two employees (a former admin- istrative staff person and one loan officer) and found personal expenditures on both of these cards. While technically a violation of UTFC's policy, the charges on the cards of the former administrative staff person and the loan officer ($478 and $184, respectively) were reimbursed to UTFC at the time of the charge. As a result, we were not particularly concerned with these charges.

This was not the case with the former Executive Director. We reviewed fiscal years 1996 and 1997 expenditures on the former Executive Director's two corporate credit cards. This review represents a subset of what UTFC would eventually review. We identified over $4,000 of possible personal charges placed on these credit cards. None of these charges had been reimbursed at the time of our review. Included in these expenses were:

- over $780 in luggage expenditures
- $468 travel expenditure related to the former Executive Director's outside consulting work
- $350 for software to support a global positioning system
- $153 to pay conference lodging for a friend of the former Executive Director's not employed by UTFC
- over $1,000 in activities related to the former Executive Director's job as President of a non-profit organization.

In addition, UTFC was also conducting its own review of the former Executive Director's credit card expenses. UTFC executives reviewed expenses made from fiscal year 1995 to December, 1997. Based on their analysis, UTFC executives requested that the former Executive Director reimburse UTFC over $9,200 for personal expenses paid by UTFC. This reimbursement amount was settled in February, 1998, but this settlement has not yet been implemented. This figure includes almost $1,600 of airline upgrade charges (trading up from tourist-class to first-class) and over $400 of gasoline and car upkeep expenses (car washing and detailing) in spite of the fact that the former Executive Director received a $350/month car allowance.

The former Executive Director disagrees with UTFC's findings and maintains that these were legitimate business expenses. Regarding these specific examples, he believes the first-class upgrades were legitimate because of the physical wear of the former Director's frequent travel, and car upkeep charges were legitimate because those were personal vehicle travel charges for trips in excess of 100 miles. There was no UTFC policy concerning trips in excess of 100 miles taken in the former Executive Director's personal car.

Based on our review as well as UTFC's review, we believe that the former Executive Director violated UTFC policy against placing personal charges on corporate credit cards. As a result, personal expenditures of the former Executive Director were inappropriately paid for by UTFC. Until our review, the committee was unaware that this policy was being violated.

The committee was unaware of personal expenditures being paid by UTFC because the committee conducted its oversight review at the gross budgetary level. As a result, no detailed review was performed of the former Executive Director's credit card expenditures. In order to exercise a reasonable level of control, the committee needs to perform periodic detailed reviews of expenses placed on the Executive Director's corporate credit cards.

Expenses Were not Well Documented or Reviewed

UTFC's credit card policy states that employees will submit a description of the business purpose for every business expense charged. While other UTFC employees's expenses were well documented in fiscal year 1996, the former Executive Director's expenses were not. In fiscal year 1997, the expense documentation of the former Executive Director significantly improved. However, for expense documentation to function as a control, the documentation given must be reviewed at a suitable level for expense appropriateness.

Most UTFC employees appear to document their corporate credit card expenses well. We reviewed fiscal year 1996 expenses for the former Executive Director and two other UTFC employees (a former administrative staff person and one loan officer) and found a discrepancy in the level of control exerted over these employees. There were no problems with the reporting of charges by the former administrative staff person and only minor problems with the reporting of charges by the loan officer. On the other hand, the former director's reporting failed to document $9,276 (25% of the total dollar charges) of his 1996 expenses. Figure XV shows the percentage of corporate credit card charges made by UTFC's three primary travelers that were not documented as necessary business expenses yet were paid as business expenses.

Figure XV
Percent of Undocumented Corporate Credit Card Charges
Fiscal Year 1996

Employee	Percent Undocumented
Former Administrative Staff	0%
Loan Officer	9
CEO	55

While the documentation level improved in fiscal year 1997, there were still personal expenses of the former Executive Director that were paid by UTFC during this time period. We believe this resulted because no detailed review was performed by the Executive Committee on the former Executive Director's expenses. Rather, the review was conducted either by the former Executive Director himself, the office manager or the accountant. In our opinion, reviewing your own expenditures for appropriateness or having subordinates review expenditures is a poor control. The expenses of the Executive Director need to be reviewed and controlled at the Executive Committee level. Expenses made by other employees need to be reviewed by a superior.

In addition to breeches of policies and procedures, some administrative processes are also poorly documented and may result in practices considered inappropriate in state agencies.

Some Administrative Practices are Poorly Documented

Employee hiring practices at UTFC are poorly documented. In addition, hiring practices for consultants and contractual workers are also often poorly documented. Because these practices are weak, they could be open to abuse. In fact, allegations of favoritism have been made about both employee and consultant/contractual hiring practices.

As a quasi-governmental organization, UTFC maintains that it is not subject to the state's Personnel Management Act or to the state's procurement procedures. However, it should be noted that the **Utah Code** does not exempt UTFC from the Personnel Management Act. In addition, it should also be noted that had UTFC followed both these acts, some of the issues identified in this report would not have occurred. However, since UTFC management believes that they are not subject to these two acts, UTFC should have developed its own, well-documented personnel and procurement system. However, UTFC's employee and consultant hiring practices are poorly documented.

UTFC Hiring Procedures are Often not Well Documented

UTFC often cannot document that the employee selected to fill a position was the best qualified candidate available. Because the hiring process is often poorly documented, UTFC cannot adequately refute charges of hiring favoritism, and such allegations have been made. Since UTFC is funded primarily with public money, we believe UTFC has an obligation to develop a well-documented, defensible hiring process.

We were unable to verify that the candidate selected by UTFC was the most qualified candidate available. First, we were unable to determine if the chosen candidate met even the job's minimum qualifications. The job descriptions, which ideally contain minimum job qualifications, were not useful. First, job descriptions did not exist for all positions within UTFC. Second, individuals currently holding the job had written the existing job description. Thus, it became unclear whether or not the stated minimum qualifications had actually been used as selection criteria, or whether the minimum qualifications listed were simply describing the personal qualifications of the individual currently in the position. Third, not all job descriptions had minimum qualifications stated, and, in one case, the minimum qualifications for the same position varied depending on who wrote the job description. As a result of these problems, we were unable to determine if selected candidates met the required minimum qualifications or further, if minimum job qualifications even existed at the time of hire.

In addition, we were unable to determine if the candidate selected was the best qualified candidate of those applying. Again, the candidate final selection process is poorly documented.

To perform this test, we requested documentation detailing the applicants who had applied for a position, evidence of selection criteria applied, and finally justification for the final selection. Toward this end, we asked to review nine hiring files. UTFC was able to produce four. The files did contain numerous resumes; however, there was no evidence of the hiring criteria applied and no evidence to support why certain individuals were selected. As a result, for these four hires, while we see evidence of competition, we cannot determine that the best qualified candidate was chosen. For the remaining five hires, we were unable to determine even if there had been some level of competition for the position. Competition is important since it enhances the chances of obtaining the best qualified candidate for the position.

Given the allegations of hiring favoritism within UTFC, our inability to document competition is a concern. Specifically, during this audit, we were told that a number of people employed at UTFC have ties to the former Executive Director or to a board member. In fact, the five individuals for whom no hiring file could be found above have allegations of favoritism leveled against them. We did verify that there may be some substance to these allegations. At least three (12 percent) of UTFC's fiscal year 1997 employees lived in the former Executive Director's neighborhood, and, in fact, two were very close neighbors. However, it should be noted that we saw no evidence that any of these employees were not competent in their jobs. Rather, our concern is with the fact that we cannot document these individuals competed and were the best qualified applicants for their respective positions.

The Chairman of UTFC's Board of Trustee shares our concern. He has stated publicly that "*hiring practices were wrong and out of control*." In our opinion, UTFC, which is primarily funded with public monies, has an obligation to develop a well-documented, defensible hiring system. Currently UTFC is in the process of re-evaluating and strengthening its hiring process.

Consultant and Contractual Hiring Practices are Sometimes not Well Documented

Consultant and contractual hires are not always done using a competitive bid process. As a result, the possibility of favoritism is present, and, in fact, such allegations have been made. In our opinion, since UTFC is funded primarily with public money, UTFC has an obligation to insure that its procurement process is fair and equitable.

Competitive bidding does not always occur at UTFC. As a result, UTFC does not often issue a Request for Proposal or solicit bids for consultant/contractual hires. Thus, when we asked to review specific consultant/contractual files to identify evidence of competitive bidding, we were told that the only thing that may exist in these files is a memorandum of understanding. Rather than relying on competitive bidding, individuals often approach UTFC for consulting/contractual work, or UTFC identifies an individual that it would like as a consultant and an agreement is reached with that individual. This process was publicly described in the Salt Lake Tribune by the Chairman of the Board. During the Tribune interview, the chairman acknowledged inviting his son to perform some consulting work in scrutinizing a company seeking UTFC assistance. The chairman justified his request by stating, "*He was the only guy I knew who had the background*." UTFC's consultant procurement process should extend beyond those who are known by UTFC employees.

As with employee hiring, we also received allegations that there might be selection favoritism when choosing consultants and contractual employees at UTFC. Again, we found some substance to the allegation. We reviewed the IRS Form 1099's issued by UTFC in 1996 (the 1997 Form 1099's were unavailable since this tax year was not complete at the time of the review). Excluding those issued to board members, 3 or 25 percent of the Form 1099's were issued to individuals who either resided in the former Executive Director's neighborhood or had an existing friendship with the former Executive Director. One of these contractual employees is a very close neighbor of the former Executive Director. Again, we must note that we found no evidence that any of these consultants or contractual employees were poor performers. Rather, our concern is with the fact that, since there was no competitive bidding process, we cannot be assured that we obtained the best provider for the most reasonable cost.

Since UTFC is publicly funded, we believe UTFC has an obligation to insure that its procurement process is fair and equitable and that the best provider is chosen for the most reasonable cost. Currently, UTFC's selection process cannot provide this assurance.

In summary, we believe that UTFC's control systems have many weaknesses. The committee charged with approving compensation and benefits was not fully aware of some compensation and benefits being given at UTFC. Further, the committee was unaware that some policies and procedures were being ignored by the former Executive Director. Finally, some basic administrative processes are poorly documented. Since UTFC is a quasi-governmental organization, not under state control but funded with public money, we believe UTFC has an obligation to develop well-documented, defensible administrative systems. Further, to overcome many of the identified weaknesses, committee decisions must be documented, budgeting information must improve, and the committee must perform periodic, detailed reviews concerning budgetary matters and policy and procedure compliance.

Recommendations:

1. We recommend that the Legislature clarify whether or not UTFC is exempt from the Personnel Management Act.

2. We recommend that UTFC and the board adopt and follow written policies and procedures. These policies should include but not be limited to: (1) vacation accrual, (2) annual leave cash-out, (3) personal expenditures on corporate credit cards, and (4) documentation and review of expenses on corporate credit cards.

3. We recommend that the Executive Committee document its approval of compensation and benefits provided for staff and, in particular, compensation and benefits provided to the Executive Director.

4. We recommend that budget information provided to the Executive Committee provide more detailed information regarding employee compensation, particularly the compensation provided to the Executive Director.

5. We recommend that the Executive Committee periodically review the activities and expenses of the Executive Director.

6. We recommend that UTFC management review the sufficiency of its documentation for personnel, procurement, and other administrative systems to ensure clarity.

7. We recommend that UTFC's board consider establishing a procedure which would allow UTFC staff to voice concerns over UTFC operations to the Executive Committee without possible reprisal from UTFC's management.

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Chapter IV
Investigation of Allegations Yielded Mixed Results

A number of allegations of inappropriate activities have been made concerning UTFC and its former executive director. In our opinion, some of the allegations have merit and stem from a lapse in controls, either from the organization's policies and procedures or from oversight by the organization's board. We believe that UTFC should work to tighten up its management controls relating to private consulting, travel expenditures, conflicts of interest, board member assets and use of corporate credit cards.

Throughout its history, UTFC has been the subject of allegations of inappropriate activities. In fact, our 1993 audit dealt with some allegations regarding board member practices and this audit does too. Allegations of inappropriate behavior began for this audit in August, 1996, when an anonymous letter was sent to selected legislators and distributed by them to UTFC's board and to the Legislative Auditor General's Office. Similar allegations concerning UTFC, but apparently from a different source, have also surfaced in local newspapers. These allegations, in part, are what prompted the UTFC board to request an audit.

For this report section we have compiled UTFC-related allegations which have surfaced in recent years and summarized similar allegations into broad areas. It should be noted that the UTFC Board has already acted on many of the allegations contained in this section. Further, although no longer employed by UTFC, it should also be noted that the former Executive Director was very cooperative during this portion of the audit. We address the allegations in the following six topic areas:

Allegation 1. The former Executive Director inappropriately used UTFC time and assets to support his private consulting business which may have worked with Utah companies. In addition, these Utah companies may have received information about UTFC-funded companies through the former Executive Director.

UTFC's former Executive Director did personal consulting work in 1996 that appears to have been performed on UTFC time and with the use of UTFC assets. In total, we question $4,182 in UTFC assets (wages and expenses) that may have been used inappropriately by the former Executive Director. UTFC records identify $2,182 of personal consulting expenses which were charged to a UTFC corporate credit card in January and February of 1996 and subsequently paid by UTFC. As of February, 1998, a settlement agreement between UTFC and the former

Executive Director had been reached, but not implemented, regarding these credit card expenses. Further, the former Executive Director did not take vacation or compensatory time for what appears to be seven personal travel days spread over two months associated with his private consulting. On the contrary, the former Executive Director reported six of these days (48 work hours)as standard UTFC work time and one day as compensatory time. However, the compensatory time was never deducted from his compensatory balance and so it was essentially treated as UTFC standard work time. Given his rate of pay at the time, these seven days (56 hours) totaled over $2,000 of inappropriate compensation provided to the former Executive Director. UTFC management believes that this compensation is not necessarily inappropriate given the amount of compensatory time the former Executive Director had earned but was unable to take.

In addition, the former Executive Director claimed that he earned an additional 28 hours of compensatory time for these seven personal travel days. Given his rate of pay at the time, these 28 hours totaled over $1,000 of potential compensation provided to the former Executive Director by UTFC. However, there is no evidence to indicate that the former Executive Director used this compensatory time. Nonetheless, we believe that it was inappropriate for the former Executive Director to claim compensatory time for personal travel.

As for the second part of this allegation, there is no information demonstrating the former Executive Director consulted with any companies in Utah. As a result, there appears to be no basis to the allegation that the former Executive Director shared confidential information regarding UTFC clients with his private consulting clients in Utah. Two specific companies were named for which the former Executive Director provided consulting services: one is located in the state of Washington and the other is located in Texas. We contacted both of these companies and requested payment information and information concerning visits which the former Executive Director made to the company. We believe we obtained all relevant information from Company A. We are less sure we obtained all relevant information from Company B.

UTFC Time and Assets Were Used in Private Consulting Work

The former Executive Director apparently engaged in personal travel on UTFC time. In our interviews with Companies A and B, we learned that the former Executive Director had taken four trips either to see these two companies or perform business on their behalf. We were supplied with information on three of the trips which appeared to total seven days. We compared these travel dates to the former Executive Director’s time sheets. Since this is personal business, we expected to see vacation or compensatory time used for these visits; however, we did not see this. Rather, all this time was coded as UTFC, program billable, non-specific hours with the exception of one day. This one day was coded as compensatory time used; however, the time was never deducted from the former Executive Director’s

compensatory time balance. As a result, we believe that all of this personal business was paid for by UTFC.

In addition, the former Executive Director claimed compensatory time earnings for these days; however, there is no evidence that he actually used this compensatory time. UTFC employees, by policy, may claim four hours of compensatory time for every night away from home. Because these trips involved overnight stays, the former executive director claimed 28 hours of compensatory time for these personal business trips. This data conflicts with the former Executive Director's response letter in which he states all these trips were conducted on his own time.

UTFC initially paid for all these trips, and the reimbursement from the former Executive Director to UTFC was not timely in two of three instances. The following briefly describes UTFC paid expenses and reimbursements for the three trips:

> The first trip was taken in January, 1996, to Pasco, Washington. Both the former Executive Director and a personal friend went on this trip and airline expenses totaling $1,254 for both parties were put on a UTFC corporate card. This expense was reimbursed to UTFC by the former Executive Director in February 1996 and appears to coincide with the former Executive Director's reimbursement from Company A for these same expenses. It should be noted that the former Executive Director had an account set up at UTFC to which a portion of his salary was credited and from which personal expenses were to be deducted. In January, 1996, this account balance was $100 and, thus, could not have covered this personal expense. However, since the former Executive Director repaid UTFC at about the same time that UTFC paid the corporate credit card bill, it appears that, in this case, UTFC was used to process but not used to finance the former Executive Director's personal expenses.
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> The second trip was also taken in January, 1996, to Kansas City. The Kansas City trip was an extension of a trip to Chicago to attend the Digital Frontier Conference. Again, the former Executive Director and a personal friend went on this trip, and airline expenses totaling $160.90 for both parties were put on a UTFC corporate card. Since the former Executive Director's account had only $100 at this time, $60.90 was financed by UTFC until March, 1996, when the account had $460. The personal friend's portion of this expense ($80.45) was reimbursed around September, 1996 from the former executive director's account. As of February, 1998, a settlement agreement between UTFC and the former executive director had been reached, but not implemented, regarding his portion of this expense ($80.45).
>
> The third trip was taken in June, 1996, to Pittsburgh and Washington DC on behalf of Company A. Only the former Executive Director went on this trip, and airline expenses totaling $767.60 were put on a UTFC corporate card. In July, when this bill was paid, the former Executive Director's account had a ($17.15) balance. Thus, this expense was financed by UTFC until November, 1996, when the account had a balance of $852.48. While the former Executive Director billed Company A for these

expenses, Company A neglected to pay the bill. In February, 1998, UTFC and the former Executive Director reached a settlement agreement regarding repayment of this expense. This settlement agreement has not yet been implemented.

We believe this use of UTFC's time and assets occurred because of lapses in UTFC's accounting controls. UTFC's accountant was not in a position to effectively challenge the former Executive Director's expenditures. Since UTFC is an at-will employer (employees can be fired for no cause), it is likely that the accountant would be cautious in challenging the former Executive Director. Further, there appeared to be no protected way that UTFC employees could approach the board with concerns. In addition, since the board conducted no detailed review of the former Executive Director's expenses or time reports, there was no one else in a position to effectively perform that review. As a result, the former Executive Director could report his time and his expenditures without challenge. Further, these expenditures included those of a non-UTFC employee for a private business purpose, which is an inappropriate use of UTFC assets.

The Former Executive Director's Private Consulting Work Does not Appear to be With Utah Companies

The former Executive Director did report 1996 self-employment income from outside consulting with Company A and Company B. In addition to consulting for these two companies, it was also alleged that the former Executive Director provided private consulting services to Utah companies and that information about UTFC-funded companies was shared with these other Utah companies. The former Executive Director maintains that he has never consulted with Utah companies. We were able to verify that $10,000 of this self-employment income came from Companies A and B. The former Executive Director maintains that the remaining $5,500 came from his activities as a car salesman, farm equipment salesman and building contractor. We believe this is a reasonable explanation as the former Executive Director did supply documentation supporting his contention that he does receive money from other sources. However, we should note that we did not document the sources of this $5,500.

In an effort to corroborate the former Executive Director's statement that he has never consulted with Utah companies, we sought to fully explain the amount he reported on his 1996 IRS Form 1040 Schedule C (which reports self-employment income to the IRS.) with the information the two companies had provided us. If we could explain the full amount reported on Schedule C with the income data the two companies had provided, then we would be able to say that no other sources of income existed (i.e., income from Utah companies).

The former executive director volunteered his Schedule C information dating back to 1992. In 1996, he reported $15,500 in self-employment income to the IRS. The two companies to which he provided consulting services account for $10,000 of this amount. The remaining $5,500 was explained as coming from other self-employment activities. He produced a number of checks supporting the fact that he does receive income from these activities. Because these activities were between two individuals (the buyer and the seller), there were no Form 1099's backing up this amount. As a result, we were unable to fully document and account for the reported $15,500. However, it is not likely that these undocumented monies came from consulting with Utah companies or that confidential information about UTFC clients was inappropriately shared with Utah companies for whom the former Executive Director was providing consulting services.

Allegation 2. UTFC participated in or supported activities which may not have benefitted UTFC. Further, UTFC paid for a friend of the former Executive Director to attend some of these activities.

While we cannot document direct benefits from some of UTFC's activities, UTFC maintains that, at the very least, intangible benefits were received. Specifically questioned were two activities. One was UTFC's participation in a conference at the Kellogg Graduate School of Management (Northwestern University) where the son of UTFC's current Chairman of the Board attended school. The second was UTFC's attendance at an economic conference in Caracas, Venezuela. While we were somewhat concerned as to the possible benefits of these two conferences, we were more concerned with the fact that the former Executive Director brought along a friend, who was also an unpaid volunteer at UTFC, to the conference at the Kellogg Graduate School of Management and to the conference in Caracas, Venezuela. Further, the friend's expenses totaling $1,287.15 were initially paid by UTFC. These expenses were reimbursed only after an anonymous letter was provided to some members of the Legislature in August, 1996.

Digital Frontier Conference in Chicago, Illinois

The former Executive Director of UTFC and a friend attended the Digital Frontier conference in Chicago. According to the Chairman of the Board, his son, who was attending Northwestern's MBA program, became co-chairman of Northwestern's Digital Frontier conference. The chairman's son approached him and asked if UTFC would donate money to the conference and if the chairman would speak. The chairman deferred the decision to the former Executive Director. Since many venture capitalists were going to be at this conference, the former Executive Director agreed to speak. In addition, UTFC contributed $1,000 to help print brochures. The board agreed to pay for the former Executive Director's airline ticket to Chicago. Thus, the board knew of this expense and approved it. The remaining expenses were supposed to be covered by the conference. However, one meal expense of $131.56 was also charged to UTFC. This expense was incurred in January, 1996. In February, 1998, a settlement was reached, but not yet implemented, between UTFC and the former Executive Director covering the reimbursement of this expense. In addition, we found an expense on a UTFC corporate card paying for the former Executive Director's friend's airfare to the Digital Frontier conference. This $337.20 expense is discussed in a later section.

As noted above, this trip was approved by the board. The former Executive Director believes that this trip was very beneficial. He maintains that he made several important links with national venture capitalists. Because of these links, national venture capitalists may have contacted UTFC-funded companies. However, the former Executive Director was unable to provide us information on specific contacts made between national venture capitalists and UTFC-funded companies. UTFC's board believes that the invitation to speak at a prestigious conference conferred distinction upon UTFC and Utah thus creating an intangible benefit. Our only concern involves the possible appearance that this conference was attended primarily because the Chairman of the Board's son made the request.

Technology Conference in Caracas, Venezuela

The former Executive Director and a friend also attended a technology conference in Caracas, Venezuela. According to the former Executive Director, UTFC was invited by the U.S. Small Business Administration to represent the United States in a technology conference for South and Central America. UTFC states it was chosen because the SBA was impressed by UTFC's development of performance-based measurement tools for early-stage seed venture lending investments. UTFC was interested in participating because establishing contacts in other countries could help UTFC's export finance activities. We reviewed the former executive director's credit card expenditures. We found a $945.95 expense for his friend which is discussed in the next section. The only other expense related to the Venezuela trip was a $336.18 hotel and meal expense. However, this expense was covered by a $779 reimbursement check given to UTFC by the Organizacion de los Estados Americanos. Because of this check, UTFC's expenses were covered.

Again, the UTFC board approved this trip. Further, the former Executive Director believes that this conference was very beneficial. He believes it possible that contacts made during this conference allowed UTFC-funded companies to open up new export markets. However, the former Executive Director could not provide us with any specific examples or documentation of the benefit. In addition, both the former Executive Director and the UTFC board believe that attendance at this conference helped solidify ties between UTFC and the SBA (UTFC administers an SBA program) thus creating an intangible benefit. Our concern is with the possibility that a high paid employees time was used for what may have been a low yield trip.

Payments for a Non-UTFC Employee

UTFC initially paid for a friend of the former Executive Director to attend the Digital Frontier conference and the technology conference in Caracas, Venezuela. The Chicago trip was taken in January, 1996, and cost $337.20. The Venezuelan trip was purchased in January, 1996, and cost $949.95. Although the former Executive Director had a UTFC account to pay for personal expenses, this account had only $100 in it and so could not cover the expense at the time it was made. While these expenses were incurred in January, 1996, we believe they were not reimbursed until after an August, 1996, anonymous letter was made public questioning the expenses.

In the former Executive Director's written response to the anonymous letter that originally contained this allegation, he maintained that he personally picked up all expenses of the friend's airfare and associated costs, rather than expend UTFC funds. As part of this response letter, two checks were presented as evidence that these expenses were reimbursed to UTFC. The first was a personal check from him dated February 15, 1996, for $1,254. On the check is the statement that this money is for airline tickets. Accompanying this check was the explanation that this personal check was used to reimburse UTFC for the trip to Chicago. However, as seen above, the expense in question was only $337.20. The former Executive Director later indicated to us that this check was actually reimbursing UTFC for him and this same friend to fly to Pasco, Washington. This personal consulting trip was discussed in allegation one. The cost of each ticket to Pasco was $627 or $1,254 for both. Thus, the friend's trip to Chicago was not reimbursed by this check as was previously indicated by the former Executive Director.

The second check presented in his written response to show that UTFC was reimbursed was one from the Organizacion de los Estados Americanos in the amount of $779. This check was an allowance check paid by the Venezuelan government to UTFC to cover hotel and meal expenses. UTFC actually incurred only $336.18 for lodging and meals as reported earlier. Since this check was intended to reimburse UTFC for its costs and since the friend was not employed by UTFC, this check could have nothing to do with reimbursing UTFC for the $949.95 cost of the friend's conference airfare. Further, the former executive director indicated that he was going to personally pay for his friend's costs, and this check, then, does not represent a personal payment.

UTFC admits that both these expenses (the $337.20 trip to Chicago and the $949.95 trip to Venezuela) were reimbursed after the August, 1996, anonymous letter was made public questioning these charges. The former Executive Director had an internal UTFC account created from which his personal expenses could be reimbursed to UTFC. This account has a July 1, 1996 entry in the amount of $1,287.15 with the notation that this was reimbursement for his friend's trips. The cost of the Chicago trip, $337.20, and the cost of the Venezuelan trip, $949.95 total $1,287.15. According to the former accountant, the July entry was made following the August letter. After the anonymous letter came out identifying expenses which had not been reimbursed, an entry dated July 1, 1996, was made which, in fact, made an adjustment to the prior fiscal year.

These expenditures occurred because the accountant was not in a position to effectively question the former Executive Director's expenses. Again, UTFC is an at-will employer and, as a result, it is likely that the accountant would be cautious in challenging the former Executive Director. Further, there appeared to be no protected way that UTFC employees could approach the board with concerns. In addition, the board did not review the former Executive Director's expenditures in detail.

Allegation 3. UTFC staff were directed to work on non-UTFC related tasks.

The former Executive Director requested at least one legal intern employed at UTFC work on a divorce case for a couple known by the former Executive Director. We confirmed that this event did take place. A UTFC intern did do work on a private divorce case at the request of the former executive director. This work did occur on UTFC premises; however, there may not have been much UTFC paid time involved. In spite of the amount of time involved, the Chairman of UTFC's Board indicated that it was poor judgement to use a UTFC intern in this way.

We spoke with the plaintiff in this case. She indicated that both she and the defendant initially had their own attorneys which was a very expensive option. As a result, when the former executive director of UTFC suggested that legal interns at UTFC could do the work for considerably less, she and the defendant agreed to that idea. She provided the former Executive Director with a check to pay for the purchase of a divorce package. She was vague as to how the intern(s) got the necessary information to prepare the case. She further stated that she never met the intern(s) who worked on the case.

We were able to determine that one legal intern did do some work on a private divorce case. Since this allegation dates back to the fourth quarter of 1995, everyone that we spoke with indicated that their memory was faint on this topic. However, we found one legal intern who indicated that he remembered doing some work on a private divorce matter while employed at UTFC. He stated that his involvement was limited to purchasing a generic divorce package from Utah Legal Services, and then, using the information he was provided, filling those forms out. He believes that it was about two hours of work and that this work was done after hours at UTFC on UTFC equipment. This individual was not paid for this work; rather he felt he was doing it as a favor. The intern's statement conflicts with statements made in the former Executive Director's written response to the anonymous letter. In his response, he made the following comment:

> *" I personally hired a student intern who assisted in doing some research for me. This intern was also employed by UTFC as a legal intern; however, he was not compensated by UTFC in any manner for the service he provided on my behalf. I paid for his time from my own personal funds and no UTFC time, monies, or conflict of interest were involved."*

The former Executive Director later clarified the above statement. He indicated that he paid for the divorce documents used by the intern. It is to this payment that he refers when stating above that he paid for the intern's time.

Allegation 4. Conflicts of interest may exist for UTFC board members.

UTFC has a conflict of interest policy which states that any potential conflict will be disclosed and that the individual will remove himself from any discussions and decisions involving the subject of the potential conflict. This policy has been followed by UTFC; however, we still believe that the appearance of conflicts of interest may exist within UTFC. We believe that UTFC staff and board members should have no connections with any company funded by UTFC. Further, we believe that UTFC would benefit from a policy of this sort, particularly from a public perception standpoint. In our review of this allegation, we found the following two examples:

- The first involves the son of the current Chairman of the Board. According to the chairman, his son had developed an innovative piece of climbing equipment. The son wanted to form a company using an investment he had in the bank, but the chairman did not like that idea. Instead, he wanted his son to apply for a loan at UTFC and convince them, through the loan process, that his idea was worthy of being funded. The chairman wanted his son to have to go through the process of preparing a business plan, making loan payments, and reporting to someone else. Most importantly, the chairman wanted to set the precedent that it was acceptable for relatives of board members to apply for UTFC loans. The chairman believed that if UTFC did not allow this, then the pool of candidates (particularly entrepreneurs) who would want to serve on the board would surely dwindle. The chairman removed himself from the process, and his son got the loan. His business was successful, and the loan was repaid.

- The second example involves another board member who is connected with a motorcycle manufacturing plant in Logan. This company applied for a loan. The board member did remove himself from the process, and the board members approving the loan appeared to take extra care to insure that the company was worthy of a loan. The company got the loan and has since repaid it, even though the company declared bankruptcy.

In both examples, UTFC's conflict of interest policy was followed. The individuals in question declared their possible conflicts and excused themselves from all discussions involving loans. While UTFC followed its policy, we believe a more prudent policy, given the financial arena that UTFC works in, might benefit UTFC from a public perception standpoint. During work on the 1993 audit, similar potential conflict of interest problems were observed with board members desiring companies for whom they worked to get a UTFC loan. However, we also noted that some of these board members removed themselves from the board because they did not believe it was proper for a board member to be involved with a company which is receiving loan funds from UTFC. In our opinion, this is a conservative position. We believe UTFC should consider adopting a position which disallows companies with whom UTFC staff and board members are associated from receiving UTFC funding.

Allegation 5. UTFC funds were misused in the acquisition of equipment for board members.

UTFC has spent over $22,800 in purchasing equipment and miscellaneous items for the use of board members. The equipment is located in board members' homes but remains an asset of UTFC. Most of this expense was for the acquisition of equipment and other miscellaneous items for the Chairman of the Board. The chairman made many of these purchases himself with a UTFC corporate credit card issued in his name. In our opinion, this extensive amount of purchases seems unreasonable given the fact that other Utah quasi-governmental organizations do not provide any assets to board members. Further, the fact that the chairman has a credit card is questionable given the fact that other Utah quasi-governmental organizations do not provide this privilege.

For some board members, UTFC has purchased either a laptop computer or a fax machine which, the board members maintain, helps them facilitate and perform UTFC business. Specifically, two board members have Toshiba laptop computers with a purchase price of $3,045 each and, one board member has a fax machine with a purchase price of $600. However, the Chairman of the Board has more than a fax machine or a laptop. According to UTFC's asset list, the chairman has a Toshiba laptop, two printers, and a docking station. These items had a purchase price of $6,114. In addition to these assets noted, the Chairman also has items he has purchased using a UTFC corporate credit card.

The chairman has a UTFC corporate credit card that has been issued in his name. Other than UTFC's general credit card policy, we could find no other policy identifying how this card was to be used. According to the former Executive Director, the chairman was given a credit card to encourage him to dine with individuals who might be helpful to UTFC. We reviewed the fiscal year 1996 and fiscal year 1997 expenditures on this card. It should be noted that fiscal year 1996 expenditures were far greater than fiscal year 1997 expenditures. During this time period, the chairman charged over $10,000 in expenditures. However, only $309 of meal expense for six meals was noted. Only one of these meal expenses had a stated business purpose (breakfast with the former Executive Director). The remaining five expenses gave neither a business purpose nor a listing of who was entertained. Instead of meals, $7,500 was spent on computer supplies, software and equipment. For example, a Global Positioning System (GPS) interface costing $231, a GPS software package costing $500, a laptop carrying case costing $154 and a laptop modem costing $106 were some of the items purchased. In addition, $2,600 was spent on miscellaneous items such as office supplies, books, and day planner supplies.

The chairman's use of the UTFC corporate card does not seem in keeping with the reason it was given. However, the chairman maintains that the items on his corporate card were purchased to conduct UTFC business. For example, he maintains that the GPS equipment was purchased to test whether an idea had by one of UTFC's clients involving GPS technology could work. We are not convinced that purchasing equipment to test ideas of loan applicants is the best methodology for UTFC to adopt. Further, since the test period is over, we wonder why the equipment continues to be located at the Chairman's house and not at UTFC.

These charges were paid by UTFC because the former Executive Director authorized most of the charges. In our opinion, the Chairman of the Board's expenses are most effectively monitored by other board members. These charges were not reviewed at any level higher than the former Executive Director (i.e., the Executive Committee or, since the Chairman sits on this committee, another sub-committee of the board). In addition, UTFC's accountant was not in a position to effectively question any of these expenses because UTFC is an at-will employer. As a result, it is likely that the accountant might be cautious in challenging either the former Executive Director or the Chairman of the Board.

That board members are provided any assets for home use is an unusual practice among the three quasi-governmental organizations that we called. Neither the Workers' Compensation Fund of Utah, the Utah Retirement Systems, nor the Utah Housing Finance Agency provide any assets to board members for home use. In addition, none of these organizations provide a corporate credit card to the Chairman of the Board. According to the current Executive Director, corporate credit cards are no longer allowed for board members. We also believe that UTFC should reconsider its practices regarding board member assets.

Allegation 6. The former Executive Director engaged in excessive out-of-state travel.

The number of out-of-state trips taken for conferences and training by the former Executive Director may appear excessive when compared to the travel of executive directors of other Utah quasi-governmental organizations. This opinion is shared by a UTFC board member who is currently the organization's acting Executive Director. It is his belief that an excessive number of trips may have occurred because the board monitored only the overall travel budget for the organization. They generally did not review or approve specific trips. The former Executive Director believes that attendance at most of these conferences were mandated by the organizations to which he belonged.

In fiscal years 1996 and 1997, the former Executive Director made approximately 50 out-of-state trips costing approximately $45,500. This expense does not exclusively belong to the former Executive Director. Sometimes other employees traveled with him and some of their expenses which were placed on the former Executive Director's credit card could not be separated. Most of these trips (over 30) occurred in fiscal year 1996. Fifty trips over a two year time period represent an average of 2.1 out-of-state trips a month. These trips were primarily for conferences or training, and their duration appeared to be between two to five days. This number of trips might appear excessive when compared to the out-of-state travel of executive directors in three other quasi-governmental organizations (the Workers' Comp- ensation Fund of Utah, Utah Retirement Systems, and Utah Housing Finance Agency). The travel of the directors in these organizations ranges from two to five out-of-state conferences/ trainings a year. In fiscal years

1996 and 1997, the former Executive Director averaged approximately 25 out-of-state conferences/trainings a year.

The former Executive Director believes that given the number of programs that UTFC has and the number of organizations to which UTFC belongs, the number of trips taken were not excessive. In fact, the former Executive Director maintains that attendance at most of these conferences was required to maintain membership.

Another contributing factor to the number of trips in fiscal year 1996 was that during this time the former Executive Director and an administrative assistant were trying to become certified to teach a particular financial seminar. It should be noted that the Executive Committee approved $25,000 to obtain this certification. In order to become certified, they had to travel to various cities and either observe the seminar or teach part of the seminar. In fiscal year 1996, as many as six trips were taken in their efforts to become certified instructors. While most of this travel was confined to cities in the west, one seminar trip was made to Guam, which cost UTFC over $2,700. Both the former Executive Director and the administrative assistant did become certified to teach the seminar. However, only three seminars have been given to UTFC clients to date. The former administrative assistant explained that both he and the former Executive Director became too involved in operational issues to give any more seminars before the former Executive Director resigned.

The current Executive Director indicated to us that he believes that the out-of-state trips made by the former Executive Director were excessive and sometimes not well justified. He believes this excess resulted because the board did not review and approve specific trips. Rather, the board reviewed only the overall travel budget. The current Executive Director has moved to correct this control problem by requiring that the board review and approve all out-of-state travel.

Recommendations:

1. We recommend that UTFC adopt a conflict of interest policy which disallows board members and their immediate families and UTFC staff and their immediate families from having any interest in any company applying for or receiving UTFC funding.

2. We recommend that UTFC's management and board reconsider its policy allowing the Chairman of the Board to have a corporate credit card. If this practice is allowed to continue, we recommend that a policy be written detailing the chairman's appropriate use of the corporate credit card and that a review system be established to monitor the card's usage.

3. We recommend that UTFC management review its practice regarding purchasing assets for board member use.

4. We recommend the Executive Committee more closely monitor out-of-state travel by

UTFC staff, particularly the Executive Director.

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Agency Response