

Audit Report

Development Agreements Monitoring

February 2017



The City's monitoring generally ensures that businesses comply with contractual requirements prior to releasing development incentives. The City made 11 incentive payments to businesses in calendar years 2014 through 2016. All payments were made after the Economic Development Department verified compliance with the contract terms and an independent reviewer confirmed the Department's results. In 82% of the compliance areas selected for review, the Department performed a thorough review. However, the Department's review of three compliance areas was limited. Additional documentation would provide a stronger basis to ensure compliance.

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Cover: Map of seven active economic development agreements, January 2017, Office of the City Auditor.

Objective

The objective of the audit was to determine if businesses and the City comply with contractual requirements of development agreements.

Background

The City uses economic development agreements to support job creation and economic growth through incentives to businesses. Since 2003, the City has entered into 21 economic development agreements. When we began this audit, the City had active economic development agreements with eight business entities, as shown in Exhibit 1. Since that time, one entity has terminated the agreement leaving seven active agreements.

Exhibit 1: Business Investments and Payments to Businesses

Business	Business's Investments to Date	Jobs Required	City's Incentive Payments to Date
	\$ million		\$ million
Samsung	4,688.5	500	55.8
Apple	253.3	3,635	-
HID Global	61	276	0.1
Visa	30.1	794	0.1
Advisory Board Co.	8.7	239	0.1
Hanger Orthopedic Group	10.8	250	0.3
Domain	No requirement	No requirement	12.8
Total	5052.4	5694	69.2

SOURCE: Economic Development Department, October 2016

NOTE: The City's economic development agreement with the Domain did not specify targets for investments or jobs.

Chapter 380 of the Texas Local Government Code authorizes municipalities to offer incentives to promote economic development.

Texas Local Government Code authorizes municipalities to offer incentives to promote economic development. The agreements contain performance-based requirements that businesses need to meet in order to receive incentives from the City.

The City's Economic Development Department oversees the City's incentive programs. These incentives can be a refund of a portion of property taxes paid by the business or a "per job" payment to businesses by the City for projects that are not capital intensive.

The Economic Development Department performs annual reviews to verify that businesses comply with their contractual requirements prior to the City releasing incentives. In 2009,¹ City Council added a requirement for an independent, third-party reviewer to confirm the results of the Department's reviews. The City hired an external accounting firm to conduct these compliance reviews in accordance with the American Institute of Certified Public Accountants' Attestation Standards.

What We Found

The City's monitoring generally ensures that businesses comply with contractual requirements prior to releasing development incentives, although the documentation reviewed for some requirements is limited.

Every year, the City's Economic Development Department reviews businesses slated to receive incentives to determine their compliance with economic development agreements. In addition, an independent reviewer assists the City in evaluating its compliance reviews, using procedures agreed-upon by both the City and the reviewer. If the annual review confirms compliance, and the independent evaluation confirms the departmental review, then the business is deemed to have fulfilled its obligations for the year. The City then pays the incentive to the business.

Auditors reviewed 11 payments made during calendar years 2014 through 2016 from the City to businesses with active development agreements. In all cases where appropriate, the City made payments to the businesses only after the Economic Development Department verified compliance with the contract terms and its independent reviewer reported that it confirmed the Department's work.

The Economic Development Department conducts the reviews using procedures that verify compliance with the terms of the agreements. In 82% of the compliance areas auditors selected for review, the Department performed a thorough review. The Department's examination included:

- paystubs and other supporting schedules to confirm jobs created;
- a new full-time employee report to confirm average annualized compensation;
- invoices and supporting documentation to support leasehold improvements;
- a 2014 list of minority- or woman-owned business enterprise (MBE/WBE) contractors showing information confirming prevailing wage pay;
- employee handbooks, labor law posters, and application process disclosures to confirm compliance with equal opportunity employment regulations;
- a copy of a memo from the City's Small and Minority Business Resources Department certifying compliance with the MBE/WBE program ordinance;
- site plan applications to confirm compliance with City Code; and
- signed certificates of compliance with the development agreements.

¹ City ordinance no. 20090312-005.

However, in three compliance areas, as noted in Exhibit 2, the City relied on assertions from the businesses to determine compliance. Additional documentation, such as the items listed in Exhibit 2, would provide a stronger basis to ensure compliance. We also identified where, for one transaction involving one business, the records documenting the City's review indicate that the City relied on the business' assertion for a particular requirement and did not provide evidence that it reviewed underlying accounting records.

Exhibit 2: Compliance Areas Needing Additional Review

Area of Compliance	Documentation Concerns
Equal Opportunity Compliance	<p>✓ reviewed: written confirmation asserting compliance with small and minority business-related requirements</p> <p>✗ did not review: documents showing efforts of notifying certified firms</p>
Undocumented Workers	<p>✓ reviewed: written verification stating that they had not been notified of any complaints regarding employment of undocumented workers</p> <p>✗ did not review: confirmation that non-U.S. citizen employees are authorized to work</p>
City Reimbursement Confirmation	<p>✓ reviewed: Department's public website to confirm the payment, including the dollar amount, to a business</p> <p>✗ did not perform: confirmation of payments against the City's accounting records</p>

SOURCE: Office of the City Auditor's analysis, October 2016

Recommendations and Management Response

- 1** | The Economic Development Department Director should strengthen the review procedures that address the documentation concerns identified in this audit to ensure the City obtains conclusive evidence of the business' compliance.

Management Response: Concur

Proposed Implementation Plan:

Equal Opportunity Compliance refers to the companies' efforts to provide opportunities for minority-owned, women-owned and local small businesses to provide non-construction commodities and services worth more than \$5,000 exclusively for use at the Austin location. Typically, these opportunities occur in the first year of the term; in subsequent years, there are few or no new opportunities. There is no way to independently verify that there actually were no new non-construction opportunities.

EDD's monitoring of this requirement is two-pronged. Regardless of whether there were new opportunities or not, EDD asks each company to report their expenditures during the year with businesses that meet the requirement in their agreement, and verifies that (1) the business was certified when the company began doing business with it, and (2) the company can support (with invoices) a sample of the reported spend. If a company's reported spend decreased over the previous year and the company did not provide opportunities to certified firms, we would question why.

The second prong differs depending on whether or not there were new opportunities reported by the company. If not, in order to ensure that the company is aware of its obligations, we ask them to document the process they follow when opportunities arise.

EDD will strengthen agreed-upon procedures to more thoroughly document the City's review.

Regarding Undocumented Workers, EDD will continue to require each company to (1) acknowledge in its Certificate of Compliance that it has complied with its Chapter 380 agreement and (2) sign an acknowledgement each year that it has complied with its obligations under Texas Government Code, Chapter 2264. Beginning in 2017 EDD will explore the feasibility of verifying the US citizenship or authorization to work in the U.S. of each employee in the samples of employees in New Full-time Jobs and Existing Jobs.

Regarding confirmation of Chapter 380 payment amounts, the information on EDD's public website regarding payment amounts and dates is from the City's accounting records;¹ however, that information on EDD's website is transcribed manually, not automatically. EDD will explore methods to automatically populate the date and amount of each Chapter 380 payment from the City's accounting system. In the meantime, EDD will have a second person confirm the accuracy of the payment and incentive information on the website after entries are posted.

Proposed Implementation Date: 2017

² EDD reports on its website the date each Chapter 380 payment was released. For all companies except The Domain, this is the date Financial Services released the payment; however, for The Domain, it is the date EDD sends the payment via certified mail in order to track the date the payment was received by The Domain.

Management Response



MEMORANDUM

TO: Corrie Stokes, City Auditor
Office of the Auditor

CC: Elaine Hart, Interim City Manager
Sue Edwards, Assistant City Manager

FROM: Kevin Johns, Director
Economic Development Department

DATE: January 31, 2017

SUBJECT: Economic Development Department Response to the Audit of Development Agreements

The Economic Development Department (EDD) reviewed your *Audit of Development Agreements Monitoring* report. According to the report, you reviewed 17 compliance areas and found that EDD and the third party independent reviewer thoroughly review 14 of those areas. For the remaining three areas of compliance, you made one recommendation:

Recommendation: The Economic Development Department Director should strengthen the procedures that address the documentation concerns identified in this audit to ensure the City obtains conclusive evidence of the companies' compliance.

Areas of compliance

1. Equal Opportunity Compliance
2. Undocumented Workers
3. City Reimbursement Confirmation

We appreciate the input and deep dive you provided on the Chapter 380 Economic Development Performance Based agreements, and we concur with your recommendation. While you found no instances of non-compliance by companies with Chapter 380 agreements, you found that, in the three areas of compliance listed above, the agreed-upon procedures have not always relied on irrefutable evidence that the companies and the City complied thoroughly with the requirements in their agreements. In some instances, especially where we are verifying that something did not occur (such as knowingly hiring undocumented workers) compliance is difficult at best to demonstrate conclusively. Nevertheless, we recognize the value in strengthening some of our procedures. Since Austin began using economic development incentives we have made comprehensive and continuous improvements to our Chapter 380 program and the performance-based agreements.

Austin's strategic use of economic development incentives began as a response to the 2001 dot.com bust and adapted following the 2008-2009 national recessions. The restrictive, performance-based process is used to attract anchor companies to targeted industry clusters in Austin in an effort to diversify the economy. The purpose of the diversification is to insure that in the event one cluster industry group melts down again there are other clusters to replace it.

Under this system, prospects meeting the criteria in the Firm-Based Incentive Matrix (approved by City Council in Resolution 20131024-056) undergo a specific cost benefit analysis called WebLOCI in order to determine how much money not to give. This software determines the net benefit to Austin through a weighting of the costs to the City (library, parks, police, fire etc.) in comparison to revenues generated by the company (primarily taxes and fees). By design, all performance-based Chapter 380 agreements are cash positive and the estimated return on investment in 2014 was 239%. Our primary socio economic goals are to create good jobs for target populations, and a larger commercial tax base. The latter is to pay for government general infrastructure improvements, operations, and to reduce the tax burden on residents.

Austin's well-recognized and transparent Chapter 380 system was designed by the citizens and approved by City Council. It requires that evaluation and proposed contract documents regarding each prospective Chapter 380 agreement be provided online for citizen review a week prior to the first of two City Council meetings. This insures public input, which is welcome at either or both meetings.

Transparency is a priority for the City and for EDD. In its nation-wide evaluation of governments using economic development incentives, national watchdog group "Good Jobs First" rated Austin's carefully crafted Chapter 380 system as 100% Transparent. In addition, the Texas State University Graduate School of Public Administration Study on Texas Incentives rates Austin as the most prudent, transparent and effective of cities within Texas using economic development incentives.

Since all Chapter 380 agreements are performance-based, no claw backs are needed; incentives are paid only after the company has met its obligations and demonstrated compliance with the terms of its agreement to the City and its third party reviewer. Considerable information is provided on EDD's website regarding Austin's Chapter 380 agreements, including information regarding each Chapter 380 payment made, and key performance verified.

Since 2014, five companies have terminated their Chapter 380 agreements and no agreements have been submitted for approval. Because of the growth of poverty and continuation of the high incidence of unemployment in our minority communities, a review of the Chapter 380 performance-based agreements tools is timely.

While we believe our Chapter 380 compliance review process is effective and transparent, we concur with your recommendation that we strengthen review procedures. EDD's Action Plan is attached as Appendix A to your report.

ACTION PLAN

Development Agreements Audit

Recommendation	Concurrence and Proposed Strategies for Implementation	Status of Strategies	Proposed Implementation Date
The Economic Development Department should strengthen the procedures that address the documentation concerns identified in this audit to ensure the City obtains conclusive evidence of the companies' compliance.	Concur	See below	See below
	<p>Equal Opportunity Compliance refers to the companies' efforts to provide opportunities for minority-owned, women-owned and local small businesses to provide non-construction commodities and services worth more than \$5,000 exclusively for use at the Austin location. Typically, these opportunities occur in the first year of the term; in subsequent years, there are few or no new opportunities. There is no way to independently verify that there actually were no new non-construction opportunities.</p> <p>EDD's monitoring of this requirement is two-pronged. Regardless of whether there were new opportunities or not, EDD asks each company to report their expenditures during the year with businesses that meet the requirement in their agreement, and verifies that (1) the business was certified when the company began doing business with it, and (2) the company can support (with invoices) a sample of the reported spend. If a company's reported spend decreased over the previous year and the company did not provide opportunities to certified firms, we would question why.</p> <p>The second prong differs depending on whether or not there were new opportunities reported by the company. If not, in order to ensure that the company is aware of its obligations, we ask them to document the process they follow when opportunities arise.</p> <p>EDD will strengthen agreed-upon procedures to more thoroughly document the City's review.</p>	Underway	

Recommendation	Concurrence and Proposed Strategies for Implementation	Status of Strategies	Proposed Implementation Date
	Regarding Undocumented Workers, EDD will continue to require each company to (1) acknowledge in its Certificate of Compliance that it has complied with its Chapter 380 agreement and (2) sign an acknowledgement each year that it has complied with its obligations under Texas Government Code, Chapter 2264. Beginning in 2017 EDD will explore the feasibility of verifying the US citizenship or authorization to work in the U.S. of each employee in the samples of employees in New Full-time Jobs and Existing Jobs.	Underway	2017
	Regarding confirmation of Chapter 380 payment amounts, the information on EDD's public website regarding payment amounts and dates is from the City's accounting records ¹ ; however, that information on EDD's website is transcribed manually, not automatically. EDD will explore methods to automatically populate the date and amount of each Chapter 380 payment from the City's accounting system. In the meantime, EDD will have a second person confirm the accuracy of the payment and incentive information on the website after entries are posted.	Planned	2017

¹ EDD reports on its website the date each Chapter 380 payment was released. For all companies except The Domain, this is the date Financial Services released the payment; however, for The Domain, it is the date EDD sends the payment via certified mail in order to track the date the payment was received by The Domain.

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Scope

The audit scope included agreements put in place since 2003 and active in fiscal years 2015 through 2016. We also reviewed incentives paid to businesses in calendar year 2014 through 2016.

Methodology

To accomplish our audit objectives, we performed the following steps:

- researched ordinances and resolutions pertaining to economic development agreements;
- interviewed Economic Development Department staff responsible for overseeing economic development agreements;
- analyzed agreed-upon procedures developed for the independent reviewer by the Economic Development Department;
- interviewed staff from the independent reviewer;
- reviewed compliance reports from businesses participating in economic development agreements with the City;
- tested the Economic Development Department's verification of contract compliance for a judgmental sample of active agreements;
- reviewed, for a sample of active agreements, the Independent Accountant's Reports on Applying Agreed-Upon Procedures prepared by the independent reviewer, and the work supporting their reports; and
- evaluated internal controls related to monitoring economic development agreements.

Audit Standards

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Office of the City Auditor was created by the Austin City Charter as an independent office reporting to City Council to help establish accountability and improve City services. We conduct performance audits to review aspects of a City service or program and provide recommendations for improvement.

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