OFFICE OF THE
UTAH STATE AUDITOR

AUDIT BRIEF

A Performance Audit of The Governor's Office of Economic Development Corporate Incentives Program

Program Results in Significant, Long-Term Tax Commitments with Limited Oversight and Accountability

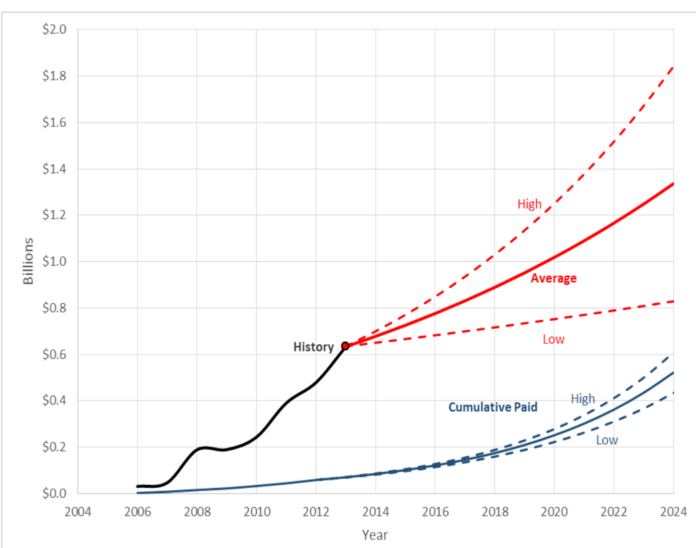
The Governor's Office of Economic Development (GOED) operates the Corporate Recruitment and Incentives Program with the mission to "increase the number of quality jobs in Utah by helping existing companies expand and by recruiting new companies to the State." GOED pursues this mission primarily through economic development tax increment financing (EDTIF), which returns a portion of new incremental tax growth created by the incented company over a given time period.

Inadequate program oversight, which includes limited policies and procedures, threatens the integrity of the corporate incentives program. This audit brief addresses three concerns that demonstrate the effect of inadequate governance:

1. Insufficient post-performance controls led to questionable incentive awards.
2. GOED gradually reduced corporate incentives requirements since 2008.
3. Inadequate oversight limits accountability for corporate incentives.

Each of these three sections contains individual findings that demonstrate the need for greater program oversight, accountability, and transparency. Due to significant concerns regarding the reliability of GOED's data, we were not able to determine the full extent of these concerns. However, several examples in our report demonstrate the effect of insufficient program controls. Implementation of the 32 recommendations in the audit report will increase stakeholder confidence in the incentives program by improving program oversight, accountability, and transparency. We are not convinced that a legitimate post-performance review process can exist without consistently applied policies and procedures for future EDTIF awards. This is especially concerning given the projected future growth of the program.

Background

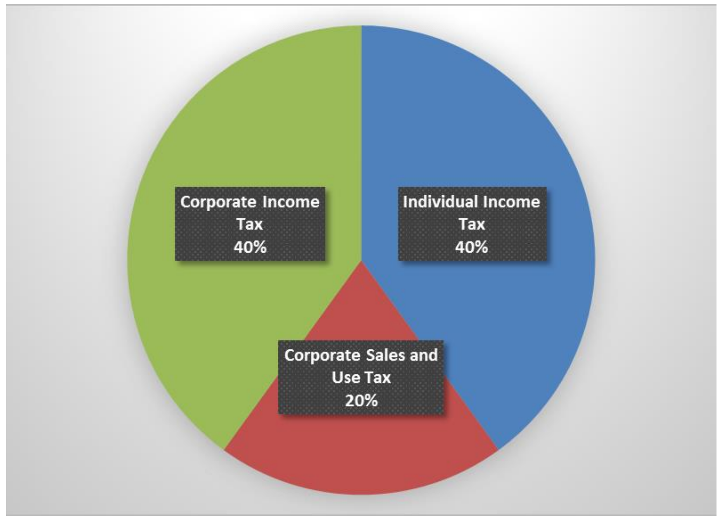


Source: OSA Analysis

GOED reported in its 2013 annual report that incented companies created 11,933 aggregate jobs since 2006 while committing more than $600 million in corporate incentives. If current trends continue, GOED's corporate incentives commitment will reach $1.3 billion by 2024, as shown to the left.

GOED's executive director, who "serves at the pleasure of the governor," has sole authority to authorize incentives with minimal oversight.

The majority of incentives are awarded via EDTIF, which awards companies up to 30 percent of new state revenue for up to 20 years. New state revenue, as illustrated at right, includes (1) corporate income tax, (2) corporate sales and use tax, and (3) withholding of employee-paid individual income taxes. All tax credits are paid out of the state income tax revenues.



Source: OSA analysis of GOED and Tax Commission Data

Section 1: Insufficient Post-Performance Controls Led to Questionable Incentive Awards

GOED inconsistently used post-performance techniques, for which policy does not exist, to approve EDTIF awards for several companies. The two findings in this section demonstrate our concern.

<u>Finding 1: GOED's undefined post-performance review process allows questionable corporate incentive awards</u>

GOED provided special treatment for some companies by altering post-performance assessments for companies that failed to meet GOED's contractual threshold test for EDTIF awards. Among concerns, GOED:

1. used *existing* company employees to inflate the average wages of the new employees created by the corporate incentive award,
2. used an incorrect benchmark to improperly issue an EDTIF award,
3. boosted the average company wage by removing low-paying jobs from the average, and
4. retroactively modified the wage criteria and issued a corporate incentive award to a company that failed to meet the wage criteria under its original contract.

All of these techniques described above are applied inconsistently and without any formal policies or procedures. GOED's treatment of Company B illustrates some of our concerns. Company B did not meet the initial wage criteria that included the average wage of its 62 new employees created as part of its contractual obligation to receive the EDTIF award. In order to justify an EDTIF award, GOED removed the 42 lowest paying jobs from the calculation, annualized employee wages, and added company-paid health benefits to employee wages. By removing these jobs, however, Company B no longer fulfilled the contractual jobs criteria, as shown below.

Company B	Number of Employees	Met New Jobs Bar?	Average Wage	Wage Bar	Met Wage Bar?
Threshold Test Results	62	Yes	$34,282	$52,020	**No**
Second Test Results*	20	**No**	$54,067	$52,020	Yes

Source: GOED and Company B data
**Second test includes annualizing wages, adding health benefits, and removing 42 low-wage employees*

Finding 2: Unverifiable jobs data prevent GOED from validating performance for some companies

GOED was unable to verify jobs that incented companies contracted to third parties. The figure below shows that GOED issued almost $2.8 million in tax credits to two companies, but could not verify 92 percent of the jobs reported by the incented companies.

Company	Year	Jobs Reported	Jobs Verified	Tax Credit Amount
Company E	1	56	2	$472,000
Company E	2	63	2	$1,178,000
Company E	3	75	2	$882,000
Company F	1	28	14	$225,000
Total				**$2,759,000**

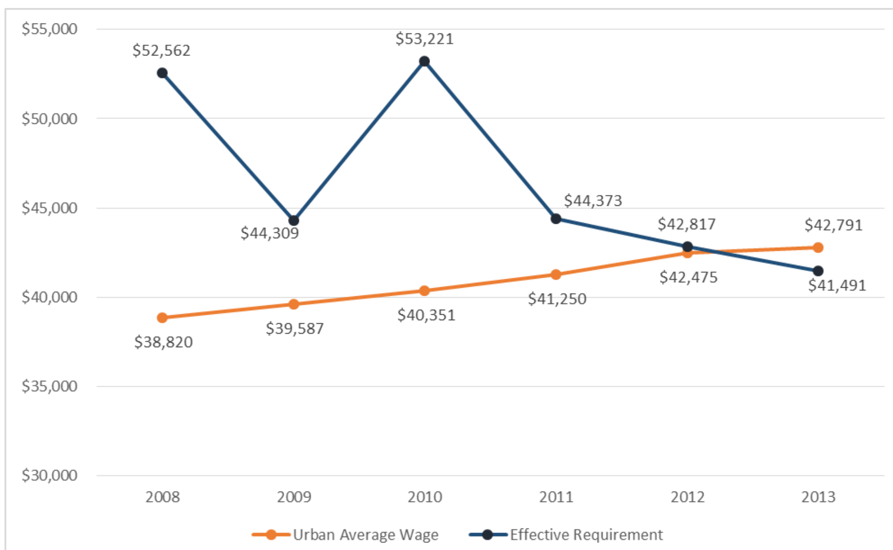
Source: GOED and company data

Section 2: GOED Gradually Reduced Corporate Incentives Requirements Since 2008

Despite improving economic conditions in the state, GOED has progressively lowered company obligations required to receive an EDTIF award, as demonstrated by the three findings in this section.

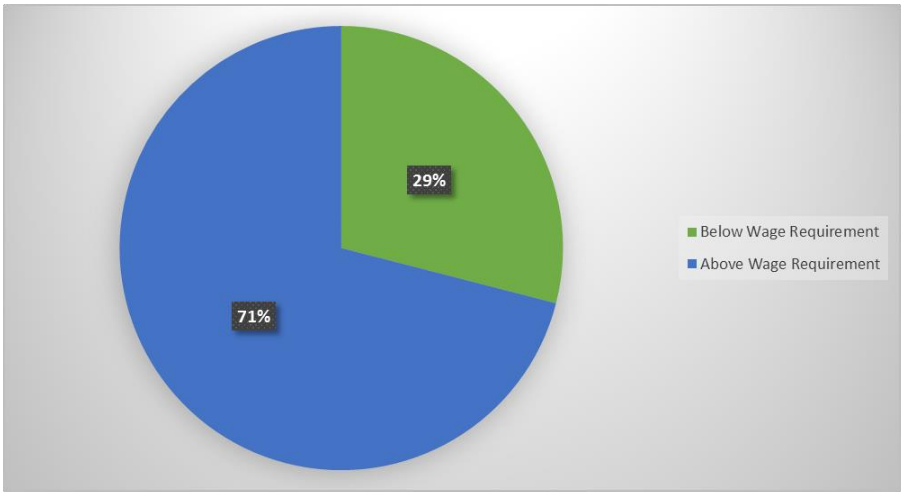
Finding 3: GOED progressively reduced wage requirements for incented companies

GOED has gradually lowered the average wage requirement for newly created jobs in EDTIF contracts from 147 percent of the average urban county wage in 2008 to 125 percent in 2013. Without the inclusion of health benefits with company wages, the effective wage requirement for companies in urban counties was less than the weighted urban county wage in 2013, as shown to the right.



Source: OSA Analysis

Finding 4: GOED incents jobs that pay below the wage requirements



Companies approved for incentives in 2012 and 2013 forecast that almost 30 percent of jobs created under an EDTIF award will pay less than the contractual wage requirement. Using questionable techniques cited in the Audit Report, a company could receive an EDTIF award while producing incremental jobs that actually lower the county average wage, thereby not fulfilling the legislative intent of incenting jobs that "*lift* the wage levels of the communities in which those jobs are created."[1]

Finding 5: Inclusion of company-paid health benefits inflates wages

GOED reports higher wages than some companies actually pay by including unverifiable company-paid health benefits in the employee wages. Almost 25 percent of companies approved for the EDTIF program in 2013 require the inclusion of company-paid health benefits with their projected wages to meet the contractual wage requirement for at least one year of their incentive period.

Section 3: Inadequate Oversight Limits Corporate Incentives Accountability

GOED has the ability to commit future tax revenue without sufficient governing policy or oversight. Considering the amount of future tax revenue GOED can commit, we believe that clearly defined operational boundaries and consistently implemented policies are needed for GOED's corporate incentive approval and review processes.

Finding 6: Insufficient statute, rules, and policy threaten the integrity of the corporate incentives process

GOED chose to follow a maximally-flexible approach allowable within the broad parameters of the statute to operate its corporate incentives program. Defining key terms and establishing policies for processes will improve GOED's accountability and minimize state liability created through its subjective application of post-performance techniques.

Finding 7: Limited oversight impairs GOED's accountability

With only the consideration of advice from its corporate incentives subcommittee, the GOED executive director can, with minimal oversight, dedicate significant future tax revenue to entice companies to relocate or expand in the state. The level of autonomy granted by statute led to questionable decisions, including the decision to approve a company for an incentive length that was double what was necessary for the company to remain and expand in the state. An improved approval process and more frequent reviews would help ensure that corporate incentives are not awarded to companies that would relocate to or expand in the state without a corporate incentive.

[1] Utah Code 63M-1-2402(1)(c) (emphasis added)

Finding 8: GOED reported misleading wages and numbers of projected jobs

GOED misled stakeholders on a regular basis regarding projected wages that a newly incented company will pay and jobs it will create. We found that 85 percent of all press releases in 2013 either falsely stated or implied that *all* projected jobs to be created would pay more than the required amount. Failure to accurately inform stakeholders leads to a misplaced assumption that EDTIF awards add more value than they actually do.

Additionally, GOED regularly reported that companies will create more jobs than required. The following figure demonstrates how GOED's contracts allow companies to create only a fraction of jobs initially reported by GOED.

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Company Projected Jobs (Aggregate)	20	40	60	80	100	100
GOED's Job Creation Requirement	50%	50%	25%	25%	25%	N/A
Number of Jobs Required for Incentive (Aggregate)	10	20	15	20	25	25

Source: OSA Analysis

In this example, GOED could report that a company subject to this provision would create 100 jobs over a five-year period. However, this company's contract would only require it to create 25 jobs over that same period of time.

Recommendations

The Audit Report includes 32 recommendations directed to both GOED and to the Utah State Legislature. These recommendations fall into three main categories.

1) **Clarify the Statute**

   The *Economic Development Incentives Act* is vague and should be clarified with clearly defined parameters. We recommend that the Legislature clearly define key terms and concepts that influence the amount of corporate incentives given to companies, including:

   a. High paying jobs
   b. New incremental job growth
   c. Competition with other states for company relocation
   d. Appropriate length and amount of rebate rates
   e. Urban versus rural county designation
   f. Significant purchases from Utah vendors

2) **Consistent, Fair, and Equitable Program**

   In order to foster positive relationships with the companies with which GOED does business and in order to minimize state liability, GOED should ensure that the corporate incentives program is administered consistently, fairly, and equitably. The current framework sets up a situation where two companies, each providing similar jobs, could receive incentives that differ significantly. Based on the current techniques used by GOED, certain companies may be evaluated differently than other companies, potentially damaging future relationships with companies and creating an unnecessary liability for the state.

3) **Transparent Oversight**

   Additional stakeholder involvement in the EDTIF process would increase the accountability of the corporate incentives program. The Audit Report recommends regular in-depth reports to stakeholders as well as cost-benefit analyses that clearly demonstrate the benefit of a corporate incentive award to the state and its taxpayers. The results of these analyses should be clearly communicated to policymakers and the public. Transparency in GOED's decision making process also protects the state from litigation by companies who might otherwise feel they were treated unfairly.