



Jacksonville Economic Development Commission Incentives Audit

June 27, 2012

Report #728

Released on: January 2, 2013

AUDIT REPORT #728

INTRODUCTION - 1 -

BACKGROUND - 1 -

STATEMENT OF OBJECTIVES - 1 -

STATEMENT OF SCOPE AND METHODOLOGY - 2 -

STATEMENT OF AUDITING STANDARDS - 2 -

AUDIT CONCLUSION - 2 -

AUDITEE RESPONSES - 3 -

OVERALL AUDITEE RESPONSE..... - 3 -

AUDIT OBJECTIVE #1 - 3 -

OFFICE OF THE COUNCIL AUDITOR
Suite 200, St. James Building



June 27, 2012

Report #728

Honorable Members of the City Council
City of Jacksonville

INTRODUCTION

Pursuant to Section 5.10 of the City's Charter and Chapter 102 of the Municipal Code, we conducted an audit of local incentive agreements. These agreements were administered by the Jacksonville Economic Development Commission (JEDC) which was replaced with the Office of Economic Development (OED) in June 2012 in accordance with Ordinance 2012-212-E.

BACKGROUND

On December 21, 2011, the Council Auditor's Office issued JEDC Audit Report #711. The report identified numerous problems and resulted in the subsequent recovery of hundreds of thousands of dollars by the City. The recoveries were primarily due to incentive overpayments to companies who had over-reported the number of jobs created or maintained. On January 18, 2012, the Finance Audit Subcommittee asked the Council Auditor's Office to present options for an additional audit of incentives. On January 24, 2012, the requested follow-up options were discussed at the Finance Audit Subcommittee's meeting. The Council Auditor proposed to expand testing on local incentive agreements with companies that promised to create jobs for local financial incentives. In the initial audit, we tested five of the population of sixteen such companies that received local incentive payments during FY2007/08 through FY2009/10. The proposal for the new audit was to test the other eleven companies that received local incentive payments for job creation. The motion to direct the Council Auditor's Office to conduct the additional incentives audit was adopted by the Audit Subcommittee.

STATEMENT OF OBJECTIVES

The objective of the audit was to determine whether jobs creation data reported to JEDC by the local incentive recipients was accurate.

STATEMENT OF SCOPE AND METHODOLOGY

In the initial audit, the population of companies that received local incentives to create and maintain jobs was sixteen. We audited the job creation data provided by five of the sixteen companies. The scope of this audit is the remaining eleven companies that received local incentive payments during FY2007/08 through FY2009/10 (for jobs created in calendar years 2007 through 2009). We expanded our testing through FY2011/12 (for jobs created through calendar year 2011) and specifically tested for existence of the jobs, full-time status of the jobs, if the employee was located at the local job site and wages where wage amounts were applicable. It should be noted that the City entered into some of the audited agreements years prior to our audit scope period. For each company, we reviewed the contract and documentation submitted to JEDC. We contacted the State of Florida and requested any job verification data available for all companies since local and State incentives are often provided simultaneously. We used the data provided by the State to limit our testing for three companies that were already audited by the State. For all others, we visited the company's site and tested a sample from the lists of employees reported to JEDC. We also reviewed various supporting documentation, including, but not limited to, quarterly unemployment compensation tax reports, payroll logs, and personnel records. When we found inaccuracies in reporting which would result in a monetary recovery for the City, we expanded our testing to cover all years that the company received local incentive payments.

Our report is structured to identify Internal Control Weaknesses, Audit Findings, and Opportunities for Improvement as they relate to our audit objectives. Internal control is a process implemented by management to provide reasonable assurance that they achieve their objectives in relation to the effectiveness and efficiency of operations and compliance with applicable laws and regulations. An Internal Control Weakness is therefore defined as either a defect in the design or operation of the internal controls or is an area in which there are currently no internal controls in place to ensure that objectives are met. An Audit Finding is an instance where management has established internal controls and procedures, but responsible parties are not operating in compliance with the established controls and procedures. An Opportunity for Improvement is a suggestion that we believe could enhance operations.

STATEMENT OF AUDITING 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.

AUDIT CONCLUSION

Jobs creation data reported by local incentive recipients to JEDC was not always accurate.

AUDITEE RESPONSES

Responses from the auditee have been inserted after the respective finding and recommendation. We received these responses from OED, via Paul Crawford, Acting Executive Director, in a memorandum dated December 18, 2012.

OVERALL AUDITEE RESPONSE

Thank you for your continued review of our organization and previous agreements (1997-2003). We are very appreciative of the feedback from your first audit of the 1997-2003 agreements and it is evident that some of the same conclusions determined in that audit were applicable to this final audit.

Since our first audit in December 2011, we have made great strides to address deficiencies and follow through with the Mayor's Compliance Task Force Recommendations. These include:

- Proactive review of compliance prior to the distribution of incentive payments.
- Clear and easily implementable clawback provisions within our agreements.
- Establishing a Compliance Office within the Finance Department with a capable and respected individual with auditing experience (previously gained in the City Council Auditor's Office).
- Modified the OED agreement template to ensure clawbacks and applicable requirements are defensible and enforceable.
- The template is on Version 35 (previous version was 26 when the first audit was performed).

AUDIT OBJECTIVE #1

To determine whether jobs creation data reported by the local incentive recipients to JEDC was accurate.

Finding 1 *Noncompliance with the job creation requirements and incorrect reporting*

We found a significant lack of compliance with the job creation requirements as well as incorrect reporting on jobs created in four out of 11 (or 36%) incentive agreements tested.

1. Company D continuously failed to comply with the job creation requirements set in the incentive agreement. From 2007 through 2011, this company reported anywhere between 37 to 39 full-time employees while creation of 46 jobs was required. The contract did not contain a clawback clause on job creation. If a simple clawback based on a ratio of jobs actually created to jobs expected was included in this agreement, the City would have recovered \$82,362 during the five years tested. Also, out of 50 reported jobs that we tested (ten for each year), three (or 6%) should not have been reported (two were

terminated prior to the year end, and one employee was not working at the local project site). Since the contract did not have a clawback on the jobs creation requirements, the City cannot seek monetary recovery, and we chose not to expand our testing to determine the exact number of jobs created.

2. Company B inaccurately reported jobs created during the years that were used to determine future incentive payments. Per this agreement, annual incentive payments from the City are applied toward an outstanding balance of the City's loan to the developer. The company agreed to create 200 jobs by end of 2006. Since only 185 new jobs were reported, a ratio of 185 to 200 was used to calculate future payments. However, we found that only 180, not 185, new jobs were created in 2006. The negative impact to the City totaled \$54,478.
3. Company T incorrectly reported the number of jobs created for each year tested. The reports often included employees that were terminated prior to the year end and sales employees that were not working at the local project site. The City's overpayments to the company from 2002 to 2010 totaled \$20,406.
4. Company G included part-time jobs in its reporting even though the contract called for full-time jobs. The company agreed to create 120 new full-time jobs and reported anywhere between 134 to 151 jobs created during the years when incentive payments were made. However, many jobs that were created were part-time jobs, which should not have counted because the contract required full-time jobs. Although Company G identified the jobs as either full-time or part-time when it reported, JEDC did not reduce incentive payments for the shortfall in full-time jobs created, with the result that the City overpaid Company G a total of \$34,835.

Recommendation to Finding 1

OED should recover \$20,406 from Company T and \$34,835 from Company G. Also, the balance of the loan to Company B should be increased by \$54,478. OED should also ensure that a job creation clawback clause is included in every incentive agreement. Finally, OED should establish procedures to verify the job creation information provided to them by companies receiving incentives before incentive payments are made.

Auditee Response to Finding 1

Agree Disagree Partially Agree

The OED has recovered payment overage from Company T and is seeking payment recovery from Company G. The OED has additionally notified Company B of the revised calculation of the loan balance to reflect the shortage in jobs. The OED agreement template has standard job creation clawbacks which will continue to be included in all future economic development agreements. The OED has initiated procedures requiring that job creation be verified before incentive payments are made to companies. This includes a review of the documentation provided by the company as well as a physical site visit to review the company's payroll system.

Finding 2 *Inadequate job creation requirements/clawbacks in the incentive agreements*

The job creation requirements and clawbacks for jobs creation requirements in three out of 11 (or 27%) incentive agreements tested were inadequate.

1. Per the project summary, it was the intention of Company E1 to create 60 new jobs and to relocate 70 existing jobs to the project site for a total of 130 jobs at the project site. However, the contract was silent on the existing jobs, and only mentioned the creation of 60 new jobs. In addition, there was no job creation clawback in the agreement.
2. Per the agreement, Company K was to create 360 new jobs and maintain 50 existing jobs. However, the jobs creation clawback only required creation of 300 jobs. Moreover, the job creation clawback did not contain clear verbiage to prohibit counting existing jobs towards the 300 job requirement.
3. Company E2 received incentive payments for two phases of the project where 50 new jobs were to be created in each phase. However, the contract only included a clawback on jobs creation for the first phase of the project.

Recommendation to Finding 2

OED should ensure that information about existing jobs is taken into consideration when job creation requirements and clawbacks are created. OED should also ensure that job creation clawbacks always correlate to the job creation requirements.

Auditee Response to Finding 2

Agree Disagree Partially Agree

The agreements tested and referenced in the audit were older agreements. The OED has a new agreement template which includes information on a company's existing jobs and the number of new jobs to be created. The agreement template additionally has standard clawbacks that relate to a company maintaining the existing jobs and creating the new jobs. The OED has reviewed the agreement template to ensure that job creation clawbacks correlate to job creation requirements.

Finding 3 *Lack of job creation clawbacks in the incentive agreements*

Some incentive agreements lacked job creation clawbacks. Two out of 11 (or 18%) agreements did not have job creation clawbacks. One of those two companies was not compliant with the job creation requirements (see Finding 1, part 1). Since there was no clawback in the agreement, the City was not able to recover any funds invested. It should be noted that the current template used by OED for incentive agreements has a clawback section.

Recommendation to Finding 3

OED should ensure that clawbacks are always included in each incentive agreement.

Auditee Response to Finding 3

Agree Disagree Partially Agree

As noted by the Council Auditor's Office, the current OED agreement template has standard clawbacks that relate to job creation. It is the OED's intention to continue to use the standard clawbacks for job creation as laid out in the agreement template for future economic development projects.

Finding 4 *Inconsistency in wage requirements in the incentive agreements*

Wage requirements in the incentive agreements were not consistent. Six out of 11 (or 55%) incentive agreements tested did not have wage requirements. Also, out of five agreements that contained wage requirements, three (or 60%) did not have any inflation adjustment verbiage (Consumer Price Index, for example). It should be noted that the current template used by OED for incentive agreements has a wage requirements section; however, it does not include any inflation adjustment verbiage.

Recommendation to Finding 4

Wage requirements should be included in incentive agreements and should have consistent language.

Auditee Response to Finding 4

Agree Disagree Partially Agree

As noted by the Council Auditor's Office, the current OED agreement template has a wage requirement. The OED will review the template to see if it would be appropriate to modify the language to include any inflation adjustment verbiage.

Finding 5 *Inadequate and inconsistent definitions for employment requirements in the incentive agreements*

Overall, we found a lack of adequate and consistent definitions for employment requirements in the incentive agreements, which could lead to the creation of jobs that do not satisfy the City's intention and vision. This lack of clarity in definitions makes it more difficult for the City to prove non-compliance with job creation requirements.

1. Only one out of 11 (or 9%) incentive agreements tested had a definition for full-time employment in terms of hours worked per week. It should be noted that a current

template used by OED defines full-time employment in terms of hours worked per week (minimum of 30 hours).

2. One out of 11 (or 9%) agreements tested did not define jobs as full-time jobs. “Retention of an average of 1,500 employees at the project site during a calendar year” was required while there was no definition of an employee in terms of full-time employment or hours worked per week. It should be noted that a current template used by OED defines permanent jobs as full-time equivalent jobs and also defines full-time employment in terms of hours worked per week.
3. Four out of 11 (or 36%) contracts tested described new jobs to be created as “full-time equivalent” jobs while the term “equivalent” was not used in the rest of the contracts reviewed. It should be noted that a current template used by OED defines new jobs as “full-time equivalent” jobs.
4. Four out of 11 (or 36%) agreements tested described the expected length of the full-time jobs created as a “minimum of two years”, while six (or 55%) contracts defined it as “more than one year”. One contract did not specify a minimum length of time. It should be noted that a current template used by OED requires for jobs “to be maintained for a minimum of two years”.
5. One out of 11 (or 9%) agreements tested required for jobs to be counted using average monthly employment while the rest of the contracts used annual counts at the end of the year. It should be noted that a current template used by OED requires for incentive payments to be calculated based on annual reports that are turned in as of the end of the calendar year.
6. One out of 11 (or 9%) contracts tested required creation of full-time and part-time jobs while the rest of the contracts usually required creation of full-time or full-time equivalent jobs. It should be noted that a current template used by OED defines permanent jobs as full-time equivalent jobs.

Recommendation to Finding 5

OED should ensure that a definition of full-time employment is included in each agreement and should use consistent employment requirement definitions for all incentive agreements.

Auditee Response to Finding 5

Agree Disagree Partially Agree

As noted by the Council Auditor's Office, the current OED agreement template contains a definition of full-time employment as 35 hours worked per week. The OED will continue to use the agreement template and maintain the definition of full-time employment in the template.

Finding 6 *Lack of record retention clauses in the incentive agreements*

Most of the incentive agreements lacked a record retention clause for audit purposes. Only two out of 11 (or 18%) contracts tested contained a record retention clause that required records to be retained for a period of 6 years at no additional cost to the City. Absence of a record retention clause limits the City’s ability to verify compliance with contractual requirements. It should be noted that a new template used by OED has such a clause.

Recommendation to Finding 6

OED should ensure that a clause on records retention is included in each incentive agreement.

Auditee Response to Finding 6

Agree Disagree Partially Agree

As noted by the Council Auditor's Office, the current OED agreement template contains a clause on the retention of records. The OED will continue to use the agreement template with the clause on the retention of records for future economic development projects.

Finding 7 *Jobs creation by third-party employers in the incentive agreements*

Agreements allow for jobs to be created by a third-party employer which creates problems with accessing records to verify employment. In one out of 11 (or 9%) agreements tested, we were partially unable to verify employment required by the agreement since no records from a third-party employer were available.

Recommendation to Finding 7

OED should ensure that a clause on records retention is included in each incentive agreement. While it should be noted that a new template used by OED contains a record retention clause, such clause should also specify that the company that received incentives must keep auditable records pertaining to jobs filled by third-party employers. In addition, we recommend that companies be required to list employees by applicable third-party employer in their routine job reporting to OED.

Auditee Response to Finding 7

Agree Disagree Partially Agree

While the current OED agreement template requires the retention of records as it relates to employment, the OED will review and modify the agreement template to specify that companies also maintain records on any employees hired through third-party employers. Additionally, the Jobs Report will be reviewed and modified as necessary to require companies to report any employees that have been hired through third-party employers.

Opportunity for Improvement 1 *Stricter Job Requirements*

In various instances, we noted that job requirements described in the new template for incentive contracts used by OED might not align with the City’s intention and vision for job creation.

1. As noted in Finding 4, the current template does not have any inflation adjustment verbiage. Incentives are paid out over a long period of time (e.g. 5 to 10 years or more), which is sometimes preceded by a construction period. With no inflation adjustment requirement, the wage requirement agreed upon when an incentive contract is signed may lose its significance.
2. As noted in Finding 5, the current template defines full-time employment as a minimum of 30 hours worked per week. It is a widely common practice to define full-time employment as employment requiring 40 hours of work per week. While this number might be different for various companies, a standard of 40 hours could be used in the OED template and adjusted on an individual company basis.
3. As noted in Finding 7, the current template allows for jobs to be created by third-party employers. Based on our audit, it appears that allowing jobs by a third-party employer usually means using temporary workers from various staffing agencies. We are not convinced that these jobs fulfill the City’s objective of creating high wage jobs and enhancing economic growth.

Recommendation to Opportunity for Improvement 1

OED should consider adding inflation adjustment criteria to job requirements. A default level of 40 hours of work per week should be used to define full-time employment. OED should consider ending the current practice of giving credit for jobs created by third-party employers.

Auditee Response to Opportunity for Improvement 1

Agree Disagree Partially Agree

As previously stated, the OED will review the OED agreement template to see if it would be appropriate to modify the wage requirement language to include any inflation adjustment verbiage. The current OED agreement template defines a full-time job as 35 hours per week. The Bureau of Labor Statistics also defines a full-time job as 35 hours per week and therefore the OED will maintain 35 hours per week as its standard definition of full-time employment. While the OED agrees that in the instance mentioned in the report the use of a third-party employer was for the hiring of temporary workers; that was one instance. Larger companies sometimes have the practice of hiring employees through a third-party employer to see if the employee will fit in with the company. The OED would like to continue to allow companies to take credit for employees hired on a probationary status through third-party employers. The language in the OED template will be reviewed and modified to further define that employees hired through third-party employers are for probationary purposes and not as temporary workers.

We appreciate the assistance and cooperation we received from OED through the course of this audit.

Respectfully submitted,

Kirk A. Sherman, CPA
Council Auditor

Audit Performed By:

Kyle Billy, CPA
Elena Korsakova, CPA