

COUNTY AUDIT DEPARTMENT

REPORT # 374

An Audit of:

ECONOMIC DEVELOPMENT LOCAL INCENTIVE AGREEMENT MONITORING

JANUARY 14, 2020



Pat Frank INTEGRITY. TRANSPARENCY. ACCOUNTABILITY.

CLERK OF COURT & COMPTROLLER • HILLSBOROUGH COUNTY, FLORIDA



January 14, 2020

The Honorable Lesley “Les” Miller, Jr., Chairman
The Honorable Ken Hagan
The Honorable Pat Kemp
The Honorable Sandra L. Murman
The Honorable Kimberly Overman
The Honorable Mariella Smith
The Honorable Stacy R. White

Dear Chairman Miller and Commissioners:

The Audit Team performed an audit of Economic Development Local Incentive Agreement Monitoring (Audit Report # 374, dated January 14, 2020). Responses to the Audit Team’s recommendations were received from the Director of Economic Development and have been included in the Report after each audit comment and recommendation.

The purpose of this Report is to furnish management independent, objective analysis, recommendations, counsel, and information concerning the activities reviewed. It is not an appraisal or rating of management.

Although the Audit Team exercised due professional care in the performance of this audit, this should not be construed to mean that unreported noncompliance or irregularities do not exist. The deterrence of fraud and/or employee abuse is the responsibility of management. Audit procedures alone, even when carried out with professional care, do not guarantee that fraud or abuse will be detected.

The Audit Team appreciates the cooperation and professional courtesies extended to the auditors by the Director and personnel of Economic Development during this audit.

Sincerely,

Heidi Pinner, CIA, CISA, CFE, CRMA
Senior Director, County Audit

CC: Mike Merrill, County Administrator
Bonnie Wise, Deputy County Administrator/Chief Financial Administrator
Ron Barton, Assistant County Administrator
Lindsey Kimball, Director, Economic Development
Kevin Brickey, Director, Management & Budget
Dan Klein, Chief Executive Officer, Clerk of Court and Comptroller
Rick VanArsdall, Chief Operating Officer, Clerk to the Board

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EXECUTIVE SUMMARY

BACKGROUND INFORMATION

Hillsborough County's Economic Development Department works to improve the County's business climate and make the County more attractive for job and wealth creation. The Corporate Business Development team within Economic Development provides assistance to businesses including negotiating and coordinating state and local financial incentives linked directly to higher job creation. In some cases, a business may be offered a reduction of their ad-valorem property taxes if the business meets certain qualifying criteria, such as creating a certain number of jobs, paying higher wages, and/or spending a certain amount in capital expenditures. Creation of an ad-valorem tax exemption incentive program is authorized under Article VII, Section 3, of the Constitution of the State of Florida and Section 196.1995, Florida Statutes. The Hillsborough County program was approved by voters in a 2010 referendum, adopted as a program ordinance in 2011 and updated in 2017 by the Board of County Commissioners (BOCC). There are other incentive programs administered by Economic Development such as the Premier Business Bonus Initiative (PBBI), Impact Fee Mitigation, and Small Business Expansion Grants.

When an ad-valorem tax exemption incentive is offered, the business enters into a written agreement with the County detailing specific requirements that the business must achieve in order to receive the exemption. The Corporate Business Development team is then responsible for monitoring the business's compliance to determine whether or not the business has met the requirements, such as performing site visits, reviewing supporting documents and invoices, and reviewing payroll and human resources (HR) data for the business. The business also submits information to the State of Florida Department of Revenue (DOR) via standardized forms and an affidavit to Economic Development showing statistics such as payroll data, capital expenditures, and number of job positions employed. Once compliance is confirmed, Economic Development issues an annual memo to the Hillsborough County Property Appraiser and prepares a separate compliance memo stating whether or not the business was in material compliance.

OBJECTIVE

The objective of the audit was to determine whether or not there are adequate controls to ensure metrics are met by local businesses before businesses receive any tax exemption incentives from the County.

SCOPE

The audit was conducted in conformance with the *Generally Accepted Government Auditing Standards* and the *International Standards for the Professional Practice of Internal Auditing*. These Standards require that County Audit plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the audit comments and conclusions based on the audit objectives. County Audit believes that the evidence obtained provides this reasonable basis.

The audit scope included the current state of management controls and testing of compliance monitoring for incentives awarded between October 1, 2017 and December 31, 2018.

OVERALL EVALUATION

Opportunities exist to improve controls over compliance review to ensure metrics are met by local businesses before receiving tax exemption incentives.

Process strengths:

- Exemptions incentives are not awarded prior to compliance verification.
- Participating businesses must supply documentation to support the achievement of program requirements.
- Participating businesses must certify compliance with affidavits.
- Annual compliance memos are drafted and delivered directly to the Property Appraiser to effectuate the ad valorem tax exemption incentive. Payments are not made to the businesses.
- Economic Development monitors the status of program participants and performs site visits to assess program compliance.

Control improvement opportunities:

- Wage and full-time equivalent (FTE) calculations use monthly totals instead of pay weeks or pay periods, which reduces the accuracy of calculations.
- Clarity is needed to determine whether or not part-time employees and/or contractors may be used to satisfy required metrics.
- Compliance verification often relies on self-reported information and/or an affidavit from the business.

Full testing results are included on page 4 of this Report.

OPINION



The overall control environment relative to providing County tax exemption incentives to local businesses for the Ad Valorem program is at the formal (defined) maturity level. This means that controls are well defined and are in place, an overall control awareness exists, and control gaps are detected and remediated in a timely manner. Performance monitoring is informal, placing great reliance on the diligence of people and independent audits. Addressing the opportunities identified in this Report will further enhance the overall control structure and provide increased consistency and assurance.

The exit conference was held on December 12, 2019.

Other minor concerns not included in this Report were communicated to management and/or corrected during fieldwork.

AUDITED BY

Heidi Pinner, CIA, CISA, CFE, CRMA, Senior Director, County Audit
Ben Everett, CPA, CIA, CFE, Audit Manager
Greg McCullough, CPA, CIA, CFE, Senior Internal Auditor

AUDIT COMMENT & RECOMMENDATIONS

Opportunities exist to improve controls over compliance review to ensure metrics are met by local businesses before receiving tax exemption incentives.

The objective was to determine whether or not there are adequate controls to ensure metrics are met by local businesses before businesses receive any tax exemption incentives from the County.

Testing of Compliance Monitoring Performed

There were 10 companies identified in the Ad Valorem Tax Exemption program at the time of testing. Two of these companies had received an actual ad Valorem tax exemption incentive as of January, 2019: Granex, Inc. and Amazon. The fiscal year (FY) 2018 exemptions provided to Granex and Amazon used the 2016 calendar year as the compliance period. The Audit Team reviewed the two incentive agreements and identified the following compliance requirements:

- Granex, Inc. was required to create at least 10 new full-time equivalent (FTE) jobs with no certain wage requirement, and to spend at least \$200,000 in capital expenditures per job created, for a total of \$2 million.

Agreement Approved	FY 2016 Exemption	FY 2017 Exemption	FY 2018 Exemption	FY 2019 Exemption	Total Exemption
June 2013	N/A	N/A	\$11,853	\$12,803	\$24,656

- Amazon was required to create at least 75 new FTEs with an average annual wage of at least \$47,581. In addition, Amazon must have a sales factor of less than 50%, meaning that Amazon’s sales to Florida taxpayers from the company’s Ruskin fulfillment center must not be more than 50% of the Ruskin fulfillment center’s total sales everywhere. There was no capital expenditure requirement for Amazon.

Agreement Approved	FY 2016 Exemption	FY 2017 Exemption	FY 2018 Exemption	FY 2019 Exemption	Total Exemption
July 2013	\$655,686	\$881,717	\$899,988	Withdrew	\$2,437,391

The Audit Team reviewed related supporting documents to determine whether or not the requirements were met, including:

- Employee HR and payroll data that the businesses file with the DOR and provide to Economic Development;
- Affidavits signed by company executives attesting to the accuracy of the data;
- Any invoices showing the amount of capital expenditures made;

- Economic Development's documentation of their monitoring results, such as their site visits, photos, memos, Excel spreadsheets, e-mails, and anything showing that each company's compliance was verified.

Results of Testing For Granex, Inc.

Exceptions were identified for the FTE requirement.

To support the requirement of 10 new full time employees, Granex supplied HR data indicating there were 11 FTEs in 2016. The Ad Valorem Program ordinance defines an FTE as "... a person who is employed by a Business that works at least 35 hours per week and is eligible to receive benefits, including health benefits, through their employer, subject to any eligible vesting periods."

- Six (6) of the 11 FTEs reported by Granex were contractors and not reported in the data that Granex filed with the DOR.
 - Three were for managers employed through a sister company called ACME Stone, Inc., which has the same owner as Granex. The Audit Team was unable to obtain any contract agreements showing that the three managers were contracted to work for Granex.
 - The other three contractors were for security guards provided through contracts with security companies and were not direct employees of Granex. These security contracts were also for time periods outside the compliance year.
- Economic Development advised that it is common practice in the industry for contract employees to be counted toward meeting job creation requirements. However, the definition of FTEs in the ad valorem program ordinance does not make mention of whether or not contractors and/or part-time employees may be used to calculate the total number of FTEs.
- The Excel formula that calculates the number of FTEs based on Granex's HR data calculated a value of 0.5 FTE if an employee worked between 20 - 34 hours per week. However, the program ordinance does not include any provision for employees working under 35 hours per week.
- The compliance spreadsheet utilizes months to calculate the number of FTEs annually, but HR data is traditionally based on pay weeks or pay periods, not months. This is problematic because 1 month typically has 4 weeks plus a couple of days and therefore will always have a partial pay week or pay period in it. The use of pay months makes it difficult to determine the number of FTEs because months don't coincide with the number of pay weeks or pay periods traditionally used by organizations.
- A calculation in the compliance spreadsheet also used the number of pay periods for data that represented pay weeks. This caused some employees working less than 35 hours per

week on average to be counted as 1.0 FTE. Changing the number of pay periods to the number of pay weeks in the formula results in 9.5 total FTE, with 0.5 FTE for each of the 3 security guards. Economic Development has advised that for compliance purposes, 9.5 would round up to 10 and achieve compliance.

Affidavit requirements were met ✓

Granex had submitted the required Compliance Assurance Affidavit which was signed, notarized and listed performance objectives that matched those of the County agreement.

Capital expenditures requirements were met ✓

The Audit Team determined that Granex met the \$2 million capital expenditure requirement, based on an invoice showing capital expenditures made by Granex in euros. The Audit Team used an online currency conversion factor as-of the invoice date and verified that the equivalent U. S. dollar amount was just over the \$2 million requirement.

Monitoring requirements were met ✓

- Economic Development provided the Audit Team with photos indicating that Economic Development performed site visits of Granex, including the grand opening.
- The Audit Team reviewed Economic Development's 2016 compliance memo stating that Granex was in compliance. The performance requirements listed in the memo agreed to the requirements in the Granex agreement.
- Economic Development also sent a memo to the Property Appraiser's Office stating that there was material compliance, which agrees with what was stated on the compliance memo.

Results of Testing For Amazon

FTE and wage requirements were met ✓

To support the requirement of 75 new full time employees, Amazon supplied HR data indicating there were 75 FTEs in 2016.

- The Audit Team selected a sample of 10 of the 75 employee line items from Amazon's HR data and compared it to the data that was submitted to the State. The wage data that Amazon submitted to Economic Development matched what was submitted to the State for those 10 employees.
- The Audit Team also reviewed the hire date listed in the HR data to determine if employees were hired before or after the date of the agreement and observed that many of the

employees listed in the report were hired before the effective date of the agreement. Per Economic Development, Amazon had no presence in Hillsborough County prior to their Ad Valorem agreement with the County and it is acceptable for companies to relocate existing employees from out of state to startup a new location. Therefore, all employees were new employees to the applicable site in Hillsborough County.

- Economic Development uses an Excel spreadsheet to analyze the HR data submitted by Amazon. The spreadsheet data is broken out in monthly columns because wording in the program ordinance requires a monthly measurement calculation. However, this requirement makes it difficult to calculate the average number of FTEs because 1 month doesn't have an exact number of pay weeks or pay periods. Most months have 4 weeks plus a couple extra days which doesn't line up exactly with each pay week or period. To verify the Amazon employment requirements, Economic Development used an alternative calculation based on the total number of working hours for the year, which the Audit Team reviewed and determined was reasonable.
- The Excel formula used to verify FTE calculates a value of 0.5 FTE if an employee works between 20 - 34 hours per week. The County's program ordinance states that an FTE is an employee working at least 35 hours per week. The ordinance makes no mention of part-time employees. While using the 0.5 FTE may be common practice, it appears inconsistent with the language in the ordinance.
- The Audit Team reviewed the wages paid and the Excel formula that calculates the average annual wage. The formula appears reasonable and the average annual wage was re-calculated by the Audit Team, which was well above the \$47,581 amount required in the agreement.

Affidavit requirements were met ✓

The Audit Team reviewed Amazon's affidavit and noted that the performance objectives listed on the affidavit agreed to the Amazon agreement except for the sales factor requirement. However, Amazon also signed another affidavit on a form called a DR-418 which showed their sales totals and resulting sales factor as being in compliance under the 50% requirement.

Capital expenditures requirements were met ✓

The Amazon agreement had no requirements for the company to make capital expenditures.

Monitoring requirements were met ✓

- Economic Development had visited the Amazon site on four different occasions: the ground breaking ceremony, a tour of the building with the Property Appraiser's Office, a tour of the building with the Governor, and an additional visit to review I-9 forms for employees listed in Amazon's HR data. Economic Development does not maintain records

documenting their tours, but had pictures on file of the Amazon site and a memo on file of the site visit to verify I-9 forms.

- The compliance memo issued by Economic Development indicated compliance with the wage and FTE requirements, but omitted stating that Amazon was in compliance with the sales factor requirement. Economic Development stated they did review the DR-418 to determine that Amazon was in compliance.
- The result of material compliance on the compliance memo agreed with the result of material compliance noted on Economic Development’s Annual Ad Valorem memo to the Property Appraiser.

Inactive Ad-Valorem Participants

The other 8 companies in the Ad Valorem Tax Exemption Program had not received any actual Ad Valorem tax incentive as of January 2019:

- One of the companies was terminated for non-compliance.
- Another company withdrew from the ad-valorem program.
- The remaining 6 companies had not yet had a compliance monitoring performed.

The Audit Team judgmentally selected 3 of the 6 remaining businesses for testing. These included NexLube Tampa, LLC, Toufayan Bakery of Plant City, Inc., and NewSouth Window Solutions, LLC. NexLube was selected due to the higher projected exemption amount, the higher exemption term and higher age of agreement since BOCC approval. Toufayan Bakery and NewSouth Window Solutions were selected due to the higher age of the agreement. The Audit Team reviewed the agreements for the selected sample items and obtained information from Economic Development to determine whether or not a compliance review should have been completed.

Company	Agreement Approved	Requirements	Estimated Incentive
NexLube Tampa, LLC	June 2012	30 new jobs Wage requirement specified No capital expenditure	\$3,393,075.00
Toufayan Bakery of Plant City, Inc.	May 2014	Maintain 212 pre-existing jobs 10 new jobs No wage requirement \$2M capital expenditures	\$255,234.20
NewSouth Window Solutions, LLC	December 2016	Maintain 109 pre-existing jobs 30 new jobs No wage requirement \$6M capital expenditures	\$349,552.00

Results of Testing

It is reasonable that the compliance review would not have been completed for these 3 companies:

- NexLube and Toufayan Bakery did not have construction completed in time for a compliance monitoring to be done.
- NewSouth Windows' exemption doesn't go into effect until the year starting on January 1, 2020.

Program Utilization Analysis

In addition to the ad-valorem program, there are other incentive programs administered by Economic Development:

- Premier Business Bonus Incentive (PBBI)
- Impact Fee Mitigation Program
- Small Business Expansion Grant

The Audit Team inquired with Economic Development about the status and utilization of these programs and the Ad Valorem program. The Audit Team also inquired to determine the reason that the programs are not used by businesses more than they are currently being used.

Results of Testing

Economic Development indicated that:

- The PBBI program is still active, but only one company used it, and the program is not being used by any organizations currently.
- The Impact Fee Mitigation Program is defunct now since the transportation impact fee was replaced by the mobility fee.
- The Small Business Expansion Grant is no longer active because the sunset date has passed for new companies to join, which was 12/31/2015.

The County's Ad Valorem ordinance #11-1 states that the exemption granted by the Board shall not result in an estimated aggregate annual amount of forgone Ad Valorem tax revenues in excess of \$2,000,000. Ordinance #17-27 increased the annual maximum to \$3,000,000. There is no lifetime maximum for the program. Based on data provided by Economic Development for FY2016-FY2018, total actual incentives remain under \$1M per year.

Per management, it is the intent of the County to use incentives as sparingly as possible. Therefore, the fact that the Ad Valorem program is utilized under its capacity is a positive.

RECOMMENDATIONS

To enhance the controls over compliance monitoring in future agreements, management should:

1. Ensure that sufficient evidence is obtained and reviewed to confirm any contract employees used to meet compliance requirements and that contracts are valid for the compliance period being reviewed.
2. Ensure they are reviewing and validating the accuracy of the formulas used for full time equivalent (FTE) calculations prior to concluding on the compliance review results for the year.
3. Clarify the definition of FTE for programs or agreements of this nature to specifically indicate what is allowed. This includes defining whether partial FTE amounts are permitted and whether third party contractors are permitted to be included in the FTE calculation.
4. Ensure that all compliance criteria are included in the annual Compliance Analysis Memo and document what evidence was relied upon to reach the compliance conclusion.
5. Modify the HR Report to allow for FTE calculations to be done more effectively, once the definition for FTE and average annual employment is clarified. Future compliance periods should use pay periods versus monthly periods, and future governing documents such as ordinances should avoid the use of months versus pay periods.

CLIENT RESPONSE

Concur

CORRECTIVE ACTION PLAN

Future incentive program ordinances, guidelines and procedures, will provide for a clear definition of what constitutes an FTE. Likewise, future incentive programs will have a clearly defined methodology for calculating average annual employment and salaries based on pay periods (versus months), as well as, clearly defined standards for how to include contract employees in these reporting numbers.

TARGET COMPLETION DATE

July 31, 2020