



ECONOMIC DEVELOPMENT INCENTIVES PERFORMANCE AUDIT

JUNE 2016

DURHAM



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CITY OF MEDICINE

CITY OF DURHAM
AUDIT SERVICES DEPARTMENT

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To: Audit Services Oversight Committee
From: Dr. Germaine Brewington, Director
Audit Services Department
Date: June 27, 2016
Re: Economic Development Incentives Performance
Audit June 2016

The Department of Audit Services completed the report on the Economic Development Incentives Performance Audit dated June 2016. The purpose of the audit was to ensure that the Office of Economic and Workforce Development (OEWD) staff monitored each recipient's compliance with the terms and conditions of their incentive agreement prior to issuing incentive payments.

This report presents the observations, results, and recommendations of the Economic Development Incentives Performance Audit dated June 2016. City management concur with the recommendations made. Management's response to the recommendations is included with the attached report.

The Department of Audit Services appreciates the contribution of time and other resources from employees of the Office of Economic and Workforce Development in the completion of this audit.

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BACKGROUND INFORMATION

The Office of Economic and Workforce Development (OEWD) may provide economic development incentives to eligible projects that support and assist in the creation, retention or expansion of businesses in Durham. These incentives are provided in the form of cash payments. Agreements often include performance requirements that the recipient must fulfill as a condition of the incentive extended by the City. For this reason, it is vital that City staff evaluate/validate the performance requirements of the recipients to ensure that the City's economic development objectives are realized.

Resolution number 9890 "Resolution Establishing an Economic Development Financial Assistance and Incentive Policy for Job Creation, Job Retention and Capital Investment" defines the different ways in which projects can qualify for incentives.

Exhibit 1 outlines all active incentive agreements as of March 29, 2016. Agreements with incentive payments that have been disbursed are identified.

BACKGROUND INFORMATION

Exhibit 1: Active Incentive Agreements As at March 29, 2016

CONTRACT NUMBER	COMPANY	INCENTIVE TYPE	CONTRACT DATE	CONTRACT TOTAL
12492	A&J CAPITAL, INC	NEIGHBORHOOD REVITALIZATION GRANT	2/2/2015	\$170,000
11802	CTR. FOR COMMUNITY SELF HELP	NEIGHBORHOOD REVITALIZATION GRANT	6/19/2014	\$220,000
11799	REINVESTMENT PARTNERS	NEIGHBORHOOD REVITALIZATION GRANT	6/18/2014	\$100,000
11579	CPGPI REGENCY DEVELOPMENT LLC	INFRASTRUCTURE REDEVELOPMENT	6/2/2014	\$1,039,687
12738	DOWNTOWN DURHAM INC	DOWNTOWN REVITALIZATION GRANT	6/1/2015	\$88,000
12754	DOWNTOWN DURHAM INC	DOWNTOWN REVITALIZATION GRANT	7/13/2015	\$160,048
13204	AMERICAN DANCE FESTIVAL	DOWNTOWN REVITALIZATION GRANT	7/1/2015	\$36,000
13160	CTR FOR DOCUMENTARY STUDIES	DOWNTOWN REVITALIZATION GRANT	7/1/2015	\$55,000
12753	DOWNTOWN DURHAM INC.	BUSINESS IMPROVEMENT DISTRICT	7/1/2015	\$653,503
10167	21C DURHAM LLC	ECONOMIC DEVELOPMENT INCENTIVE	9/18/2012	\$5,723,537
10203	GENTIAN GROUP LLC	ECONOMIC DEVELOPMENT INCENTIVE	10/26/2012	\$605,000
11286	CONCCORD HOSPITALITY ENTERPRISES COMPANY	ECONOMIC DEVELOPMENT INCENTIVE	10/14/2013	\$1,332,266
12069	AUSTIN LAWRENCE PARTNERS EAST LLC	ECONOMIC DEVELOPMENT INCENTIVE	6/1/2014	\$3,973,095
12680	MATTHEWS ENTERPRISES INC	RETAIL & PROFESSIONAL SVCS	3/31/2015	\$12,300
12658	M RESTAURANT GROUP LLC	RETAIL & PROFESSIONAL SVCS	3/31/2015	\$12,300
12502	WOODZARK INC	SIGN & FAÇADE GRANT	3/11/2015	\$6,407
12528	DSP INVESTMENTS INC	SIGN & FAÇADE GRANT	3/6/2015	\$15,424
12545	SHERRY CLAYTON/WAVELENGTHS	SIGN & FAÇADE GRANT	3/27/2015	\$2,429
12602	LUNA EMPANADA LLC	RETAIL & PROFESSIONAL SVCS	3/31/2015	\$2,000
12688	TOP OF THE NINTH INC	SIGN & FAÇADE GRANT	5/12/2015	\$1,736
12679	SIDNEY WRITES LLC	SIGN & FAÇADE GRANT	5/14/2015	\$861
12496	BERNARDS FORMAL WEAR	SIGN & FAÇADE GRANT	3/16/2015	\$4,135
12544	BLUE CORN INC	SIGN & FAÇADE GRANT	3/25/2015	\$2,412
12624	PLEIADES GALLERY	RETAIL & PROFESSIONAL SVCS	3/31/2015	\$1,000
12431	ARGOS THERAPEUTICS, INC.	ECONOMIC DEVELOPMENT INCENTIVE	8/18/2014	\$924,676
7332	EMC CORPORATION	ECONOMIC DEVELOPMENT INCENTIVE	10/19/2009	\$1,000,000
13151	FRONTIER COMMUNICATIONS OF THE CAROLINAS, LLC	ECONOMIC INCENTIVE - JOB CREATION	11/16/2015	\$64,500
13152	WILLOWTREE, INC.	ECONOMIC INCENTIVE - JOB CREATION	11/16/2015	\$73,500
13239	Wexford Chesterfield Parking, LLC	ECONOMIC DEVELOPMENT INCENTIVE	10/5/2015	\$6,000,000
13403	Durham ID Phase I Developers, LLC	ECONOMIC DEVELOPMENT INCENTIVE	9/22/2015	\$5,250,000
2243	CAPITOL BROADCASTING COMPANY	ECONOMIC INCENTIVES	7/1/2007	\$1,835,000

Incentive Agreements with payments issued

Per Exhibit 1 the City has entered into several material incentive agreements where the incentive payments will be issued in the future. Therefore, the findings of this audit will help strengthen the process to ensure recipients are meeting their obligations per the agreements and that the City's economic development incentives are realized.



EXECUTIVE SUMMARY

Purpose

The purpose of the audit was to ensure that OEWD staff monitored each recipient's compliance with the terms and conditions of their incentive agreement prior to issuing incentive payments.

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 and 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.

Results in Brief

The Office of Economic and Workforce Development staff is charged with validating a recipient's compliance with the terms and conditions of their incentive agreement. OEWD staff monitored each recipient's compliance with the terms and conditions of their incentive award; however, issues identified during the audit highlighted some deficiencies in the monitoring process. The City has entered into several material incentive agreements where incentive payments will be issued in the future. Therefore it is important that OEWD staff address the following issues in order to enhance their monitoring efforts currently and going forward:

- 1) Utilize a centralized record keeping system to ensure continuity of incentive payments regardless of staff composition;
- 2) Ensure a process exists to verify job creation data. The OEWD staff should receive a certified copy of the company's employment insurance filings with the North Carolina Employment Security Commission as proof of qualified job creation if job creation is required by the contract. A company's employment insurance filing with the North

EXECUTIVE SUMMARY

Carolina Employment Security Commission is the best source data to validate job creation. Self-reported data is not adequate proof to verify that job creation did in fact occur. City staff should validate job creation data to ensure that the companies seeking incentives met the job creation requirement per the agreement;

- 3) Ensure review of all invoices and supporting documentation occurs prior to payment approval; and
- 4) Utilize a monitoring instrument such as an excel spreadsheet to track the recipient's compliance with the terms and conditions included in the agreement.



OBJECTIVES, SCOPE AND METHODOLOGY

Objective

The objective of the audit was to:

- Ensure OEWD staff monitored recipient's compliance with the terms and conditions of their incentive awards prior to issuing incentive payments.

Scope

The scope of this engagement included all current practices as they pertained to the process of monitoring compliance by the recipients, with the terms and conditions of the economic development incentive agreements. Only incentive agreements with payment activity were considered for sample selection. In addition, the audit did not examine the process of awarding incentive agreements.

Methodology

Audit staff performed the following tests and procedures to achieve the objectives of the engagement:

- Reviewed Resolution 9890 "Resolution Establishing an Economic Development Financial Assistance and Incentive Policy for Job Creation, Job Retention and Capital Investment";
- Interviewed OEWD staff responsible for monitoring a recipient's compliance with terms and conditions of the agreement;
- Obtained and reviewed a list of all incentive agreements active as of March 20, 2016;
- Determined all incentive agreements for which payments had been issued;
- Selected a sample of incentive agreements (which had payments issued) and performed the following:
 - Reviewed the terms and conditions of the agreement;
 - Verified documentation to ensure validation of compliance by recipients with the terms and

OBJECTIVES, SCOPE AND METHODOLOGY

- conditions of the incentive agreements prior to making incentive payments; and
- Reviewed payment documentation in the MUNIS system.

During the audit, staff also maintained awareness to the potential existence of fraud.

AUDIT RESULTS

The Office of Economic and Workforce Development staff is charged with validating a recipient’s compliance with the terms and conditions of their incentive agreement(s). Even though OEWD staff monitored a recipient’s compliance with the terms and conditions of their incentive awards, issues identified during the audit highlighted some deficiencies in the monitoring process. Audit Services staff judgmentally selected a sample of 14 incentive agreements. The 14 agreements— selected by the type of incentive and the results—are listed below:

Incentive Type (Number of Agreements Selected for Review)	Agreement Totals	OEWD Staff Verified Compliance with the Terms and Conditions of the Agreement
Neighborhood Revitalization Grant (1) • Reinvestment Partners	\$100,000	Yes
Infrastructure Redevelopment (1) • CPGPI Regency Development LLC	\$1,039,68	Yes
Economic Development Incentive (4) • 21C Durham LLC • Gentian Group LLC • EMC Corporation • Capitol Broadcasting Company	\$9,163,537	Finding 1, Finding 2
Business Improvement District (1) • Downtown Durham Inc.	\$653,503	Yes
Downtown Revitalization Grant(1) • Downtown Durham Inc.	\$88,000	Yes
Sign & Façade Improvement Grant(4) • DSP Investments Inc. • Woodzarks Inc. • Lisa Kaye and Company* • Piece of the Pie, LLC*	\$43,870	Finding 3
Building Improvement Incentive Grant(2) • Empress Development, LLC* • Marbull LLC*	\$90,000	Yes

*These Contracts were paid in full in FY 2016 and are not listed in Exhibit 1

Finding 1 Lack of adequate documentation prevented Audit Services staff from substantiating whether OEWD staff verified recipient's compliance with the terms and conditions for one of the incentive agreements reviewed

The Economic Development Incentive Agreement being referenced in this finding was dated July 2007. As of May 25, 2016 the City had paid this contractor approximately \$1,650,000 in incentive payments. The agreement required the contractor to meet certain obligations before incentive payments could be issued. Due to a lack of adequate documentation, Audit Services staff were unable to verify whether OEWD staff ensured that the recipient met their obligations prior to the City issuing the required incentive payments. Lack of documentation was attributed to staff turnover. According to OEWD management, "This project, which was initiated in July 2007, has had the oversight of multiple project managers and directors that are no longer with the City. Perhaps some of the data requested was maintained electronically, and we now have no access to them. We realize however, that there is a need for us to fine-tune our processes to ensure that the integrity of our record-keeping is able to be maintained throughout transitions in leadership and/or personnel. We are now working to correct those processes".

Employee turnover is a normal part of doing business, and processes should be in place to avoid knowledge loss as a result of employee turnover. Lack of maintaining adequate documentation can hinder a newly hired employee's ability to monitor a recipient's compliance with the terms and conditions of their agreement. Due to the long duration for which an incentive agreement can remain active, a high probability for staff turnover exists. It is important to retain knowledge about the agreements in the Department.

Finding 2 OEWD staff did not verify job creation data as required by the agreement for one of the economic incentive agreements examined

OEWD staff did not verify job creation data for one of the economic development incentive agreements reviewed. Per agreement Section 6(b), the company was required to create 50 qualified jobs established no later than October 19, 2012 and 62 qualified jobs established no later than December 31, 2015. Also, per the agreement section 6(e)(v) "The contractor was to provide to the City a certified copy of the Company's employment insurance filings with the North Carolina Employment Security Commission every 6 months as proof of qualified job creation beginning with the 6-month period ending June 30, 2010 and ending with the 6-month period ending on December 31, 2015." Per OEWD staff, the recipient was unable to provide this information and in the absence of this data OEWD staff after consultation with the City Attorney's office relied on self-reported company information to determine whether the company met its obligation of creating the required jobs. The self-reported data was attested by the Human Resources Director of the company to being a true and accurate account of information per the incentive requirement. OEWD staff did not undertake other measures to validate the accuracy of the self-reported data.

Self-reported data is not adequate proof to verify that the job creation required per the agreement did in fact occur. City staff should validate job creation data to ensure that the incentivized companies met the job creation requirements per the agreement. The risk existed to the City that the company may not have met its obligation of creating the required jobs.

There are several active economic incentive agreements where job creation is required. A company's employment insurance filing with the North Carolina Employment Security Commission is the best source data to validate job creation.

Finding 3 Overpayment of an incentive payment was noted for one of the Sign & Façade Improvement incentive agreements

One instance of overpayment in the amount of \$500.00 dollars was noted by the Audit Services Staff. Even though the amount of overpayment was immaterial and only one such instance was noted, the overpayment resulted due to the invoice being approved prior to being reviewed. According to the agreement the City would reimburse the incentivized company 50% of the total invoiced amount for qualified expenditures. OEWD staff questioned the invoice after approving it for payment and found that the invoice amount was inaccurate. However, the check had already been issued and received by the incentivized company. OEWD staff has invoiced the company for the amount owed to the City. Invoices should always be reviewed prior to approval. The practice of approving an invoice prior to reviewing it can result in potential financial loss to the City.

Opportunities for enhancing the current incentive monitoring process were noted during field work which are described below.

Utilization of a centralized record keeping approach

Lack of a centralized record keeping system existed. Failure to place all required documents in one centralized place could hinder continuity of review/payments in the event of staff turnover. For two of the incentive contracts examined supporting documentation was not filed in the project file. In some instances the information was stored at several locations including on individual desk tops and emails.

The Audit Services staff also noted that several OEWD staff had oversight responsibility for monitoring compliance for different deliverables on the same incentive agreement. For instance, for

some incentive agreements, the workforce requirements were maintained separately from other project requirements. Therefore even though a project manager was assigned, interdependencies on staff monitoring for compliance played a role in the approval of incentive payments. The project manager usually relied on other staff to confirm compliance with their assigned deliverables. This confirmation was accepted absent of receiving any supporting documentation; nor was supporting documentation provided or placed in a centralized location where it could be reviewed.

It is easier to manage documentation located in a centralized record keeping system. With the increasing need for good information flow, centralized filing becomes part of a system for maintaining, tracking and sharing up-to-date information. Approvers can easily access data and in case of staff turnover data remains complete and intact.

Utilization of a monitoring instrument to facilitate and track the monitoring of compliance with the incentive agreements by the recipients

A monitoring instrument was not used to track the recipient's compliance with the terms and conditions included in the agreement. A monitoring instrument such as an excel spreadsheet which tracks the following:

- Key obligations/deliverables that have to be met prior to the City issuing incentive payments;
- Documentations required to verify compliance with the requirements;
- Verification methodology and documentation provided by the contractor to substantiate compliance with obligations/deliverables;
- Exceptions allowed and
- Key financial information;

AUDIT RESULTS

would help provide a snapshot at any given point in time as to how many incentives have been obtained and what conditions have been met by the incentive. In addition, in case of staff turnover this instrument would provide contextual information on the status of each contractor meetings its obligations.

Conclusion

The Office of Economic and Workforce Development staff is charged with validating a recipient's compliance with the terms and conditions of their incentive agreement. OEWD staff monitored each recipient's compliance with the terms and conditions of its incentive awards. However, issues identified during the audit highlighted some deficiencies in the monitoring process. The City has entered into several material incentive agreements where the incentive payments will be issued in the future. Therefore it is important that OEWD staff address the following issues in order to enhance their monitoring efforts:

- 1) Utilize a centralized record keeping system to ensure continuity in case of staff turnover;
- 2) Ensure a process exists to verify job creation data. The OEWD staff should receive a certified copy of the Company's employment insurance filings with the North Carolina Employment Security Commission as proof of qualified job creation if required by the agreement. A company's employment insurance filing with the North Carolina Employment Security Commission is the best source data to validate job creation. Self-reported data is not adequate proof to verify that the job creation required per the agreement did occur. City staff should validate job creation data to ensure that the incentivized companies did in fact meet the job creation requirements per the agreements;
- 3) Ensure review of all invoices and supporting documentation occurs prior to payment approval; and
- 4) Utilize a monitoring instrument such as an excel spreadsheet to track the recipient's compliance with the terms and conditions included in the agreement.

RECOMMENDATIONS

Recommendation 1

The Office of Economic and Workforce Development staff should utilize a monitoring instrument such as an excel spreadsheet to track the recipient's compliance with the terms and conditions included in the agreement. A monitoring instrument should capture all the information pertinent to the agreement such as:

- Key obligations/deliverables that have to be met prior to the City issuing incentive payments;
- Documentations required to verify compliance with the requirements;
- Verification methodology and documentation provided by the contractor to substantiate compliance with obligations/deliverables;
- Exceptions allowed and
- Key financial information.

Recommendation 2

The Office of Economic and Workforce Development staff should use a company's employment insurance filing with the North Carolina Employment Security Commission as the best source data to validate job creation.

Recommendation 3

The Office of Economic and Workforce Development staff should ensure review of all invoices and supporting documentation occurs prior to payment approval.

Recommendation 4

The Office of Economic and Workforce Development staff should establish a centralized record keeping system. All e-mail and other supporting documentation received to substantiate the recipient's compliance with the terms and conditions of the agreement should be maintained in a centralized location easily accessible by the employees.

MANAGEMENT'S RESPONSE



Memo to: Dr. Germaine F. Brewington, Director of Audit Services
From: Grace Dzidzienyo, Acting Director Office of Economic and Workforce Development
Date: June 22, 2016
Subject: Economic Development Incentives Performance Audit June 2016

The following is the management's response to the auditor recommendations put forth in the:
Economic Development Incentives Performance Audit dated June 2016.

Recommendation 1:

The Office of Economic and Workforce Development staff should utilize a monitoring instrument such as an excel spreadsheet to track the recipient's compliance with the terms and conditions included in the agreement. A monitoring instrument should capture all the information pertinent to the agreement such as:

- Key obligations/deliverables that have to be met prior to the City issuing incentive payments;
- Documentations required to verify compliance with the requirements;
- Verification methodology and documentation provided by the contractor to substantiate compliance with obligations/deliverables;
- Exceptions allowed and
- Key financial information.

Management Response

We concur. Management is in full agreement with the recommendation.

The department has conducted fairly extensive research for a tool to capture key information regarding obligations, deliverables and requisite financial information for all incentive agreements. The tool that would best fit the needs of the department is a fully-integrated, multi-user portfolio management system that tracks activities from the initial call and deal structuring, through the approval process, and the servicing of the grant or incentive. The tool could also incorporate demographics, job tracking, financial statement and insurance monitoring reporting data as needed to effectively manage our economic development operations. Moving forward the department will collaborate with TS regarding **Portfol Economic Development Management Software** (the leading software utilized by peer entities), or other software with these capabilities.

Implementation Date: TBD (contingent upon TS approval and funding availability).

Recommendation 2:

The Office of Economic and Workforce Development staff should use a company's employment insurance filing with the North Carolina Employment Security Commission as the best source data to validate job creation.

Management Response

We concur. Management is in full agreement with the recommendation.

The department will seek to obtain source data from the NC Employment Security Commission to valid job creation reports submitted for incentive agreements.

Implementation Date: September 30, 2016.

Recommendation 3

The Office of Economic and Workforce Development staff should ensure review of all invoices and supporting documentation occurs prior to payment approval.

Management Response

We concur. Management is in full agreement with the recommendation.

The department currently has in place a process where the project manager reviews invoices and supporting documentation, and, provides signoff before submission for payment.

Implementation Date: June 22, 2016.

Recommendation 4

The Office of Economic and Workforce Development staff should establish a centralized record keeping system. All e-mail and other supporting documentation received to substantiate the recipient's compliance with the terms and conditions of the agreement should be maintained in a centralized location easily accessible by the employees.

Management Response

We concur. Management is in full agreement with the recommendation.

The department will review current practices and implement a protocol for the set-up and retention of records and supporting documentation in a centralized manner.

Implementation Date: September 30, 2016.

