



# CITY OF SAN ANTONIO

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August 6, 2013

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Councilwoman, District 5

**Ron Nirenberg**  
Councilman, District 8

**SUBJECT: Audit Report of Economic Development Incentives**

Mayor and Council Members:

We are pleased to send you the final report of the Economic Development Incentives Audit. This audit began in October 2012 and concluded with an exit meeting with department management in May 2013. Management's verbatim response is included in Appendix B of the report. The Economic Development Department management and staff should be commended for their cooperation and assistance during this audit.

The Office of the City Auditor is available to discuss this report with you individually at your convenience.

Respectfully Submitted,

Kevin W. Barthold, CPA, CIA, CISA  
City Auditor  
City of San Antonio

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**CITY OF SAN ANTONIO**  
**OFFICE OF THE CITY AUDITOR**



Audit of Economic Development Department

Economic Development Incentives

Project No. AU13-006

August 6, 2013

Kevin W. Barthold, CPA, CIA, CISA  
City Auditor

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## Executive Summary

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As part of our annual Audit Plan approved by City Council, we conducted an audit of the Economic Development Department's (EDD) economic development incentive contracts. The audit objectives, conclusions, and recommendations follow:

### **Are the City and companies receiving economic development incentives from the City in compliance with incentive contracts?**

Yes, the City and the majority of companies tested complied with fiscal year 2012 contract requirements. For the remaining companies that were not fully compliant, the City provided, on a case-by-case basis, reduced incentives or terminated the contracts.

### **Is EDD adequately monitoring incentive contracts?**

Yes, EDD is adequately monitoring the incentive contracts. However, the extent by which a contract is monitored and staff's effectiveness could be enhanced and improved by the development of specific contract language pertaining to staff's ability to verify compliance and the reduction of tax abatements when companies fail to meet a portion of their contractual obligations. Furthermore, the contractual language should be aligned with departmental practices.

We also found that EDD could make improvements to strengthen its policies and procedures that would enhance EDD's monitoring function.

Additionally, EDD has inadequate documentation of the recipients' compliance with prior years' contract requirements related to investments.

We recommend that the Director of EDD:

- Collaborate with the City Attorney's Office to ensure that contracts allow for adequate verification of compliance, provide clear guidelines for reducing tax abatements, and are aligned with departmental practices.
- Create additional policies and procedures to ensure recipients are complying with contract terms. These additions should cover site visits, Bexar Appraisal District record verification, and analytical procedures for evaluating compliance reports.
- Ensure that all recipients provide sufficient support documentation.

Economic Development Department Management's verbatim response is in Appendix B on page 7.

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## Background

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The City offers incentives such as loans, grants, and tax abatements to encourage capital investments, the creation and retention of jobs, and growth and development of targeted areas of the City. In fiscal year (FY) 2012, the Economic Development Department (EDD) was responsible for monitoring approximately 80 EDD and City Center Development Office (CCDO) incentive contracts.

Chapter 380 of the Texas Local Government Code gives EDD authority to provide economic loans and grants. Chapter 312 of the Texas Tax Code gives EDD authority to provide tax abatements. Additionally, the goals of SA2020, a community-wide initiative to improve San Antonio, provide EDD with guidance on the industries the City would like to see developed. These industries include Aerospace, Healthcare & Bioscience, Information Technology & Information Security, and the New Energy Economy (e.g. hydroelectric power).

Incentives, including grants, loans, and tax abatements, for the EDD contracts total over \$110 million. Recent recipients include companies such as Nationwide, Petco, Southwest Airlines, and Xenex. Incentives for the CCDO contracts total over \$20 million. Recipients receiving these incentives include Can Plant, Pearl Parkway, and South Flores Lofts.

EDD is in the process of implementing Salesforce, a new cloud-based project management software system. Salesforce offers tools that will enhance how the department manages and monitors contracts. The new software is expected to be fully implemented in July of 2013.

## Audit Scope and Methodology

The audit scope covered active FY 2012 incentive contracts. Specifically, auditors focused on FY 2012 requirements including jobs, wages, and investments. Additionally, all prior investment requirements were included in the scope (e.g. a 2005 contract might have job and wage requirements for 2012 as well as investment requirements for 2007).

We interviewed EDD staff, observed monitoring processes, and reviewed policies and procedures, incentive contracts, and ordinances.

We selected a random sample of 30 incentive contracts and verified that they were supported by the related ordinances. We then expanded the random sample to 47 incentive contracts and tested that the recipients were in

compliance with FY 2012 terms of the contracts. We also verified that the recipients met prior years' investment requirements.

We reviewed the contracts for consistency and clarity. We also verified that recipients provided adequate support documentation. If documentation of FY 2012 compliance was not adequate, we worked with EDD monitoring staff to obtain sufficient documentation. For each recipient not in compliance, we verified that the issue was resolved or that the grant and/or abatement from the City were appropriately modified. When applicable, we also verified funds were appropriately returned to the City.

We also verified that the FY 2012 grant payments and tax abatements were made for the correct amount and in a timely manner. Tax abatements for the 2012 tax year were reconciled to the Bexar Appraisal District website. Grant payments were tied to the City's financial accounting system, SAP.

We relied on computer-processed data in SAP and on the Bexar Appraisal District website to validate FY 2012 incentives. Our reliance was based on performing direct tests on the data rather than evaluating the systems' general and application controls. We do not believe that the absence of testing general and application controls had an effect on the results of our audit.

The use of Salesforce, the department's new project management software system, was not included in the scope of this audit because it is not yet fully implemented.

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 Results and Recommendations

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### A. Contract Language

#### Contract Language and Compliance Verification

The contract language, which is negotiated on a case-by-case basis with each individual economic development prospect, sometimes limits EDD's ability to verify certain contractual obligations. For instance, although contracts generally require recipients to provide semi-annual or annual certification attesting to the number of jobs and wages, they do not explicitly require documentation to support the information reported.<sup>1</sup> Also, the contracts allow site visits to verify business activities and the number of jobs, but frequently exclude other terms of the contracts such as wages and investment requirements.

Contracts should allow for monitoring of all terms and clearly guide recipients on the documentation required to determine compliance with their particular contract. Contracts should also ensure that the City is able to adequately verify compliance with all terms of the contract.

#### Contract Language and Reduced Abatements

The contracts do not clearly describe how abatement reductions are to be implemented if investment requirements or wage requirements are not met. Additionally, by contract, the recipients are given a 60-day cure period<sup>2</sup> for failures to maintain the minimum number of required employees. However, the contracts do not clearly state that a 60-day cure period applies to tax abatements that are to be reduced for this type of non-compliance if the failure is immaterial (e.g. 2,486 of 2,500 jobs created, or 99% compliance).

Contracts that clearly describe procedures for reduced abatements provide guidance to staff and recipients and increase the consistency and transparency of departmental practices.

#### Contract Language and Departmental Practices

In certain instances, EDD followed departmental practices rather than contract terms when determining contract compliance. Specifically,

- The majority of contracts tested require recipients to pay 100% of their employees hourly wages that meet the City's living wage threshold.

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<sup>1</sup> Support documentation is only referenced on the annual or semi-annual forms that are submitted by the recipients. A sample form is generally added to the contract as an attachment.

<sup>2</sup> A cure period allows the recipient additional time to meet contract requirements.

However, the department applied this requirement only to full-time employees, and not part-time, contracted, or temporary employees.

- A majority of contracts tested state that the minimum number of full-time employees is “calculated by averaging the two most current semi-annual Employee Wage Information for Tax Phase-In Request Forms”. However, at times, EDD only uses the most recent number of full-time employees instead of the average to determine compliance if the most recent employee count was higher than the previous report. Additionally, EDD has included contracted and temporary positions if they are offered the same wage and benefits of full-time employees, which is generally not clearly described as allowable in the contracts.
- The contracts tested generally refer to minimum investments in the terms of each contract. However, when monitoring the contracts, EDD only requires approximate investments rather than minimum investments.

Per EDD management, these variances are a result of complying with the intent of the agreements and to provide employers with opportunities to continue hiring efforts and vigorous business activities rather than the enforcement of specific contract language, which is sometimes ambiguous or contradictory.

Aligning departmental practices with the incentive contracts facilitates contract compliance and monitoring, while minimizing misunderstandings regarding the responsibilities of each party.

### **Recommendation**

The Director of Economic Development should collaborate with the City Attorney’s Office to ensure that contracts allow for adequate verification of compliance, provide clear guidelines for reducing tax abatements, and are aligned with departmental practices.

### **B. Contract Monitoring**

Tax abatements were not systematically confirmed with Bexar Appraisal District to verify that they were for the correct amount and site visits were not performed to verify that compliance reports and related support documentation provided to the City were accurate. Additionally, compliance reports were not analyzed for reasonableness.

This occurred, in part, due to insufficient policies and procedures. Policies and procedures help ensure compliance with contract requirements by defining standards and promoting accountability for individuals who monitor the contracts.

Insufficient policies and procedures can lead to inadequate monitoring and undetected errors.

**Recommendation**

The Director of Economic Development should create additional policies and procedures to ensure recipients are complying with contract terms. These additions should cover site visits, Bexar Appraisal District record verification, and analytical procedures for evaluating compliance reports.

**C. Prior Years' Contract Compliance**

EDD did not adequately document recipients' compliance with prior years' contract requirements related to investments in personal and real property improvements. In FY 2012, staff began the process of obtaining this data, much of which should have been collected in 2006 and 2007.

Without sufficient support documentation, EDD cannot provide assurance that the recipients are in compliance with their contracts.

**Recommendation**

The Director of Economic Development should ensure that all recipients provide sufficient support documentation.

## Appendix A – Staff Acknowledgement

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Rebecca Moulder, CIA, Auditor in Charge  
Maria Cristina Hernandez, Auditor

## Appendix B – Management Response



# CITY OF SAN ANTONIO

SAN ANTONIO TEXAS 78283-3961

July 18, 2013  
 Kevin W. Barthold, CPA, CIA, CISA  
 City Auditor  
 San Antonio, Texas

RE: Management’s Corrective Action Plan for AU13-006 Audit of Economic Development Incentives

The Economic Development Department has reviewed the audit report and has developed the Corrective Action Plans below corresponding to report recommendations.

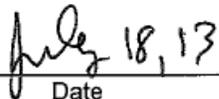
Recommendation					
#	Description	Audit Report Page	Accept, Decline	Responsible Person's Name/Title	Completion Date
1	<p><b>Contract Language</b></p> <p>The Director of Economic Development should collaborate with the City Attorney’s Office to ensure that economic development agreements: 1.) allow for adequate verification of compliance, 2.) provide clear guidelines for reducing tax abatements, and 3.) are aligned with departmental practices.</p>	4	ACCEPT	Assistant Director, EDD	ONGOING
<p><b>Action plan:</b></p> <p>The Economic Development Department (EDD) is working closely with the City Attorney's Office (CAO) to draft contract language that clarifies requirements concerning supporting documentation and access to records, tax abatement reduction guidelines and the applicable cure periods for non-compliance with contract terms. Further, EDD will emphasize aligning this clarified contract language with newly-augmented Standard Operating Procedures (SOP's) that will provide greater uniformity in compliance determinations and monitoring standards to be utilized in the Contract Monitoring System (Salesforce). Final Monitoring SOP's will be completed and implemented by October 1, 2013.</p>					

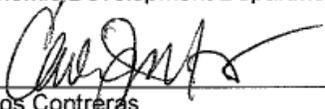
Recommendation					
#	Description	Audit Report Page	Accept, Decline	Responsible Person's Name/Title	Completion Date
2	<p><b>Contract Monitoring</b></p> <p>The Director of Economic Development should create additional policies and procedures to ensure recipients are complying with contract terms. These additions should cover 1.) Site visits, 2.) Bexar Appraisal District record verification, 3.) And analytical procedures for evaluating compliance reports.</p>	5	ACCEPT	Senior Management Analyst	OCT 01, 2013
<p><b>Action plan:</b></p> <p>Standard Operating Procedure's (SOP's) are being revised and expanded that govern all aspects of the compliance monitoring process, including frequency of, and procedures to follow associated with:</p> <ol style="list-style-type: none"> <li>1.) Site visits, which will commence in August 2013;</li> <li>2.) Verification of Bexar County Appraisal District (BCAD) records to ensure reductions and/or increases in ad valorem taxes owed have been modified in accordance with the compliance status of the contract. The Economic Development Department (EDD) has coordinated with BCAD to ensure that correct abatement percentages are reflected for the 2012 tax rolls; and</li> <li>3.) Evaluating compliance status through the implementation of a cloud-based Contract Monitoring System that will provide for consistent evaluation standards and monitoring continuity for the life of the contract. This System allows for real-time contract compliance and site visit updates and status reporting of all agreements by multiple members of the Operations and Monitoring division, to other EDD staff, Director, and executive leadership.</li> </ol>					
3	<p><b>Prior Years' Contract Compliance</b></p> <p>The Director of Economic Development should ensure that all recipients provide sufficient support documentation.</p>	5	ACCEPT	Senior Management Analyst	OCT 01, 2013
<p><b>Action plan:</b></p> <p>The Economic Development Department (EDD) has collaborated with the City Attorneys Office (CAO) to clarify and strengthen contract language regarding requirements to provide appropriate documentation supporting contract compliance. In addition, the Standard Operating Procedures (SOP's) augmented by EDD Operations and Monitoring staff will establish the procedures and associated frequency required to obtain and store this documentation in the cloud-based Contract Monitoring System, which will further enhance standardization of departmental procedures for the life of the contract. Full implementation of this system in accordance with finalized SOP's is expected to be completed by October 1, 2013.</p>					

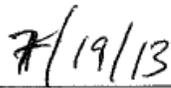
We are committed to addressing the recommendations in the audit report and the plan of actions presented above.

Sincerely,

  
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Rene Dominguez  
Director  
Economic Development Department

  
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Date

  
\_\_\_\_\_  
Carlos Contreras  
Assistant City Manager  
City Manager's Office

  
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Date