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Arvin Enterprise Zone Audit Report

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ENTERPRISE ZONE OVERVIEW

The State Enterprise Zone (EZ) Program represents California's primary economic development program. Eligibility for EZ designation is limited to jurisdictions that can demonstrate needs related to economic conditions, such as high poverty or unemployment rates. The original hypothesis behind the EZ Program is that by targeting significant economic incentives to disadvantaged communities, these communities will be more effective in competing for new businesses and retaining existing businesses. The anticipated results are increased tax revenues, less reliance on social services, and lower public safety costs. Residents and businesses directly benefit from these more sustainable economic conditions through improved neighborhoods, business expansion, and job creation.

The State Department of Housing and Community Development (HCD) is responsible for the EZ designation process and program oversight. The EZ program, after designation, is a 15-year partnership between local governments, government agencies, non-governmental agencies and private businesses to generate new private-sector investment and growth. To assist in this partnership, the State establishes a geographical area in which businesses may be eligible for exclusive State incentives and programs, which include the following:

- tax credits for sales and use taxes paid on qualified machinery;
- tax credits for hiring qualified employees;
- a 15-year net operating loss carry-forward;
- accelerated expense deductions; and
- priority for various state programs, such as State contracts.

In addition, California Revenue and Taxation Code Section 17053.74 governs the tax credit for a taxpayer who employs a qualified employee in an EZ. The tax credit is applied as follows:

- 50 percent of qualified wages in the first year of employment.
- 40 percent of qualified wages in the second year of employment.
- 30 percent of qualified wages in the third year of employment.
- 20 percent of qualified wages in the fourth year of employment.
- 10 percent of qualified wages in the fifth year of employment.
- Cap on EZ employment tax credit of \$37,440.

By statute, all EZs are required to report on their activities relative to their goals, objectives, and commitments as stated in the application for designation and HCD's Memorandum of Understanding (MOU) with the EZ. HCD has the authority to audit, at least once every five years, any designated EZ during the duration of the designation. In addition, HCD shall, for each audit, determine a result of superior, pass, or fail, per California Government Code Section 7076.1.

Arvin Enterprise Zone Audit

Introduction

The Arvin EZ is one of 40 EZs in California providing tax incentives to qualified businesses. The Arvin EZ announced that it had received a final EZ designation for the period effective September 30, 2009 through September 29, 2024.

Audit Objectives

The HCD auditors evaluated Arvin's EZ performance toward meeting the goals, objectives, and commitments, as stated in their application, MOU and MOU Supplemental with HCD. At the conclusion of the audit process, a performance score was determined, based on Arvin's documentation supporting its achievement of goals and objectives related to EZ administration, marketing, budgeting, vouchering, and other relevant activities [CGC 7076.1(b)]:

- Determine whether the EZ Program is effective in the delivery of program goals, objectives, and commitments.
- Determine whether the EZ submits reports timely and is sufficiently managing compliance responsibilities.
- Determine a performance score of superior, pass, or fail based on an evaluation of the program activities, responsibilities, and other factors contributing to the Arvin EZ program performance.
- Assess compliance with EZ Act, California Code of Regulations, and HCD authorized procedures.

Audit Authority and Guidance

- Government Code Section 7070
- California Code of Regulations, Title 25, Division 1, Chapter 7, Subchapter 21, Articles 1-14
- California RTC Code Section 17053.74
- HCD Management Memos
- HCD Application for Designation Guidebook, HCD EZ Monitoring Guidebook
- Arvin EZ Application for Designation
- Arvin EZ established policies and procedures
- Internal control best practices

EZ Audit Scope

- EZ application, MOU and MOU Supplemental
- EZ performance reports
- EZ Biennial report
- Voucher process and periodic monthly reports
- Activities and documentation available for the audit period

Arvin Enterprise Zone Audit *(continued)*

Audit Methodology

- Review Government Code Section 7070-7089 and 7097-7099, California Code of Regulations, HCD guidance on reporting requirements
- Review EZ application, MOU, MOU Supplemental and corresponding tables
- Review self-evaluation report; Biennial report; monthly reports to HCD
- Review program policies and procedures
- Interview EZ personnel
- Interview Employers' Training Resources personnel, a third party administrator for Arvin EZ vouchering applications
- Review EZ website

Audit Sampling Methodology

1. **Voucher Program** – To select the sample for testing, specific parameters were defined for voucher applications that were approved or denied during the period, January to December 2012.
 - Per Arvin's EZ voucher activity log, there were 108 voucher applications submissions from January to December 2012. The auditors identified 70 voucher applications from all employee qualifying categories (A-K) for testing. Each voucher application was evaluated according to regulatory requirements.
 - For each category with less than five voucher applications, all submissions were tested. For Arvin EZ, all voucher applications for categories A-J were tested. Sixty-five voucher applications were tested for category K.
 - Voucher number sequence was verified to determine if voucher numbers were appropriately issued.
2. **Monthly Reporting** – comparison of January through December 2012 monthly reports and voucher activity log:
 - January to December 2012 monthly reports were compared to the voucher activity log to determine any reporting discrepancies.
 - HCD auditors verified Arvin EZ monthly report dates, comparing that information to the date that HCD's EZ Program received the reports, to determine report timeliness.
 - HCD auditors verified the accuracy of the information provided on the Arvin EZ monthly reports.
 - Reconcile remittance amounts and the count for voucher applications.
 - Identify if applications were from an active or expired EZ.
3. **MOU Supplemental and Biennial Report** - support documentation was compared to MOU goals, objectives, and commitments to determine the level of achievement. Evaluated biennial reporting regulatory compliance.

Arvin Enterprise Zone's Performance Score and Adequacy of Controls

Performance Score: Fail

Arvin's EZ audit failure was based on an overall lack of achievement and documentation for its goals and objectives that originated with the EZ designation application and continued through the commitments created by the Arvin/HCD MOU and MOU Supplemental agreements. Also, the Arvin EZ had significant regulatory failures in the areas of EZ administration, marketing, budgeting, vouchering and vouchering administration.

Note: The audit score achieved by a G-TEDA (EZ) is governed by CCR Section 7076.1, with the G-TEDA being able to achieve a score of: Superior (100 percent), Pass (99 to 75 percent) or Fail (< 75 percent). A G-TEDA audit score of less than 75 percent (below 75 percent in meeting goals, objectives, and commitment) will require a formal agreement between HCD and the G-TEDA. The agreement will be for a maximum of 180 days, by the end of which all audit findings must be remediated.

Adequacy of Controls

The audit of the Arvin EZ documented areas of noncompliance. This was evidenced by noncompliance with regulations, the EZ application, the EZ MOU/MOU Supplemental and HCD policies and procedures.

Auditors noted noncompliance with the following:

- EZ is operating without a full-time EZ manager.
- Employers' Training Resources is administering the EZ voucher application without an executed MOU.
- All voucher applications are approved by the Deputy Director of Employers' Training Resources without proper authorization.
- Budget resources, committed to the EZ application and MOU Supplemental, were not provided.
- Monthly reports and fee remittance are not being performed according to regulatory requirements.
- Conflict of Interest statement certifications have not been completed for staff involved in the administration of the vouchering program.
- No support documentation is kept to confirm efforts (commitments) have been implemented or completed.
- No tracking mechanisms are in place so that commitment efforts or EZ deliverables can be reported.
- Self-evaluations are not being performed to measure progress made in meeting goals, objectives and commitments that were established with the granting of Arvin's EZ designation.
- Inaccuracies in the voucher application process.
- Vouchering policies and procedures do not exist.
- Management controls and oversight of the voucher program is not meeting regulatory requirements.

Arvin Enterprise Zone Audit Finding Log

Arvin's EZ log of audit findings includes the compliance or control issue, how the issue was noted and the criteria/risk that should be complied with or managed. Since Arvin EZ received a G-TEDA audit score of less than 75 percent (below 75 percent in meeting goals, objectives, and commitment and/or specific regulatory compliance exceptions), no recommendation is given. Instead, a formal written agreement, to address all EZ audit findings, will need to be executed between HCD's EZ Program and Arvin EZ.

| | Finding/Criteria/Recommendation | Action Plan | Action Owner | Estimated Completion Date |
|---|---|--|--------------------------------|-----------------------------------|
| 1 | <p><u>Voucher Program Administration</u> The administration of the vouchering process is done by a third party, Employers' Training Resources (ETR). ETR has been processing Arvin's voucher applications since designation.</p> <p><u>Findings</u> The analysis of the voucher process and test samples of the voucher applications supported the following findings:</p> <ul style="list-style-type: none"> • No executed MOU and designee authorization. • Deputy Director of ETR is signing as the EZ manager. • Voucher application documentation did not meet accuracy and timeliness criteria. • Dates on the voucher certificate and voucher activity log (report) are not the same. • The voucher activity log and the G-TEDA monthly reports show a discrepancy in the total amount of vouchers received. • Voucher Certificate, Section C, Enterprise Zone/Zone Manager Information: Contains information on ETR not Arvin EZ. • After reviewing and processing denied applications, application packages are returned to the applicant/consultant without copies being kept. | <p>Management's Action Plan:</p> <p>Arvin EZ must enter into an agreement, per regulatory requirements, with HCD's EZ Program that will address all audit findings contained within the "Arvin Enterprise Zone Audit Report".</p> | <p><i>Arvin EZ Program</i></p> | <p><i>Governed by Statute</i></p> |

| | Finding/Criteria/Recommendation | Action Plan | Action Owner | Estimated Completion Date |
|---|---|--|--------------------------------|-----------------------------------|
| | <ul style="list-style-type: none"> • When an application package receives a cursory review and is denied (not processed), the application package and remittance fee is returned, which are not logged in the voucher activity log. • Voucher applications received in December 2012 were assigned incorrect voucher numbers. • Not all applications were date stamped. • Monthly G-TEDA reports submitted late. • No documentation to confirm when G-TEDA reports and fees were submitted to HCD. • The 2/2012 and 3/2012 G-TEDA monthly reports stated that Arvin was an expired zone. • Page 2, Section IV of the Voucher Application is not completed. The “approved” or “denied” box is not checked. Name of reviewer, title, and date are not indicated or requested. • There are no written policies and procedures for the vouchering administration process. <p>Criteria CCR Title 25 Section 8463 Administration of a Vouchering Program, Section 8466, HCD Management Memo 8-01, 11-01.</p> | | | |
| 2 | <p>Business Administration Since Arvin’s EZ designation in September 2009, the EZ Program has never had a full-time manager. At the time of the audit, the City Manager had responsibility for EZ management.</p> <p>Findings</p> <ul style="list-style-type: none"> • No full-time EZ manager. • No documentation to verify that their commitments, per their application, MOU and MOU Supplemental, have been implemented or completed. • Not tracking goals and objectives for the EZ Program. Therefore, they are unable to report on commitment efforts or EZ deliverables. | <p>Management’s Action Plan:</p> <p>Arvin EZ must enter into an agreement, per regulatory requirements, with HCD’s EZ Program that will address all audit findings contained within the “Arvin Enterprise Zone Audit Report”.</p> | <p><i>Arvin EZ Program</i></p> | <p><i>Governed by Statute</i></p> |

| | Finding/Criteria/Recommendation | Action Plan | Action Owner | Estimated Completion Date |
|---|---|--|--------------------------------|-----------------------------------|
| | <ul style="list-style-type: none"> Not conducting self-evaluations to determine the progress made towards meeting goals, objectives, and commitments. <p>Criteria Title 25 CCR Section 8462 Designation of Zone Manager and Staffing; Application/MOU between HCD EZ Program and Arvin EZ.</p> | | | |
| 3 | <p>Budget The funding committed to the Arvin EZ Program provided.</p> <p>Findings</p> <ul style="list-style-type: none"> The primary source of funding for the EZ was identified in Arvin’s application as being from Redevelopment Agency (RDA). RDA funding was not provided. Arvin EZ did not receive a \$500,000 grant from Economic Development Block Grant. Funds from the voucher application fees are minimal due to the lack of voucher volume and a \$70 application fee. Funding for Arvin EZ, per application (resolution) and MOU supplemental, is not being allocated to the EZ Program. <p>Criteria Title 25 CCR Section 8462 Designation of Zone and Manager and Staffing; MOU and MOU Supplemental.</p> | <p>Management’s Action Plan:</p> <p>Arvin EZ must enter into an agreement, per regulatory requirements, with HCD’s EZ Program that will address all audit findings contained within the “Arvin Enterprise Zone Audit Report”.</p> | <p><i>Arvin EZ Program</i></p> | <p><i>Governed by Statute</i></p> |
| 4 | <p>Vouchering Fees ETR receives the voucher application fee checks that are made payable to City of Arvin. If approved, these checks get forwarded to Arvin, along with the voucher application package and voucher certificate. Arvin deposits the fee checks and issues a check, made payable to ETR, for the amount required to pay HCD’s EZ Program fee. Upon ETR receiving and depositing the check, ETR issues a fee check, payable to HCD EZ Program, for same amount.</p> | <p>Management's Action Plan:</p> <p>Arvin EZ must enter into an agreement, per regulatory requirements, with HCD’s EZ Program that will address all audit findings contained within the “Arvin Enterprise Zone Audit Report”.</p> | <p><i>Arvin EZ Program</i></p> | <p><i>Governed by Statute</i></p> |

| Finding/Criteria/Recommendation | Action Plan | Action Owner | Estimated Completion Date |
|--|--|--------------------------------|-----------------------------------|
| <p>Findings</p> <ul style="list-style-type: none"> • ETR processes the voucher application late. • The voucher application fees get processed as time permits (as long as five months). • Application fees are not submitted to HCD by the 25th of the month, following receipt. <p>Criteria Title 25 CCR Section 8433 Procedure for Remittance of Department Fees (a); EZ MOU.</p> | | | |
| <p>5 Conflict of Interest Arvin EZ staff involved in the administration of the vouchering program must execute their responsibilities in compliance with all regulatory requirements. This includes processing the voucher applications objectively and securing confidential information.</p> <p>Finding The Arvin EZ Manager and ETR staff, who is the third party administrators for the vouchering program, did not certify that they are free of any conflict of interest with the EZ voucher applicants or EZ's obligations to objectively evaluate and process applications.</p> <p>Criteria Title 25 CCR Section 8463 Administration of a Vouchering Program.</p> | <p>Management's Action Plan:</p> <p>Arvin EZ must enter into an agreement, per regulatory requirements, with HCD's EZ Program that will address all audit findings contained within the "Arvin Enterprise Zone Audit Report".</p> | <p><i>Arvin EZ Program</i></p> | <p><i>Governed by Statute</i></p> |

Audit Observations

Arvin EZ has been operating without a full-time manager to oversee the operations of the program. In 2009, a City employee, Redevelopment Associate, was assigned the responsibilities to administer the EZ Program. In 2012, when the RDA funds were abolished, the Arvin City Manager assumed the responsibilities of the EZ Manager.

The Arvin EZ voucher administration has been outsourced to a third party, Employers' Training Resources (ETR). To date, Arvin EZ and ETR have been unable to agree on the MOU's term and conditions. This has created a situation where voucher certificates that have been issued may have been done so by an entity that did not have the legal authority to issue those vouchers.