

STATE OF CONNECTICUT



*EVALUATION OF THE REVISED
DEPARTMENT OF ECONOMIC AND COMMUNITY
DEVELOPMENT 2017 ANNUAL REPORT*

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ ROBERT J. KANE

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AUDITORS OF PUBLIC ACCOUNTS

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September 21, 2018

EVALUATION OF THE REVISED DEPARTMENT OF ECONOMIC AND COMMUNITY DEVELOPMENT 2017 ANNUAL REPORT

OVERVIEW

Section 32-1m of the General Statutes provides that, not later than February 1st annually, the Commissioner of Economic and Community Development shall submit a report that includes information regarding the activities of the Department of Economic and Community Development (DECD) and business assistance or incentive programs not administered by the department, during the preceding state fiscal year.

Public Act 17-219 provides that, as part of each audit the Auditors of Public Accounts performs of DECD, the auditors shall evaluate the annual reports submitted since the last audit and the analyses required under subdivisions (2) and (4) of subsection (a) of Section 32-1m of the General Statutes. Subdivisions (2) and (4) pertain to analyses of the economic development portfolio of DECD and business assistance or incentive programs not administered by DECD that are included in the annual report. The auditor's evaluation shall include:

- 1) A determination of whether evidence is available to support the accuracy of the data presented in such annual report;
- 2) An evaluation of management practices and operations regarding the ease or difficulty for taxpayers to comply with the requirements of the incentive programs;
- 3) Recommendations for improving the administrative efficiency or effectiveness of the incentive programs; and
- 4) An evaluation of whether such annual reports satisfy the reporting requirements under subsection (a) of Section 32-1m of the General Statutes.

On April 24, 2018, the Auditors of Public Accounts completed a preliminary review of the DECD annual report for the fiscal year ended June 30, 2017. Our preliminary review focused on determining whether data presented in the annual report appeared accurate and whether the annual

report satisfied the reporting requirements under subsection (a) or Section 32-1m of the General Statutes. We are reviewing the remaining Public Act 17-219 requirements in a separate performance audit, which our office will release in early 2019. The preliminary review disclosed statutorily required items that were not included in the report, unsupported data, excluded programs, and problems with DECD's economic impact calculations. As a result of our review, DECD issued a revised report on May 31, 2018. We have completed an evaluation of the revised report to determine whether our previous recommendations have been implemented and whether the DECD changes in the revised report appear to be accurate.

RESULTS OF EVALUATION

The results and recommendations that were noted in our original report are presented below along with the current status of the recommendations based on our evaluation of the revised DECD annual report. DECD's responses to our original recommendations are included. Though we discussed the results of our current review with DECD, due to time constraints, the department did not have the opportunity to provide formal responses. We made changes to this evaluation as a result of our discussions with DECD.

Item No. 1 – Statutorily Required Items Not Included

Results of Original Review:

Our review disclosed that the following statutorily required items were not included in the annual report.

For business assistance or incentive programs not administered by DECD, the report did not include:

- An analysis of the programs' estimated economic effects on the state's economy;
- An analysis of whether the statutory and programmatic goals of each business assistance or incentive program are being met, with obstacles to such goals identified;
- Recommendations as to whether any such existing business assistance or incentive program should be continued, modified, or repealed; and the basis for such recommendations and any recommendations for additional data collection; and
- The methodologies and assumptions used in carrying out the analysis.

It appears that the data required to analyze the estimated economic effects on the state's economy is currently not being collected. In addition, since DECD does not administer these programs, it may not be in the best position to recommend whether the programs should be continued, modified, or repealed.

Recommendation:

The General Assembly should consider modifying the reporting requirements included in Section 32-1m of the General Statutes or require that non-DECD-administered programs provide the data needed to estimate the economic impact on the state's economy.

Agency Response:

“DECD is unable to obtain, verify, and report on information in a timely manner when the information is not held at DECD. Senate Bill #262, which DECD supports, would remove the requirement for DECD to report on non-DECD administered programs, with the exception of Connecticut Innovations (CI). In future reports, we will incorporate their results into the DECD Annual Report.”

Status as of September 21, 2018:

This recommendation is being repeated. For business assistance or incentive programs not administered by DECD, the report did not include:

- An analysis of the programs' estimated economic effects on the state's economy;
- An analysis of whether the statutory and programmatic goals of each business assistance or incentive program are being met, with obstacles to such goals identified;
- Recommendations as to whether any such existing business assistance or incentive program should be continued, modified, or repealed; and the basis for such recommendations and any recommendations for additional data collection; and
- The methodologies and assumptions used in carrying out the analysis.

The data required to analyze the estimated economic effects on the state's economy for business assistance or incentive programs not administered by DECD is currently not being collected. In addition, since DECD does not administer these programs, it may not be in the best position to recommend whether the programs should be continued, modified, or repealed.

During the 2018 session, DECD proposed legislation (Senate Bill 262) to remove its requirement to report on business assistance programs DECD does not administer, with the exception of Connecticut Innovations, Inc. However, the legislation was not adopted. DECD should continue working with the General Assembly to either modify the reporting requirements included in Section 32-1m of the General Statutes or require that non-DECD administered programs provide the data needed to estimate the economic impact of these programs on the state's economy.

Item No. 2 – Unsupported Data

Results of Original Review:

Our review noted that certain amounts reported did not agree with supporting documentation. We highlighted some of the differences noted below, but did not determine how these differences could affect the department’s economic impact calculations (e.g., estimated net state revenue and DECD dollar cost per job).

Tax Credits:

- DECD understated the Urban and Industrial Site Reinvestment total tax credits awarded by \$71,000,000 (12% of total) and overstated total credits earned by \$14,900,000 (5%).
- DECD understated the total Film Production Infrastructure tax credits issued by \$7,219,632 (7%).
- DECD overstated the Film and Digital Media Production tax credits issued during the fiscal year ended June 30, 2017 by \$1,021,364 (1%).
- For tax credit programs not administered by DECD, the department reports the amount claimed for the industries using the most credits. These amounts did not agree with supporting documentation for the Research and Development Expenditures and Research and Experimental (Incremental) Expenditures tax credits.

Small Business Express:

- DECD understated the amount reported by \$16,492,239 (7%) in its portfolio, because it did not include 80 projects.
- DECD understated the amount of funds leveraged by \$67,816,408 (24%).
- DECD overstated the amount of assistance provided by the department’s lending partners by \$2,804,250 (8%).
- DECD understated the amount of new jobs to be created by 195 (3%) and understated the amount of jobs to be retained by 1,405 (7%).

Manufacturing Assistance Act (MAA):

- DECD understated the amount reported by \$73,794,800 (9%) in its portfolio, because it did not include 14 projects. We also noted that the portfolio of MAA assistance does not include 297 inactive projects that received \$242,401,364 of financial assistance. DECD considers a project inactive if the company has gone out of business, relocated, or the department’s contract with the company has expired. However, since DECD considered

inactive projects in the economic impact calculation, the department should disclose the amount of the inactive projects that it did not include in its active portfolio.

- DECD understated the amount of funds leveraged by \$114,096,077 (3%).
- Grants and loans awarded by DECD under the Small Business Revolving Loan Fund were included in the MAA portfolio. However, DECD did not include loans that its lending partners provided in the report. Furthermore, the MAA principal and interest payments DECD reported as collected during the fiscal year ended June 30, 2017, did not include the principal and interest payments for the Small Business Revolving Loan Fund.
- DECD understated the amount of new jobs to be created by 1,500 (9%) and understated the amount of jobs to be retained by 1,987 (3%).

Brownfields:

- DECD understated the amount reported for Brownfields by \$835,000 (0.4%).
- DECD reported that \$755,984 of fees for the Brownfield Remediation and Revitalization Program have been collected since the inception of the program. Further review disclosed that this amount is an estimation and is not the actual amount collected. The amount of actual fees collected is maintained by the Department of Energy and Environmental Protection.

Airport Development Zone Program:

- DECD did not provide sufficient supporting documentation for the total amounts it reported for the Airport Development Zone Program. DECD has only administered the program since 2015 and did not have access to the data for 5 of the companies that were approved prior to 2015.
- DECD overstated the amount of jobs created and retained in 2017 by 7 (4%).

Job Retention:

- DECD likely overstated the number of jobs retained because certain companies received funding multiple times or under multiple programs. Companies that received funding multiple times may have had a requirement to retain the same jobs each time they received funding. DECD counted these jobs multiple times. In addition, if companies received funding under multiple programs, DECD likely counted the jobs retained under multiple programs. It is unclear how many jobs DECD may have overstated.

Recommendation:

DECD should ensure that amounts reported in the annual report and included in economic impact calculations are accurate and adequately supported.

Agency Response:

Tax Credits:

“These omissions were due to different cut-off dates in the data worksheets used for the REMI analyses. DECD recognizes the importance of reporting accurate data in the annual report, and will improve its internal controls to ensure that the calculations and data reported in the annual report are supported and accurate. When earlier cut-off dates are used for REMI analyses because of lags in the claim data, this will be specifically noted in the document.

A formula error in the Research and Development Expenditures and Research and Experimental (Incremental) Expenditures worksheets has resulted in errors in the claims by industry, but the total claims reported are accurate and tie to Department of Revenue Services data.

Small Business Express:

Please note that all Small Business Express (EXP) funding agreements went through DECD’s standard funding procedures and are accounted for properly in DECD’s internal records, including our loan billing system. The discrepancy noted by the Auditors is only in data used for our calculations for various economic impacts for this report.

DECD recognizes its need for a centralized reporting mechanism and has recently launched a Customer Relationship Management (CRM) system. CRM was designed to satisfy many of the Annual Report reporting requirements. It will take some time for CRM to be fully implemented agency-wide, so DECD is committed to improving internal controls to ensure that our records accurately support the data reported in the annual report.

The discrepancy in EXP projects is the result of relying on two different spreadsheets containing different sets of data. We intend to consolidate our source records (i.e. CORE data, loan system, project logs, and other monitoring reports) and develop a comprehensive database to track the reporting requirements for the Annual Report. In addition, we will reconcile the loan activities from our lending partners to be included in the comprehensive database.

Manufacturing Assistance Act:

Please note that all MAA funding agreements went through DECD’s standard funding procedures and are accounted for properly in DECD’s internal records, including our loan billing system. The discrepancy noted by the Auditors is only in data used for our calculations for various economic impacts for this report. As noted above, DECD did not rely on consistent sources of data in our reporting – a problem we will correct through use of our CRM system and other data management efforts.

We intend to consolidate our source records (i.e. CORE data, loan system, project logs, and other monitoring reports) and develop a comprehensive database to track the reporting requirements for the annual report. The comprehensive database will provide supporting schedules at certain cut off dates for the reported data.

We further agree that if we exclude certain data, we should clearly disclose that in our report.

Airport Development Zone Program:

The discrepancy in Airport Development Zone jobs was the result of human error. In future reports DECD will footnote the lack of data prior to 2015, before DECD administered the program.

Job Retention:

Actual retained and newly created jobs are always audited by a third party against contractual requirements during the loan period to determine loan forgiveness and to ensure compliance with our contracts. For purposes of the Annual Report analysis, we use data provided at the time of application, if we have not yet completed an audit.

It is possible that reporting for companies with funding under multiple programs may include a very small amount of overlap in employee retention numbers. Of the over 1,500 companies in the portfolio, 67 (4%) companies received funding via multiple programs or multiple contracts. Further, when we analyze future economic benefits to the state, we do not include the retained employees. We look only to the incremental new jobs created by the company that will impact the state economy.

DECD recognizes the need to improve its internal controls to ensure that the reported data is fully supported by the internal records. While CRM is not fully implemented agency-wide, we intend to consolidate our source records (i.e. CORE data, loan system, project logs, and other monitoring reports) and develop a comprehensive database to track the reporting requirements for the annual report. The comprehensive database will provide supporting schedules at certain cut off dates for the reported data.”

Auditors’ Concluding Comments:

Even though only a small percentage of companies received funding multiple times or under multiple programs, it would still result in the overstatement of thousands of retained jobs. DECD uses the amount of retained jobs as a statistic to demonstrate the success of its business assistance and incentive programs. Therefore, it is important that DECD reports accurate job retention amounts. In addition, DECD uses these amounts to determine the dollar cost per job that businesses created or retained. If DECD overstates the amount of retained jobs, therefore, it would understate the cost per job.

Status as of September 21, 2018:

Our review did not disclose any material differences between the amounts reported in the annual report and the amounts per supporting documentation. Therefore, this recommendation is not being repeated. For our review of amounts included in DECD's economic impact calculations, see Recommendation No. 4.

Item No. 3 – Excluded Programs

Results of Original Review:

Our review disclosed that DECD might have left out of the annual report some business assistance or incentive programs, such as the Department of Labor (DOL) Subsidized Training and Employment Program (Step Up). The Step Up program provides wage and training subsidies to employers that hire an unemployed jobseeker. Section 32-1m of the General Statutes provides that the report should include an analysis of each business assistance or incentive program that DECD did not administer with 10 or more recipients in the preceding fiscal year or credited, abated, or distributed more than \$1,000,000 in the preceding fiscal year. The department did not think it was necessary to include the Step Up program in the report since DOL prepares a separate report on the program. However, since the public act summary for PA 17-219 listed the Step Up program as an example of a non-DECD administered business assistance or incentive program, it appears that the General Assembly intended that the program would be included in the report.

We also noted that Connecticut Innovations administers programs such as the Connecticut Sales and Use Tax Relief Program that may meet the requirements of inclusion in the report. DECD did not obtain the amount of sales tax exemptions claimed from the Department of Revenue Services. Therefore, we do not know whether any of the Connecticut Innovations programs meet the requirements in Section 32-1m of the General Statutes and would need to be included in the annual report.

Recommendation:

DECD should work with other state and quasi-public agencies to ensure that all non-DECD administered business assistance or incentive programs are included in the annual report.

Agency Response:

“As noted previously, DECD does not have access to data to verify, analyze, or report on other state programs. DECD supports passage Senate Bill #262 which would clarify this requirement going forward.”

Status as of September 21, 2018:

DECD did not address this recommendation in its revised annual report. Therefore, this recommendation is being repeated. Our review disclosed that DECD might have left some business assistance or incentive programs out of the annual report. One example is the Department of Labor (DOL) Subsidized Training and Employment Program (Step Up). The Step Up program provides wage and training subsidies to employers that hire the unemployed.

Section 32-1m of the General Statutes provides that the report should include an analysis of each non-DECD administered business assistance or incentive program with 10 or more recipients or credited, abated, or distributed more than \$1,000,000 in the preceding fiscal year. DECD did not think it was necessary to include the Step Up program in its annual report because DOL prepares a separate report on the program. However, the public act summary for PA 17-219 listed the Step Up program as an example of a non-DECD administered business assistance or incentive program. Therefore, it appears that the General Assembly intended that the program should be included in the report.

We also noted that Connecticut Innovations administers programs such as the Connecticut Sales and Use Tax Relief Program that may meet the requirements for inclusion in the report. DECD did not obtain the amount of sales tax exemptions claimed from the Department of Revenue Services. Therefore, we do not know whether any of the Connecticut Innovations programs meet the requirements in Section 32-1m of the General Statutes and would need to be included in the DECD annual report. DECD informed us that information on programs administered by Connecticut Innovations will be included in the fiscal year ended June 30, 2018 annual report.

Item No. 4 – Economic Impact Analysis

Results of Original Review:

DECD analyzed the economic and fiscal impacts of the incentive programs it administers using a model designed by Regional Economic Models Inc. (REMI). The department entered the direct economic activities, such as project costs and the amount of the tax credits awarded, as inputs into the REMI model. The REMI model then estimated the direct, indirect, and induced impacts of the financial assistance. We reviewed some of the department's economic impact calculations and noted the following.

- Using the REMI inputs used by the department, we noted the following differences in the economic impact calculations due to formula errors.
 - DECD overstated the cumulative net state revenue for the Manufacturing Assistance Act by \$259,676,000 (27%).

- DECD overstated the cumulative net state loss for the Film and Digital Media Production tax credit by \$19,385,917 (5%).
- DECD overstated the cumulative net state loss for the Film Production Infrastructure tax credit by \$11,164,863 (20%).
- DECD overstated the cumulative net state loss for the Digital Animation tax credit by \$3,000,230 (4%).
- Our review of the tax credits, financial assistance, and project costs included in the REMI inputs disclosed the following. We did not determine how the differences noted would affect the department's economic impact calculations. Some of the differences noted under Item No. 2 – Unsupported Documentation would also affect the amounts that DECD should enter as a REMI input.
 - DECD understated the amount of claimed Film and Digital Media Production tax credits included in the economic impact analysis by \$31,112,198 (8%).
 - DECD understated the amount of claimed Film Production Infrastructure tax credits included in the economic impact analysis by \$18,294,098 (30%).
 - DECD did not consider project costs for 2 Film Production Infrastructure tax credits in the economic impact analysis, totaling \$18,326,623 (4%).
 - DECD understated the amount of Urban and Industrial Site Reinvestment tax credits earned for 3 projects totaling \$21,800,000 (7%).
 - DECD did not consider project costs, totaling \$40,000,000 (1%), and financial assistance, totaling \$20,000,000 (2%), in the economic impact analysis for the Manufacturing Assistance Act.
- DECD did not consider loan forgiveness awarded to recipients when calculating the economic impact of the assistance provided. In addition, we noted that some projects received funding under multiple programs and the project costs were included in each program's economic impact calculation, which would overstate the total impact for the state.
- DECD did not include 2 companies that had left the Urban and Industrial Site Reinvestment program when it calculated the economic impact of the program. However, since these companies earned \$5.2 million prior to leaving the program, it appears DECD should have factored in the tax credits when calculating the economic impact for the program.

- The projected new net state revenue for the Oxford Airport Development Zone was reported as \$165,532,499 and the projected new net state revenue for the Groton Airport Development Zone was reported as \$316,268,000. Our review disclosed that DECD based these amounts on 10-year projections run before the zones received approval. DECD did not base the reported amounts on actual activity for the program. The actual impact for these zones would be included in the economic impact calculations for the Enterprise Zone Incentive programs.

Recommendation:

DECD should ensure that amounts included in the economic impact calculations are accurate and all relevant factors are included in the department's analysis.

Agency Response:

“These omissions noted above were due to formula errors or omissions of source data in our worksheets. DECD shall improve its internal controls to ensure that the calculations and data reported in the annual report are supported and accurate.

The economic impact calculation included in the annual report is based on the impact each DECD program individually has on the community. The economic impact is not overstated because the analysis is specific to each program. We are not providing a total economic impact of all programs by aggregating the results.

The companies that left the Urban and Industrial Site Reinvestment program will be included in future analyses.

DECD has no ability to monitor or report on the actual activity that occurs in enterprise and development zones over time since neither companies nor hosting communities are required to report results to DECD. The analysis that was shared in the annual report is a projection, not actual results and will be clearly marked as such in future reports.”

Auditors' Concluding Comments:

Including total project costs attributable to funding received from multiple programs in the economic impact analysis for each program provided funding, would overstate the impact that each program had individually. In addition, even though the department does not report the aggregated amount of economic impact for all programs, a reader looking at the impact for all individual programs would conclude that the total impact of the DECD-administered business assistance and incentive programs is greater than it actually is.

Status as of September 21, 2018:

DECD addressed many of the specific errors noted during our interim report. However, our review of the revised report disclosed additional errors in DECD's economic impact calculations. Therefore, this recommendation is being repeated.

DECD analyzed the economic and fiscal impacts of the incentive programs it administers using a model designed by Regional Economic Models Inc. (REMI). The department entered the direct economic activities, such as project costs and the amount of the tax credits awarded, as inputs into the REMI model. The REMI model then estimated the direct, indirect, and induced impacts of the financial assistance. We reviewed some of the department's economic impact calculations and noted the following.

- We noted various errors in the REMI inputs used in the Manufacturing Assistance Act (MAA) economic impact analysis. As a result, DECD completed a new REMI calculation to determine the effect of the errors. The new calculation determined that DECD overstated the cumulative net state revenue by \$12,275,398 (2%).
- DECD did not consider loan forgiveness awarded to companies when calculating the economic impact of the assistance provided. DECD has forgiven over \$230 million of loans (22%) for the Manufacturing Assistance Act and Small Business Express programs. DECD informed us that loan forgiveness was not included in the economic impact calculations in the revised report due to the limited amount of time available to reissue the report. However, DECD informed us that loan forgiveness will be considered in the economic impact calculations for the fiscal year ended June 30, 2018 annual report.
- Our review identified additional inputs that may not be properly addressed in DECD's current economic impact analyses. DECD informed us that it will reevaluate its methodology for calculating the economic impact of the assistance provided for the fiscal year ended June 30, 2018 annual report.

Item No. 5 – Data to Consider Including in Future Reports

Results of Original Review:

Recipients receiving assistance under the Manufacturing Assistance Act or the Small Business Express program may be eligible for partial or full loan forgiveness if they meet certain job creation goals. In addition, a certain portion of DECD's outstanding loan balances may be uncollectible due to companies that have gone out of business. Forgiven or uncollectible loans represent funds DECD will never collect. The amount of uncollectible loans may be an indication of how well companies that receive financial assistance are doing, and whether incentive programs are helping

businesses successfully grow and expand. Therefore, reporting this information provides the reader with a more accurate picture of the business assistance funding that DECD provided.

Recommendation:

The General Assembly should consider amending the reporting requirements in Section 32-1m of the General Statutes to include information on uncollectible loans, and potential and actual loan forgiveness.

Agency Response:

“We appreciate the detail in which this audit has evaluated the annual report. As indicated above we will be making many improvements in securing accurate and timely data and correct formulas for future annual reports. In fact, we plan to reissue the 2017 annual report with the corrected data. We also welcome additional areas of inclusion, though some may require more customer reporting or changes in our systems in order to be implemented.

As to the specific suggestions noted above, DECD already provides information via Open Data on companies that have gone out of business and are therefore uncollectible. It would be possible to also include this in our annual report. With the CRM improved data collection, more detailed reporting on loan forgiveness will also be possible once the system is fully installed.”

Status as of September 21, 2018:

DECD did not include information regarding uncollectible loans, and potential and actual loan forgiveness in the revised annual report. While Section 32-1m of the General Statutes does not currently require this information, including data on uncollectible loans and potential and actual loan forgiveness would provide a more accurate picture of DECD’s business assistance funding. DECD permanently loses funds on forgiven or uncollectible loans. In addition, the amount of uncollectible loans may indicate how well companies that receive financial assistance are doing, and whether incentive programs are helping businesses successfully grow and expand. Therefore, this recommendation is being repeated.

ACKNOWLEDGEMENT

The Auditors of Public Accounts would like to recognize the auditors who contributed to this report:

Bryne Botticelli
Catherine Dunne

CONCLUSION

In conclusion, we wish to express our appreciation for the courtesies and cooperation extended to our representatives by the personnel of the Department of Economic and Community Development during the course of our examination.

Catherine L. Dunne

Catherine L. Dunne
Principal Auditor

Approved:



John C. Geragosian
State Auditor



Robert J. Kane
State Auditor