Thomas A. Schweich

Missouri State Auditor

ECONOMIC DEVELOPMENT

Missouri Quality Jobs Tax Incentive Program

July 2012

Report No. 2012-65

http://auditor.mo.gov

July 2012

Thomas A. Schweich
Missouri State Auditor

CITIZENS SUMMARY

Findings in the audit of the Missouri Quality Jobs Tax Incentive Program

Background

The Missouri Quality Jobs Act of 2005 authorized the creation of the Missouri Quality Jobs (MQJ) Tax Incentive Program, which provides tax incentives to qualified companies for facilitating the creation of new, or retention of existing, jobs in Missouri. The Department of Economic Development (DED) manages the MQJ Tax Incentive Program.

The tax incentives authorize qualified companies to retain state income taxes withheld from employees in created or retained jobs and/or receive tax credits. Tax incentives are not awarded until jobs are created or retained. To be eligible for incentives: (1) the jobs must be for full-time positions, (2) the employer must pay at least 50 percent of the health insurance premiums for each employee, and (3) the average wage for the jobs must be at least the average wage for the county (or for the state if county average is higher). The benefit period lasts up to 5 years, and the tax credits are refundable, transferable and sellable.

Program Data

Data used to measure the economic impact of the MQJ program are based on projections which are significantly overstated. Since the inception of the program in 2005, the DED has approved projects anticipated to create a total of 45,646 jobs, however, according to the 2012 MQJ annual report, the DED had reduced the estimated jobs by 18,960 (41 percent). In addition, the projected level of business investment, and tax incentives to be retained have also been overstated.

Significant weaknesses also exist in the manner in which actual program data is obtained, maintained, verified, and reported to the legislature. Actual program data is not timely and is not verified to ensure accuracy and compliance with program requirements, and therefore, the data presented to the public and the legislature is outdated and not reliable. The DED has not established a timely deadline for businesses to submit the MQJ annual report required by state law. The amount of tax incentives reported to the legislature on the tax credit activity report are understated, and the DED does not ensure key project data entered in the tax credit system is accurate, reliable, and complete.

As a result of these deficiencies, the overall economic impact of the MQJ program cannot be accurately assessed.

Oversight and Verification of Business Data

DED oversight of companies receiving MQJ incentives is not adequate. Procedures to verify project eligibility are not adequate and have resulted in noncompliant projects receiving tax incentives. We identified one project where the "new" jobs consisted of jobs which were spin-off jobs from an existing company. The DED did not perform adequate verification of the parent company's employment levels to determine if the project was eligible for benefits prior to the company receiving benefits.

We also identified 12 projects which were not in compliance with program reporting requirements. In addition, the DED did not ensure base employment was consistently calculated or properly documented in project files, which makes it difficult to determine how many jobs were created or maintained. For nine of the ten project files reviewed, the DED had limited or no documentation to support details of site visits, and the DED had not established procedures to ensure companies comply with the statutory requirement to pay at least 50 percent of health insurance premiums.

Program Design

The current law dictating how program benefits are calculated and awarded is difficult to administer and monitor. In addition, although state law limits total MQJ tax credits to $80 million annually, there is no limit on the amount of tax withholdings allowed to be retained on an annual or cumulative basis, and the MQJ program contains no sunset provision.

In the areas audited, the overall performance of this entity was **Poor**.*

American Recovery and Reinvestment Act (Federal Stimulus)

Not applicable.

*****The rating(s) cover only audited areas and do not reflect an opinion on the overall operation of the entity. Within that context, the rating scale indicates the following:

Excellent: The audit results indicate this entity is very well managed. The report contains no findings. In addition, if applicable, prior recommendations have been implemented.

Good: The audit results indicate this entity is well managed. The report contains few findings, and the entity has indicated most or all recommendations have already been, or will be, implemented. In addition, if applicable, many of the prior recommendations have been implemented.

Fair: The audit results indicate this entity needs to improve operations in several areas. The report contains several findings, or one or more findings that require management's immediate attention, and/or the entity has indicated several recommendations will not be implemented. In addition, if applicable, several prior recommendations have not been implemented.

Poor: The audit results indicate this entity needs to significantly improve operations. The report contains numerous findings that require management's immediate attention, and/or the entity has indicated most recommendations will not be implemented. In addition, if applicable, most prior recommendations have not been implemented.

Missouri Quality Jobs Tax Incentive Program
Table of Contents

THOMAS A. SCHWEICH

Missouri State Auditor

Honorable Jeremiah W. (Jay) Nixon, Governor
and
Chris Pieper, Acting Director
Department of Economic Development
Jefferson City, Missouri

We have audited certain operations of the Missouri Quality Jobs Tax Incentive Program in fulfillment of our duties under Chapter 29, RSMo and Section 620.1300, RSMo. The scope of our audit included, but was not limited to, the 3 years ended June 30, 2011. The objectives of our audit were to:

1. Analyze the costs and benefits of the program to determine if it is an effective and efficient use of state resources.

2. Evaluate the internal controls over significant management and financial functions related to the program.

3. Evaluate compliance with certain legal requirements related to the program.

4. Evaluate the economy and efficiency of certain management practices and operations.

For the areas audited, we (1) determined that due to weaknesses in program data, program effectiveness and efficiency could not be determined, (2) identified deficiencies in internal controls, (3) identified noncompliance with legal provisions, and (4) identified the need for improvement in management practices and procedures.

Except for the matter discussed in the last paragraph of the Scope and Methodology Section, we conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our 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 such a basis.

The accompanying Management Advisory Report presents our findings arising from our audit of the Missouri Quality Jobs Tax Incentive Program.

Thomas A. Schweich
State Auditor

The following auditors participated in the preparation of this report:

Deputy State Auditor:	Harry J. Otto, CPA
Director of Audits:	John Luetkemeyer, CPA
Audit Manager:	Robert Showers, CPA, CGAP
In-Charge Auditor:	Amanda Locke, M.Acct

Quality Jobs Tax Incentive Program
Introduction

Background

The Missouri Quality Jobs Act was established in 2005 as a tax incentive program under Sections 620.1875 to 620.1890, RSMo. The authorizing statutes do not explicitly state the purpose of the Missouri Quality Jobs (MQJ) Tax Incentive Program; however, the program provides tax incentives to qualified companies for facilitating the creation of new or retention of existing jobs in Missouri. The Department of Economic Development (DED) manages this tax incentive program.

The MQJ program provides tax incentives to qualified business after jobs are created or retained. To be eligible for incentives, the following criteria must be met: (1) the jobs created or retained must be for employees in full-time positions; (2) the employer must pay at least fifty percent of the health insurance premiums for each employee; and (3) the average wage for the jobs created or retained must be at least the county average wage (or the state average wage if the county is higher). Qualified companies who have met program requirements are eligible to retain state income taxes withheld[1] from employees in newly created or retained positions and/or receive tax credits.[2] The benefit period for a project to receive tax incentives is up to 5 years, and begins after the project meets the minimum program requirements. The tax credits are refundable, transferable, and sellable. Minimum eligibility requirements must be met within 2 years of the application approval date or the authorization expires and the company may reapply.

The MQJ program includes provisions for five project types, with each project type having its own minimum requirements and tax incentive award criteria. The project type, minimum number of required jobs, and specific tax incentives allowed by project type are presented in the following table:

[1] Withholdings are the state income taxes that an employer deducts and withholds from employees' wages every pay period.
[2] Tax credits can be used to offset state taxes due or receive tax refunds if the amount of the tax credits exceeds the amount of taxes due.

Project Type	Minimum Number of Required Jobs	Tax Incentive Allowed
Small and expanding companies	20 jobs in rural areas or 40 jobs in non-rural areas	Withholdings only
Technology	10 jobs	Withholdings, with refundable tax credits allowed in the event the withholding tax is not sufficient
High Impact	100 jobs	Withholdings, with refundable tax credits allowed in the event the withholding tax is not sufficient
Job Retention[1]	Retention of full-time employees that existed in the taxable year immediately preceding the year in which application for the program is made. The employer's site must have maintained at least 1,000 employees in the 24 months preceding the application.	Tax credits only (up to $1 million annually for each project, with maximum issuance for all projects of $3 million annually)
Small business job retention and flood survivor relief (Flood Survivor)[2]	Retention of at least the level of full-time, year-round employees that existed in the taxable year immediately preceding the year in which application for the program is made.	Tax credits only (with maximum issuance for all projects of $500,000 annually)

[1] No tax credits shall be issued for job retention projects approved after August 30, 2013. Only one job retention project has been approved since program inception. As a result, our review focused on job creation projects.

[2] No tax credits shall be issued for small business job retention and flood survivor relief projects approved after August 30, 2010.

The minimum requirements and project eligibility have been modified since the Missouri Quality Jobs Act was established. The above table reflects statutory requirements as of March 2012. Due to the statutory changes, the DED uses the statute in effect when the application is received from the company to determine program eligibility requirements.

Eligibility authorization

To become authorized to participate in the MQJ program, a business must submit a Notice of Intent (NOI) Application to the DED. By statute, the DED must review and approve the project within 30 days of the NOI. Once the eligibility requirements have been met and the jobs have been created, the business must submit an Application to Retain Withholdings to be allowed to retain withholdings. The DED will review the application and, if requirements are met, authorize the business to begin retaining withholdings.

Reporting

The DED provides the General Assembly and the public key program information for the MQJ program through both the tax credit activity report and the MQJ annual report.

Agencies administering tax credit programs are required under Section 33.282, RSMo, to submit the estimated amount of tax credit activity for the next fiscal year to the State Budget Director for submission to the Chairmen of the Senate Appropriations and House Budget Committees. In addition to the estimates of tax credit activity, the agencies must also include a cost benefit analysis of the program for the preceding fiscal year. The annual estimates and cost benefit analyses are submitted on forms called tax credit activity reports. State law requires the tax credit activity report be submitted to the State Budget Director by October of each year and to the Chairmen of the Senate Appropriation and House Budget Committees by January 1st of each year.

The DED is also required by Section 620.1890, RSMo, to submit an annual report of the MQJ program to the General Assembly by March 1st of each year. This report is required to include the names of participating companies, location of such companies, the annual amount of benefits provided, the estimated net state fiscal impact (direct and indirect new state taxes derived from the project), the number of new jobs created or jobs retained, the average wages of each project, and the types of qualified companies using the program.

In addition, Section 135.805, RSMo, requires companies receiving tax credits to submit an annual report to the DED. This report is required to include the actual number of jobs created as a result of the tax credits for each month of the preceding 12-month period, the business size, the address of the business headquarters, all addresses of the business offices, the number of employees at the time of the annual update, the estimate of the number of employees projected to increase as a result of the completion of the project, and the estimated or actual project cost. The DED makes this information available to the public, as required by section 135.805, RSMo.

Scope and Methodology

To gain an understanding of the MQJ program, we interviewed DED officials involved in the application and approval process as well as staff involved in monitoring MQJ projects, and officials at the Department of Revenue (DOR).

We obtained a data file of projects involved in the program since project inception (calendar year 2005) from the Customer Management System (CMS) as of March 2011. We later obtained a similar data file in February

2012. We analyzed the data files to determine the total tax incentives authorized, issued, redeemed, and retained. The March 2011 file was scanned for unusual transactions or possible noncompliance with program requirements. We compared project totals from the data file to those reported per the MQJ Annual Report to the General Assembly and the tax credit activity report.

We reviewed the project files for ten projects that had received tax incentives. As part of this review, we interviewed staff of the DED, reviewed documentation submitted by the companies, and determined if required procedures were followed. In addition, we reviewed one authorized project that had not been issued tax incentives and contacted an official from another project who had chosen to create the jobs in another state.

To understand how the economic impact of the MQJ program is calculated, we met with representatives of the DED responsible for generating the economic impact estimates. We also interviewed DED staff regarding assumptions provided by the companies to calculate the economic impact of the tax incentives.

We obtained aggregate totals of annual tax credit redemptions from the DOR. However, we were not provided detailed tax credit redemption information because the Director of the DOR denied us access due to the department's interpretation of the Missouri Supreme Court decision in the case of Director of Revenue v. State Auditor 511 S.W.2d 779 (Mo. 1974). This external impairment limited our ability to conduct work and therefore, we could not verify the completeness and accuracy of annual redemption totals.

1. Program Data

Data used to project the economic impact of the Missouri Quality Jobs (MQJ) program are significantly overstated. Significant weaknesses also exist in the manner in which actual program data is obtained, maintained, verified, and reported to the legislature. Actual program data is not timely and is not verified to ensure accuracy and compliance with program requirements, and therefore, the data presented to the public and the legislature is outdated and not reliable. As a result of these deficiencies, the overall economic impact of the MQJ program cannot be accurately assessed.

1.1 Program activity projections

Program activity projections reported to the General Assembly regarding the economic impact of the program appear significantly overstated. Our review of program activity projections identified the following issues:

Number of jobs

The number of jobs expected to be created as reported by companies have been overstated. From the inception of the program in 2005 through December 2011, the DED has approved projects anticipated to create a total of 45,646 jobs by the end of the projects' benefit periods. However, approximately 40 percent of approved projects failed to meet minimum number of job created or retained requirements resulting in the expiration of the projects. As a result, the DED has reduced the estimated jobs to be created by 18,960 jobs to 26,686 jobs by the end of the projects' benefit periods, according to the 2012 MQJ annual report; a reduction of 41 percent. As of December 31, 2011, a total of 7,176 jobs have been created according to DED data. The number of jobs expected to be created is a key element when calculating the estimated economic benefit of the program.

Level of investment

The projected amount companies will invest as a result of the program appears significantly overstated in the MQJ annual report. Based on project applications approved through 2011, a total of $4.93 billion is projected to be invested in facilities and equipment by the end of the projects' benefit period, according to the 2012 MQJ annual report. However, based on information from the Customer Management System (CMS), companies have reported actual investments of approximately $1.1 billion as of February, 2012, or 22.3 percent of the projected amount. The investment amounts in the CMS are self-reported from the participating companies and are not verified. In some cases no investment amount is reported by the company even though an estimated amount of investment was included in the company's initial application.

Tax incentives

The total projected amount of tax incentives may be significantly overstated in the MQJ annual report. The projected amount of tax incentives through 2018 for projects approved as of December 31, 2011, was $501 million. However, according to the 2012 MQJ annual report, cumulative tax incentives expected on all projects receiving benefits in 2011 over the next 5 years (through 2016) are expected to be $149 million.

Economic impact

The method in which economic impact is calculated overstates the economic benefits of the program. The economic benefit reported on the tax credit activity report is calculated using projected jobs and investment information from tax credit applications. As stated above, actual program activity has historically been significantly lower than projected.

By utilizing authorized project information to estimate economic impact, key stakeholders are not provided realistic expectations of program benefits.

1.2 Verification of withholding information

The DED does not require companies to provide payroll information to support the amount of withholdings retained for each new employee. Six of eight project files with retained withholdings did not contain documentation to support the amount of withholdings retained for new employees.

When actual withholding documentation is not submitted, DED personnel estimate the amount of total withholdings they believe should be withheld for a project. If actual reported withholdings significantly exceed DED estimates, DED officials stated they investigate the discrepancy. However, we noted two projects where the DED did not investigate significant discrepancies. For one project, the business had retained withholdings totaling approximately $1 million over a 2-year period; approximately $383,000, or 62 percent, more than the amount estimated by the DED. For the other project, the business had retained withholdings totaling approximately $592,000; approximately $145,000, or 32 percent, more than the amount estimated by the DED.

Without detailed payroll information to support withholdings retained by participating employers, the DED has less assurance withholdings retained are appropriate and accurate.

1.3 Annual report timeliness

The DED has not established a timely deadline for businesses to submit the MQJ annual report required by state law. Section 620.1881.4, RSMo, requires companies receiving MQJ incentives to submit an annual report to the DED which includes "the number of jobs and such other information as may be required by the department to document the basis for the benefits." The annual report requests information on the number of new jobs created and the average wages paid, including information on the individual employees. State law does not specify when the annual report is due to the department. However, the DED policy does not require the annual report to be submitted until November 30 of the following year. As a result, if a project was not eligible or businesses withheld an inappropriate amount, the DED may not be aware of the issue for nearly 2 years.

Without a timely annual report from the companies, program data reported to the General Assembly is not timely, and the DED is unable to confirm if: (1) the companies have continued to employ the minimum number of jobs required to be eligible to retain the withholdings, (2) the amount retained was accurate, or (3) if the business is due to receive any additional tax credits.

1.4 Tax credit activity report

The amount of tax incentives reported on the tax credit activity report are understated. According to tax credit activity reports covering fiscal years 2008 to 2011, tax incentives redeemed and retained have totaled \$52.9 million. However, according to information in the CMS, actual redemptions and retentions for the same timeframe were approximately \$58.7 million.

The primary reason for the difference is that the DED did not update prior year data to reflect actual activity when the next year's tax credit activity report was prepared. In addition, a DED official said some of the difference is due to timing between when the tax credit activity report was prepared and when the tax incentives were issued by the DED and/or retained by the companies and companies making adjustments to the amount of withholdings retained, and because prior to calendar year 2010 the DED did not revise the tax credit activity report to reflect the adjustments made. Updating tax incentive redemptions for each tax credit activity report would provide the General Assembly more accurate and timely information.

1.5 Data accuracy

The DED does not ensure key project data entered in the CMS is accurate, reliable, and complete. Our scans of DED project data files identified instances of incorrect authorized credit amounts, industry codes, number of jobs, average wages, annual report status, and investment data within the CMS.

Without accurate and complete data, the DED cannot properly monitor and evaluate the program.

Recommendations

The DED:

1.1 Establish procedures to ensure the economic benefit projections reported to the General Assembly reflect a realistic assessment of program performance.

1.2 Obtain company payroll information to verify the amount of state income taxes withheld for each new employee is appropriate.

1.3 Establish procedures to require companies receiving MQJ program incentives to submit annual reports in a more timely manner.

1.4 Ensure tax incentive redemption data reported on the tax credit activity report is accurate and reflects actual program costs.

1.5 Establish procedures to ensure data entered in the CMS is accurate, complete, and reliable.

Auditee's Response

1.1 DED has established procedures to ensure that economic benefit projections reported to the General Assembly reflect a realistic assessment of program performance. As described in greater detail below, annual reports covering program activity from the program's enactment in 2005 through 2011 have evaluated economic impact based both on anticipated job creation and investment, as well as verified job creation to date and capital investment reported to date. This provides stakeholders a range of estimated economic impact to compare against the actual cost of the benefits provided in order to evaluate the program's effectiveness.

Number of Jobs

DED disagrees that companies participating in the Missouri Quality Jobs Program have overstated the number of jobs they anticipate creating. The anticipated job creation number included in the notice of intent is the company's best estimate of the new jobs they will create over the next five to eight years. The anticipated job numbers are updated each year in the annual report to eliminate projects that have failed to achieve or maintain the required job creation thresholds. Regardless, the actual benefit a participating company may receive is based on the jobs they actually create, rather than their anticipated job creation provided in the notice of intent.

With regard to how anticipated job creation factors into the estimated economic impact of the Missouri Quality Jobs Program, annual reports covering program activity from the program’s enactment in 2005 through 2011 have evaluated the program's economic impact based both on anticipated job creation provided by participating companies, as well as the verified job creation to date. This provides stakeholders a range of estimated economic impact to compare against the actual cost of the benefits provided in order to evaluate the program's effectiveness.

Level of Investment

DED disagrees that the estimated amount of capital investment reported by companies participating in the Missouri Quality Jobs Program is overstated. The capital investment estimates provided by participating companies in their notice of intent represent the company's best estimate of future capital investment over the next *five to eight years. The actual level of capital investment, like the actual number of jobs created, is adjusted by DED to reflect capital investment occurring over time as it is reported by companies.*

With regard to how capital investment factors into the estimated economic impact of the Missouri Quality Jobs Program, annual reports covering program activity from the program's enactment in 2005 through 2011 have evaluated the program's economic impact based both on the anticipated capital investment reported by participating companies in their notice of intent, as well as the actual capital investment reported to date. This provides stakeholders a range of estimated economic impact to compare against the cost of the benefits provided in order to evaluate the program's effectiveness.

Tax incentives

DED disagrees that the projected amount of tax incentives authorized for companies participating in the Missouri Quality Jobs Program may be overstated. The $501 million figure quoted by the State Auditor represents the total amount of benefits authorized for all approved projects since the program's enactment in 2005. However, only $335 million is currently authorized for active projects. These active projects are either still within their benefit period or still within the two or three year period following approval during which they can meet the minimum job creation thresholds for participation in the program. Projects are disqualified if they fail to meet minimum job creation thresholds or if they fail to maintain the requisite number of jobs.

Economic Impact

DED disagrees that the method used in the Missouri Quality Jobs Annual Report to calculate economic impact overstates the benefit of the program. Annual reports covering program activity from the program's enactment in 2005 through 2011 have evaluated economic impact based both on anticipated job creation and investment as reported by companies in their notice of intent, as well as verified job creation to date and capital investment reported to date. In addition, the employment impact charts in the annual reports separate direct and indirect jobs to show a ramp-up of anticipated employment over a 15-year period. In this way, the report provides stakeholders a range of estimated economic impact to compare against the actual cost of the benefits provided in order to evaluate the program's effectiveness.

For example, the 2012 MQJ Annual Report shows the program's estimated benefits to the state's general revenue given the cost of the incentives provided. When using only the actual jobs verified to date and the capital investment reported to date and conservatively assuming no additional growth, the return on investment is $3.26 in general revenue for every $1 of incentive provided. When all active projects are included, thereby also considering anticipated jobs and capital investment, the projected return on investment grows to $4.16 for every $1 of incentive provided.

1.2 *DED disagrees with the State Auditor's statement regarding the information collected to support the amount of withholding claimed. DED obtains company payroll information to identify each specific employee and their wages in order to verify the average wage, verify that new jobs thresholds have been achieved and maintained, and calculate the amount of any tax credits for which the company may be eligible, as applicable. DED provides the company with an estimate of the company's withholdings based on a chart provided by the Department of Revenue showing the average withholding rates for different ranges of adjusted gross income. However, the actual benefit the company will receive under Missouri Quality Jobs is determined by the actual amount of withholding taxes that would otherwise be remitted to the Department of Revenue, and not on the estimate provided by DED. Companies file their withholding information with the Department of Revenue, and the Department of Revenue determines the amount of withholding taxes owed by the qualified company. While as with the two projects cited there may be differences between the withholding estimate provided by DED and the actual withholding tax the company owes to the Department of Revenue, it is the actual withholding taxes owed that determines the actual amount of the benefit.*

1.3 *DED has established procedures and a deadline for participating companies to submit an annual report by November 30 of each year. Different companies begin to retain benefits under the program at different times throughout a calendar year, and this November 30 deadline allows nearly all projects to have at least one year from the time they begin to retain benefits to satisfy the reporting requirements. In addition, DED verifies job numbers through Department of Labor records for unemployment insurance reporting for the same time periods. In light of this verification, the timing of participating companies' submission of their annual reports does not impair DED's ability to determine eligibility at any time. Moreover, if a company were to retain withholdings for which they were ineligible, they would be required to repay the amount to the Department of Revenue with penalty and interest.*

1.4 DED disagrees that the redemption data reported on tax credits activity reports for the program is understated. Section 33.282, RSMo requires submission of tax credit activity reports for approval by the General Assembly as part of the budget process. There is no statutory mechanism for amending reports previously approved by the General Assembly. However, since 2010, DED has updated the redemption data for the tax credit activity reports to reflect adjustments occurring during the year in order to provide the most up-to-date and accurate information to the General Assembly.

1.5 DED has established procedures to ensure that data entered into DED's internal tracking database is accurate, complete and reliable. DED staff periodically review database entries and correct any data entry errors identified. The State Auditor has not identified any instance of a data entry error in DED's internal database resulting in an incorrect amount of benefits being provided to a participating company.

Auditor's Comment

1.1 The purpose of the tax credit activity report sent to the legislature is to provide information on the projected costs and benefits of the program. However, due to actual activity being significantly less than authorized, the reports for the MQJ do not accurately reflect the costs and benefits of the program. At a minimum, the DED should disclose that program activity projections have historically overstated the economic impact.

1.2 The Department of Revenue does not perform any verification of program eligibility to ensure only the withholdings of employees in the new jobs are retained. While the DED does receive individualized payroll data to determine eligibility, such data does not include information on withholding amounts of each eligible employee. As a result, the DED cannot verify that withholdings retained are appropriate.

1.3 Requiring reporting of MQJ-related data 11 months after the year-end appears untimely given most companies report withholding information to the IRS and DOR quarterly, and many large companies report on a monthly basis.

1.5 While we did not identify specific errors which resulted in an incorrect amount of benefits provided, weaknesses in data reliability increase the risk of potential improprieties occurring.

2. Oversight and Verification of Business Data

DED oversight of companies claiming MQJ credits and retaining withholdings is not adequate. Procedures to verify project eligibility are not adequate and have resulted in noncompliant projects receiving tax incentives. In addition, the DED has not obtained or maintained sufficient documentation to verify base employment, and base employment is not consistently calculated. Documentation and oversight of site visits are not adequate, and verification of insurance premium requirements is needed.

2.1 Project eligibility

The DED has not established adequate policies and procedures to verify project eligibility or reclaim retained withholdings when businesses fail to meet program requirements.

Potentially ineligible project

Our review of ten project files identified one company that received tax incentives despite being potentially ineligible. Our review of the project file determined that despite claiming to be a new company, the company was a spin-off of an existing company, and the "new" employees were actually pre-existing employees of the parent company. Per Section 620.1878(14), RSMO, the spin-off company is eligible for MQJ benefits if the parent company replaced the jobs lost in the spin-off. Our review of the project file showed the DED treated the company as if it were "new" and did not obtain documentation of the parent company's base employment prior to awarding benefits. A subsequent DED review determined the parent company had replenished the jobs that were lost due to the spin-off. As of February 2012, the company had retained tax withholdings totaling $2,059,705.

Noncompliant projects

We identified 12 projects which were not compliant with program reporting requirements. The projects involved have withheld a total of $2,740,258 for activity occurring during calendar years 2008 through 2010, but as of February 2012, had yet to submit an annual report. Annual reports for eight of these projects were due November 2011, and six were due November 2010. Two of these projects had not submitted annual reports for multiple years. Based on discussions with DED officials, the business is given every chance to comply with the reporting requirement.

Without the annual report required by state law, the DED is unable to determine whether businesses meet program requirements and are eligible for the tax incentives received.

2.2 Base employment

The DED has not ensured base employment is consistently calculated or properly documented in project files. Base employment is the greater of the number of full-time jobs in place at the time of the company's application for MQJ incentives, or the average number of jobs at the facility for the 12 months prior to the application date. Jobs created in excess of the base employment are generally eligible for tax incentives as long as minimum wage and benefit requirements are met.

For three of the ten projects tested, the DED did not have sufficient documentation in the project files to support base employment. In addition, for one project, the DED did not use the same methodology as the other projects when calculating base employment.

Maintaining adequate documentation of, and consistently calculating, the base employment is necessary for the DED to ensure companies receive the appropriate amount of tax incentives.

2.3 Site visits

The DED did not adequately document monitoring procedures performed during site visits. For nine of ten projects reviewed, limited or no documentation was available to support details of the visit. The DED did not document how many and which employees were selected for verification, or the specific payroll information reviewed.

Requiring adequate documentation of the details of each site visit would improve the review process and would provide the DED with additional assurance site visits are properly performed.

2.4 Insurance premium verification

The DED has not established procedures to ensure companies comply with statutory requirements to offer to pay at least 50 percent of new employee health insurance premiums. State law requires companies to pay at least 50 percent of health insurance premiums for new jobs created to be eligible for MQJ tax incentives. Four of five project files reviewed did not contain sufficient documentation to determine whether the business paid at least 50 percent of health insurance premiums. In addition, the DED does not perform procedures to verify the insurance premium requirement during site monitoring visits, but relies on a certification provided by the company that the requirement has been met.

Without adequate verification procedures, the DED has little assurance businesses receiving MQJ tax incentives comply with state law related to employee health insurance premiums.

Recommendations

The DED:

2.1 Establish procedures to ensure projects that have not complied with program requirements are disqualified, and investigate to determine whether tax incentives were improperly issued or retained. In addition, the DED should ensure adequate documentation is included in project monitoring files.

2.2 Ensure base employment is consistently calculated and properly documented.

2.3 Ensure site visits of participating companies are properly documented.

2.4 Establish procedures to ensure companies pay 50 percent or more of new employee health insurance premiums as required by state law.

Auditee's Response

DED has not provided benefits to any non-compliant projects, and DED disagrees with the assertion that any of the projects referenced by the State Auditor that received benefits were non-compliant.

2.1 ***Potentially Ineligible Project***

DED disagrees that the company in the 2007 project referenced was "potentially ineligible" for the Missouri Quality Jobs Program. The referenced company was approved for benefits in 2007. At the time of that approval, the company clearly met the definition of a "qualified company" under the statute and was clearly "eligible" for the program.

The State Auditor appears to question whether this qualified company's parent company was a "related company" and whether there was any reduction in employment at the qualified company's parent company when several employees of the parent company were transferred to the qualified company. As the State Auditor acknowledges, DED documented, through employment information provided by the parent company and verified through the Department of Labor, that there was no decrease in employment at the parent company and that the qualified company retained the appropriate amount of benefits since the time it was approved in 2007.

Noncompliant Projects

DED disagrees that there are 12 projects out of the more than 400 projects reviewed by the State Auditor on this issue that have not submitted an annual report. Currently, there are only three projects that have not submitted an annual report. Because these three projects have not submitted annual reports, they are no longer eligible to receive benefits under the program. In any event, if a company fails to submit an annual report, no additional benefits are provided.

2.2 DED thoroughly documents base employment calculations in project files. Each file contains lists of employees, including names, titles, wages, hire dates and average hours worked. The files also include a Base Employment Calculation Worksheet showing *employment by month for the twelve-month period prior to the application. The files also contain supporting documentation for any updates to base employment following approval. Employment data is also verified through Department of Labor unemployment insurance information.*

DED acknowledges that base employment was calculated differently before and after the 2007 statutory change to the definition of "project facility base employment," which altered the formula for calculating base employment. The single project referenced as using a different methodology for calculating base employment was approved in 2005, prior to this statutory change.

2.3 DED ensures that all sites visits are properly documented. Detailed compliance checklists are completed for site visits documenting the specific activities performed during the site visit. Activities performed during the site visit and documented on the compliance checklist include; (1) verification of information provided in the notice of intent and application, including but not limited to the NAICS code, number of employees, wages, etc.; (2) verification of the process for tracking those employees that qualify for the retention of withholding to verify that withholding on only those employees are retained; (3) review of employee withholding reports for the most recent period; (4) verification that any new jobs are identifiable and separately queried or isolated in the applicable on-site tracking system; (5) verification of the company's process for filling vacancies that occur in the facility's base employment; (6) review of on-site payroll information and random employee payroll amounts to verify the information submitted; (7) verification of compliance with the requirement to offer health insurance and pay fifty percent of the premiums; and (8) verification of the fully executed E-Verify enrollment and documentation of employee verifications. DED does not include specific employee information in the compliance checklist document to show the specific employees whose information was reviewed due to privacy concerns for the employee and for the business.

2.4 DED has established procedures to ensure that participating companies offer health insurance and, if accepted by the employee, pays at least 50% of the premiums. First, DED collects information regarding the company's health plan at the time the company submits its notice of intent. At that time, the company certifies under penalty of perjury that it complies with the health insurance premium requirement. In connection with its annual report, the company again must attest under penalty of perjury that it continues to comply with the health insurance requirement. Finally, during *site visits compliance staff verifies evidence of employer-provided health insurance and paying at least fifty percent of the premiums. In the event that the company cannot provide evidence during a site visit or if the company is unable to make the annual certification, benefits would no longer be provided.*

Auditor's Comment

2.1 DED personnel did not perform the necessary procedures to determine if the potentially ineligible company was eligible until auditors questioned the DED about what appeared to be a "related company". While the DED eventually determined the company to be eligible, the department did not obtain the supporting documentation necessary to make this determination until tax incentives had been received by the participating company. Regarding noncompliant projects, the data presented in our finding was obtained from the CMS system as of February 2012.

2.2 Base employment calculations were not consistently noted in the DED project files we reviewed. In addition, the use of a different methodology of calculating base employment cited in our report was not impacted by the statutory change of 2007.

2.3 Project files contain specific employee information for the purposes of determining eligibility. It is not clear how including such information in monitoring documents jeopardizes individual privacy. In any event, documentation of specific employee information verified could be accomplished in a manner that would not jeopardize privacy.

3. Program Design

Improvements are needed to increase the efficiency and effectiveness of the program. Several areas were identified which result in significant inefficiency, inaccurate information, and additional costs to the state. In addition, state laws have not been established to limit the amount of state income tax incentives that may be retained and include a sunset provision.

3.1 Current law

The current law dictating how program benefits are calculated and awarded to companies is difficult for the DED to administer and effectively monitor. The DED must obtain and review detailed payroll information from program participants to calculate and verify which individual employees are considered part of "base employment" and which employees are considered "new."

Similarly, to determine if a participating company has retained the appropriate amount of withholdings, a business must identify which employees are considered to be in the "new job" each pay period as well as the amount of withholdings paid by those employees. The amount of withholdings retained for each employee is variable by its nature, making it difficult to estimate withholdings on a particular project.

As part of our review, we interviewed the Chief Executive Officer of a company which considered expanding in Missouri, but ultimately decided to expand his company in another state. According to this individual, one of the factors leading to the decision to not come to Missouri was that the programs offered are cumbersome and complicated.

Simplifying the mechanism used to calculate program benefits would not only help reduce the level of effort necessary to administer and monitor the program at the state level, but would make the administration of the program less burdensome to program participants. Allowing a set dollar amount of withholdings, or establishing a set percent of salary to be retained for each job created or retained, would simplify the program and enable the DED to better ensure the appropriate amount of tax incentives are awarded for each project.

3.2 Withholding cap

Although state law limits total MQJ tax credits issued to $80 million annually, there is no limit on the amount of withholdings allowed to be retained on an annual or cumulative basis. Based on actual program results through 2011, the amount of withholdings is the primary cost associated with the MQJ program with withholdings exceeding tax credits issued by a ratio of nearly 2 to 1.

Without a limit on the amount of withholdings authorized, the ability to contain the total cost of the program is limited. Implementing an annual and/or cumulative cap on the amount of withholdings authorized to be retained would help to better contain the cost of the MQJ program.

3.3 Sunset provision

State law does not include a sunset provision for the MQJ program. The Sunset Act, passed in 2003, provides for new programs to sunset after a period of not more than 6 years unless reauthorized by the General Assembly or the program is exempted from the Sunset Act. The Act requires the Committee on Legislative Research to review applicable programs before the sunset dates and present a report to the General Assembly regarding the sunset, continuation, or reorganization of each affected program. However, the General Assembly exempted the MQJ program from the Sunset Act provisions.

By adopting a sunset provision for the MQJ program, the General Assembly can better determine whether the program is achieving its intended purpose and whether program funding should be increased, decreased, or eliminated.

Recommendations

The DED work with the General Assembly to:

3.1 Revise state law to simplify the mechanism used in the calculation of program benefits.

3.2 Revise state law to establish an annual and/or cumulative limit on the amount of tax withholdings that may be retained.

3.3 Revise state law to include a sunset provision for the MQJ program.

Auditee's Response

The DED declined to respond to the above recommendations.

Missouri Quality Jobs Tax Incentive Activity

The following table lists the Missouri Quality Jobs tax incentives authorized, issued, and redeemed through June 30, 2011, per the tax credit activity report. Amounts shown as issued and redeemed include withholdings retained, and tax credits issued and redeemed.

Fiscal Year		Amount Authorized for 5 year period	Amount Issued	Amount Redeemed
2006	$	6,497,013	0	0
2007		51,688,243	1,715,530	1,715,530
2008		76,476,912	3,744,069	2,805,251
2009		81,717,502	11,348,054	6,203,572
2010		57,057,508	14,863,017	14,238,179
2011		59,914,412	28,099,496	27,936,799
Totals	$	333,351,590	59,770,166	52,899,331

Source: *Report on Missouri Tax Credits Administered by the Department of Economic Development*

The following table lists the Missouri Quality Jobs tax credits issued and the withholdings retained through December 31, 2011, per the Missouri Quality Jobs annual reports.

Calendar Year		Actual Tax Credits Issued	Actual Withholdings Retained	Total Tax Incentives	Actual Jobs Created[1]
2008	$	2,449,893	6,943,422	9,393,315	3,405
2009		4,064,312	10,499,548	14,563,860	2,836
2010		8,284,454	20,896,513	29,180,967	1,548
2011		11,092,000	12,756,121	23,848,121	459
Totals	$	25,890,659	51,095,604	76,986,263	8,248

[1] Includes 7,176 jobs created and 1,072 jobs retained.

Source: SAO analyses of the Missouri Quality Jobs annual reports for calendar years 2011, 2010, 2009, 2008, 2007, and 2006. Data on actual credits issued, withholdings retained, and jobs created was not presented in the annual reports until 2008. The 2008 report included cumulative data from previous years.

Tax Credit Redemptions

The following table shows redeemed tax credits for fiscal years 2008 through 2011 for all state tax credit programs. We did not audit the information.

Tax Credit Redemptions by Program

Program		Year Ended June 30,			
		2008	2009	2010	2011
Adoption (Special Needs)	$	3,095,525	2,222,415	1,894,187	1,346,454
Affordable Housing Assistance		11,392,907	9,917,951	11,647,956	4,880,797
Agricultural Product Utilization Contributor		1,207,849	145,162	114,674	466,048
Alternative Fuel Vehicle Refueling Property		n/a	0	0	23,365
Bank Franchise		2,137,560	2,710,300	2,013,584	4,233,673
Bank Tax Credit for S Corporation Shareholders		1,149,975	1,862,266	1,823,612	2,787,708
Brownfield Jobs/Investment		1,726,005	1,965,406	1,650,222	1,620,384
Brownfield Redevelopment		26,493,252	29,194,789	17,590,273	11,432,109
Business Use Incentives for Large-Scale Development (BUILD)		4,975,510	7,074,994	8,306,413	10,976,914
Business Facility		2,815,251	5,896,798	2,883,729	5,682,965
Cellulose Castings[1]		n/a	n/a	n/a	n/a
Certified Capital Business		9,874,295	4,754,869	495,459	586,135
Charcoal Producers[1]		106,952	134,663	14,642	521,380
Children in Crisis		306,146	403,291	420,857	587,137
Community Development Corporation		11,990	990	5,915	22,703
Development		696,889	966,216	1,589,618	1,001,142
Disabled Access		28,922	17,206	12,526	26,273
Distressed Areas Land Assemblage		0	0	6,731,635	13,534,347
Domestic Violence		750,714	612,456	789,233	757,609
Dry Fire Hydrant		742	11,133	2,634	7,715
Enhanced Enterprise Zone		756,006	1,454,319	2,916,392	4,000,689
Enterprise Zone		13,832,974	6,719,004	1,505,589	1,130,301
Examination Fees and Other Fees[2,3]		2,686,591	4,322,410	5,227,134	4,974,981
Family Development Account		8,749	0	3,000	25,000
Family Farms Act		33,818	88,137	104,798	49,825
Film Production		1,920,709	970,673	1,925,158	1,563,218
Food Pantry		243,711	459,810	793,734	1,081,076
Guarantee Fee		39,694	30,812	n/a	n/a
Health Care Access Fund		0	0	0	0
Historic Preservation		140,111,002	186,426,164	107,973,542	107,767,393
Homestead Preservation		1,030,621	94,337	2,478,624	773,465
Life and Health Guarantee Association[2]		0	0	0	3,260,829
Low Income Housing		98,305,085	105,967,104	142,141,458	143,055,387
Maternity Home		983,153	842,674	762,701	726,355
MDFB Bond Guarantee		0	0	0	0
MDFB Development and Reserve		0	0	0	0

Appendix B
Tax Credit Redemptions

Program	Year Ended June 30, 2008	2009	2010	2011
MDFB Export Finance	0	0	0	0
MDFB Infrastructure Development	19,877,329	26,916,508	13,970,215	25,597,348
Missouri Health Insurance Pool[2]	723,364	2,631,835	7,896,391	10,931,565
Missouri Property and Casualty Guarantee Association[2]	1,186,805	2,214,045	592,308	(53)
Missouri Quality Jobs	2,805,251	6,203,572	14,238,179	27,936,799
Neighborhood Assistance	11,039,982	13,202,082	10,065,993	8,513,472
Neighborhood Preservation	5,343,647	5,176,659	6,739,123	4,427,639
New Enterprise Creation	813,513	320,766	77,098	11,499
New Generation Cooperative Incentive	5,068,747	4,190,256	3,287,882	1,984,424
New Jobs Training	4,762,743	4,175,591	3,228,601	3,175,559
Pregnancy Resource	563,669	951,744	1,198,394	1,103,384
Property Tax	100,164,994	118,573,853	118,594,589	114,886,668
Public Safety Officer Surviving Spouse	0	9,583	11,910	16,861
Qualified Beef	0	0	0	9,447
Qualified Equity Investment	0	0	0	1,199,285
Rebuilding Communities	1,967,262	1,548,622	1,553,894	1,277,135
Qualified Research Expense[1]	100,926	n/a	890,135	n/a
Residential Dwelling Accessibility	0	16,363	23,040	20,086
Residential Treatment Agency	214,901	202,900	47,599	323,376
Retain Jobs	5,546,167	9,992,850	8,145,996	5,758,163
Seed Capital	34,317	11,133	0[4]	0[4]
Self-Employed Health Insurance	1,039,564	1,729,167	652,850	1,428,143
Shared Care	78,360	92,803	159,222	44,152
Small Business Incubator	252,392	548,639	219,014	107,549
Small Business Investment (Capital)	20,711	30,634	0[4]	1,701
Sponsorship and Mentoring Program[1]	n/a	n/a	n/a	n/a
Transportation Development[1]	2,223,821	1,066,386	9,176	52,124
Wine and Grape Production	118,844	153,821	112,057	29,411
Wood Energy	1,215,292	4,576,446	1,546,453	3,818,378
Youth Opportunities	4,137,223	4,723,545	4,405,158	3,589,991
Totals	$ 496,022,421	584,526,152	521,458,689	545,145,614

n/a - Tax credit did not exist in this fiscal year.

[1] The tax credit has expired or has been repealed. Redemptions may be reported due to carry forward provisions.

[2] Redemptions are calendar year rather than fiscal year and are based on the tax year the credit was applied against.

[3] Until the fiscal year 2007 budget process the amount reported by the Department of Insurance, Financial Institutions, and Professional Registration for this credit was only the examination fee portion and not other taxes and fees for which credits were also redeemed.

[4] The tax credit program has met the cumulative program cap.

Source: Office of Administration, Department of Revenue, and tax credit administering agencies