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Missouri State Auditor

Economic Development

Neighborhood Assistance Program Tax Credit

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CITIZENS SUMMARY

Findings in the audit of the Neighborhood Assistance Program Tax Credit

Program Administration

The audit identified several opportunities to improve the administration of the Neighborhood Assistance Program (NAP) tax credit. The Department of Economic Development does not provide all appropriate information to allow the General Assembly to properly review and determine the effectiveness of the NAP. Without accurate information, legislators cannot determine if the program should continue, be modified or terminated. The project selection scoring system used to rate potential projects appears well-designed, however, it may not ensure the most effective use of program resources. Program policy guidelines provide per project funding limits that do not vary based on the rating issued. Amending program guidelines to allow additional funding that reflects the results of the scoring system would help maximize the effectiveness of the program and take full advantage of the scoring system in place. Currently, DED does not always follow program guidelines and justification for exceptions to guidelines is not adequately documented. Decisions to award additional funding to specific projects should be made in accordance with policy guidelines, using consistent and objective criteria, and the justification should be well documented.

In the areas audited, the overall performance of this program was **Good**.*

*****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.

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Honorable Jeremiah W. (Jay) Nixon, Governor
and
Mike Downing, Director
Department of Economic Development
Jefferson City, Missouri

We have audited certain operations of the Neighborhood Assistance Program Tax Credit in fulfillment of our duties under Chapter 29, RSMo, and Section 620.1300, RSMo. The scope of the audit included, but was not limited to, the 2 years ended June 30, 2015. 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 the current program structure is generally an efficient use of state resources, (2) identified no significant deficiencies in internal controls, (3) identified no significant instances of noncompliance with legal provisions, and (4) identified inefficiencies resulting from certain 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 Neighborhood Assistance Program Tax Credit.

Nicole R. Galloway, CPA
State Auditor

The following auditors participated in the preparation of this report:

Deputy State Auditor:	John Luetkemeyer, CPA
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Neighborhood Assistance Program Tax Credit Introduction

Background

The Neighborhood Assistance Program (NAP) tax credit was established in 1978 under Sections 32.100 to 32.125, RSMo, and has no expiration. The program was designed to provide assistance to community-based organizations to enable them to implement community or neighborhood projects in the areas of community service, education, crime prevention, job training, and physical revitalization. The Department of Economic Development (DED) administers the program and is responsible for issuance of all tax credits based upon verification of qualified contributions to an approved NAP project. With approximately $8.2 million in redemptions in fiscal year 2015, the NAP is the state's 9th largest tax credit program. See Appendix B for redemption information on all state tax credits.

Tax credits can generally be broken into three categories. Some are established to create certain economic benefits, some are established to induce certain social benefits, and others are created for both economic and social benefits. The NAP is designed to create both economic and social benefits with more emphasis on social impact. NAP credits can be used by entities to offset costs of service delivery or for capital improvements. NAP service delivery projects focus on applicants who provide services addressing a targeted problem or need in a neighborhood. Capital campaign projects involve an entity seeking to raise funds for the acquisition, construction, improvement, and/or renovation of real property that will house services that address a targeted problem or need in a neighborhood.

The NAP is a donation tax credit program. Tax credits are awarded to individuals and entities making a donation to an authorized project. Generally, tax credits will equal 50 percent of the value of donations for an approved project. However, for projects located in a city, town or village with populations less than 15,000, or in unincorporated areas (with the exception of Clay, Jackson, St. Charles and St. Louis counties), the tax credits equal 70 percent of the donation value. The program has three statutorily established eligibility requirements:

1. Applicant Eligibility - There are three type of eligible applicants: not-for-profit corporations organized under Chapter 355, RSMo; organizations holding a 501(c)(3) ruling from the IRS; or Missouri businesses, defined as a person, firm, partner in a firm, corporation, or a shareholder in an S corporation doing business in Missouri, and subject to state income tax, that is conducting a project outside the scope of normal business operations.

2. Project Eligibility - There are five different types of eligible projects: community services, education, crime prevention, job training, and physical revitalization.

3. Donor Eligibility - Eligible donors are limited to businesses or individuals who have business income (i.e. farm income, sole proprietor, S corporations, etc.).

The NAP tax credits cannot be transferred, sold, or assigned, and are not refundable. The credits cannot be carried back to offset prior tax liability, but can be carried forward for 5 years to offset future tax liabilities. Any remaining balance of tax credits not claimed in this period is forfeited.

The NAP tax credits may be used to offset the following taxes and must be claimed in this order first: (1) against the annual tax on gross premium receipts of insurance companies under Chapter 148, RSMo, if applicable; (2) against the tax on banks under Section 148.030, RSMo, if applicable; (2) against the tax on other financial institutions under Chapter 148, RSMo, if applicable; (4) against corporate franchise tax under Chapter 147, RSMo, if applicable; (5) against state income tax under Chapter 143, RSMo, if applicable; or (6) against the annual tax on gross receipts of express companies under Chapter 153, RSMo, if applicable.

Approval process

The DED reviews applications in two rounds per fiscal year, but reserves the right to approve additional projects outside of the normal application rounds. Round 1 applications are expected to start on July 1st, and Round 2 applications are expected to start on January 1st.

The NAP has a fiscal year authorization cap of $16 million. Section 32.115.2(4), RSMo, sets the limit on the 70 percent credits at $6 million annually. The $16 million authorization cap is broken out as follows:

Round 1 - 50 percent	$5,000,000
Round 1 - 70 percent	$3,000,000
Round 2 - 50 percent	$5,000,000
Round 2 - 70 percent	$3,000,000

Any credits not authorized in first round of a fiscal year carry over to the second round, but do not carry over to the next fiscal year.

Applicants submit an application to the DED detailing the project, its projected outcomes, and expected costs. Once DED personnel determine the application is complete and both the applicant and the project are eligible for tax credits, the application is reviewed and given a score on a 100 point scale based on the following criteria:

- Services, targeted clients, and need
- Other facilities, targets, and milestones
- Capacity (i.e. past history and fundraising capacity)
- Budget efficiency and impact

While DED does not require a minimum score to be approved, DED personnel look for a logical break in the scores in each grouping of projects and approve all projects above that score. Projects falling below that score can reapply in the next round. The DED has implemented a policy limiting the amount of 50 percent credits any one project can receive to $250,000, and the amount of 70 percent credits to $350,000 per project.

After a project is approved, the DED notifies applicants of its agreement to award NAP state tax credits to eligible donors making qualifying donations to the project. The DED and the applicant sign a tax credit agreement that defines the relationship between the two parties and governs the use of contributions made available to the applicant for the project.

The approved applicant receives donations directly from the donor. The DED issues tax credits after receiving a completed application for tax credit from the donor. This application is accompanied by a donation verification from the project's director and specific documentation to support the donation.

Reporting

The DED provides the General Assembly and the public key program information for the NAP annually through tax credit activity reports.

Agencies administering tax credit programs are required under Section 33.282.2, 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 submission of the tax credit activity report 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.

Scope and Methodology

To gain an understanding of the NAP tax credit program, we interviewed DED officials involved in the evaluation and approval of project applications, the issuance of tax credits, and the reporting process. We also discussed project oversight with Department of Revenue (DOR) personnel responsible for performing site visits. Our audit also included visits to two not-for-profit entities with approved NAP projects; one a service delivery project and the other a capital campaign project, as well as phone interviews with 4 additional participating entities.

To evaluate the project selection process, and determine whether required laws and procedures were followed, we reviewed 28 project files and related documentation, and interviewed DED staff.

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

We obtained aggregate totals of annual tax credit redemptions from the DOR. In accordance with the Missouri Supreme Court decision in the case of *Director of Revenue v. State Auditor* 511 S.W.2d 779 (Mo. 1974), auditors are not provided individual tax returns. As a result, auditors were not able to verify the completeness and accuracy of redemption data provided.

1. Program Administration

Opportunities exist to improve the administration of the Neighborhood Assistance Program (NAP) tax credit. The DED does not provide accurate and useful information to allow the General Assembly to properly review and determine the effectiveness of the NAP. In addition, the current project selection scoring system used to rate potential projects appears well-designed, however, current program policy guidelines require the same funding limits for all approved projects regardless of rating. Amending program guidelines to allow additional funding that reflects the results of the scoring system would help maximize the effectiveness of the program and take full advantage of the scoring system in place. Currently, DED does not always follow program guidelines and justification for exceptions to guidelines is not adequately documented. Decisions to award additional funding to specific projects should be made in accordance with policy guidelines, using consistent and objective criteria, and the justification be well documented.

1.1 Economic impact

The DED does not provide accurate and useful information to allow the General Assembly to properly review and determine the effectiveness of the NAP. Without accurate information, legislators cannot determine if the program should continue, be modified or terminated. Program activity projections reported by the DED to the General Assembly annually on the tax credit activity report assume full utilization and overstate the economic impact of the NAP tax credit program

According to the fiscal year 2014 tax credit activity report prepared by the DED, over the next 10 years the $11.9 million in credits authorized in fiscal year 2014 will return $0.16 in state revenue for every dollar of tax credit authorized, create $82.7 million in new economic output, including $8.7 million in construction spending, and $7 million in additional earnings for 1,040 individuals receiving either a high school diploma or GED. The economic activity projections reported are based on data provided in the preliminary project applications.

DED projections assume 100 percent of authorizations will be utilized; however, program data shows approximately 14 percent of credits authorized are not issued because some projects may fall short of donation goals and require less tax credits than planned. Adjusting economic projections to account for uncompleted projects would provide a more accurate picture of the economic impact of the program.

1.2 Selection process

The NAP project selection process does not ensure the most effective use of program resources. While state statute does not establish a per project tax credit limit, the DED has implemented per project limits of up to $250,000 for 50 percent credits and $350,000 for 70 percent credits. Current program guidelines do not allow for credits to be awarded in excess of per project limits. Per DED, the project limits in place are intended to provide broad access to the program and finance a number of projects each year. However, the DED is not taking full advantage of the scoring system in place, and does not ensure the most highly rated projects receive adequate funding. As a result, highly rated projects may be at risk of not being completed, and a significant portion of tax credits are left unauthorized each year.

During the 2 years ended June 30, 2015, there were 128 projects approved. Under the current process, the highest rated of those projects were subject to the same authorization limit as the lowest. In addition, of the $32 million in credits statutorily available to be authorized for the 2 years ended June 30, 2015, $6.6 million (21 percent) was left unauthorized.

Project review

Our review identified highly rated projects with capital needs in excess of the established per project limits. For example, one 50 percent project reviewed had been awarded the maximum of $250,000, but the not-for profit entity still needed to raise an additional $440,000 to begin construction. Officials with this entity stated they had identified additional potential donors, but were having difficulty obtaining additional donations because they didn't have credits left to offer. In this case, authorization of additional credits to this highly rated project would have helped ensure timely completion of the project.

Similarly, the two highest rated 70 percent projects (scores of 80.25 and 77) in the first authorization round of 2014 were capital projects awarded the $350,000 maximum, although the projects potentially had additional capital needs. In the same authorization round, the lowest rated project receiving funding (score of 51.5) was also a capital project and also received the $350,000 maximum.

The use of a maximum authorization limit is effective in ensuring the broad use of the program, however, modifying guidelines to allow for additional credits when justified may help ensure the completion of certain projects or ensure the delivery of additional services for highly rated projects. Utilizing the scoring system in place to ensure the most highly rated projects can receive additional tax credits when appropriate would help increase the effectiveness of the program.

1.3 Program guidelines

The DED did not always follow program guidelines when authorizing tax credits. Though current program guidelines appear to provide for no exceptions to the per project limits, our review noted 4 of the 128 projects approved were authorized credits for significantly more than DED's authorization limit (discussed in finding 1.2). No justification for exceeding the limit was documented. The total authorized amount for these 4 projects was $3.4 million in NAP tax credits, or approximately $2.4 million over the authorization limit. We noted the following issues with these 4 project applications:

- Two of the four projects were not subjected to the project scoring and evaluation process. Under the normal process, NAP tax credit project applications are first reviewed for eligibility, and then scored on a 100 point scale using pre-established evaluation criteria, by a panel of scorers. For the two projects in question, credits were authorized without such an evaluation or scoring.

- No justification was documented or provided for why these 4 projects warranted additional authorizations. As noted above, two projects were not scored. The other two projects received scores that did not seem to justify the additional authorizations. One project was authorized tax credits of approximately $1.5 million and received a score of 70, which would generally place it in the middle of the projects selected during a normal evaluation process. The other project was authorized credits of $900,000 and received a score of 60.25, which would generally rank it at the bottom of the projects selected for authorization. During several funding rounds in our review period, projects with such a score would have fallen below the cutoff for funding and not received any authorizations.

Three of the projects were involved in other state programs (2 through the Department of Elementary and Secondary Education and 1 through the Department of Natural Resources Division of Missouri State Parks) and were referred to the DED from those agencies. While state statutes provide the DED significant flexibility in how to decide which projects should receive NAP tax credits, ensuring projects are evaluated in a consistent manner provides the DED and the public assurance program resources are being used in the most fair and effective way possible. Determining which projects are worthy of tax credits in excess of the established authorization limits in an objective and structured manner provides the public and stakeholders assurance any tax credits authorized are justified.

Recommendations

The DED:

1.1 Report economic benefit projections to the General Assembly that more accurately reflect program performance.

1.2 Consider modifying program guidelines related to authorization limits to allow for additional funding when justified for higher rated projects identified by the scoring system.

1.3 Ensure all project applications are evaluated in a consistent manner and ensure the justification for any credits authorized above authorization limits is documented.

Auditee's Response

1.1 The economic benefit projections performed by DED related to the Missouri Neighborhood Assistance Tax Credit Program are performed in accordance with Section 33.282.2, RSMo, and based on information submitted by tax credit applicants pursuant to Sections 32.100 to 32.125, RSMo, and the Tax Credit Accountability Act of 2004, Sections 135.800 to 135.830, RSMo.

1.2 DED will evaluate and determine the best method for providing the potential increases in credit awards and define the process to accomplish the same. DED and the non-profit community can work together to define circumstances to award more funding at the application stage as well as after the award, and incorporate those processes into the guidelines. The process will include the means to provide awards in excess of $500,000.

Currently, DED allows not-for-profits to request increases after the original approval in tax credits up to a $500,000 budget: (1) after they have determined the additional demand for the service, (2) after they have determined the availability of new donors, and (3) after DED has determined their capacity to deliver the additional results. Those same parameters will create the basis for how decisions for additional credits may be made at either point (at application stage or after project has proceeded).

Consistent with the Auditor's comments, DED will create a clear process, established in guidelines, that: avoids paying more for accomplishing the same result; or providing additional funding to non-profits without the capacity to serve additional needs, or limiting outcomes where circumstances may provide for increased awards of credits.

1.3 DED appreciates the Auditor's comments and the need for consistency. The two projects referenced that were not subjected to the project scoring and evaluation process were a part of the Start Smart Initiative. That initiative was in partnership with the Department of Elementary and Secondary Education (DESE) and the Community Development Block Grant Program. The review and evaluation process consisted of the two departments providing expertise in their respective areas. DED evaluated the capacity of the applicants, the costs of the project (cost per square foot, cost/beneficiary), need in the community for the facility, the impact this facility will have on the need identified, and sustainability of the project. DESE evaluated the quality of the curriculum, the staff, professional, and teacher required qualifications, outcomes projected and identified the strengths and weaknesses of their proposed plan.

DED will amend its evaluation process to reflect the Auditor's comments. DED will add documentation to the file for any project authorized credits above the guidelines.

Neighborhood Assistance Program Tax Credit

The following table lists the Neighborhood Assistance Program tax credits authorized, issued, and redeemed for fiscal years 2005 through 2015. The figures presented reflect amounts provided as of our fieldwork completion and may not reflect amounts reported by the DED on past or future tax credit activity reports.

Fiscal Year	Amount Authorized	Amount Issued	Amount Redeemed
2005	$ 11,904,526	11,263,135	9,232,117
2006	13,215,892	13,150,725	9,911,355
2007	11,938,233	13,176,389	13,808,031
2008	13,735,379	13,222,190	10,743,394
2009	13,039,981	11,447,049	12,869,703
2010	10,806,606	10,284,768	10,032,256
2011	11,568,409	8,129,873	8,505,828
2012	12,338,129	8,493,353	9,757,102
2013	14,157,914	10,144,225	7,392,113
2014	11,875,480	9,640,126	10,848,983
2015	15,974,536	11,435,785	8,230,286
Total	$ 140,555,085	120,387,618	111,331,168

Source: DED Customer Management System

Tax Credit Redemptions

The following table shows redeemed tax credits for fiscal years 2012 through 2015 for all state tax credit programs. We did not audit the information.

Program		Year Ended June 30,			
		2012	2013	2014	2015
Adoption (Special Needs)	$	1,036,226	744,155	718,495	380,715
Affordable Housing Assistance		5,629,466	7,406,988	5,620,750	3,358,808
Agricultural Product Utilization Contributor		1,468,156	1,267,239	2,022,953	1,051,662
Alternative Fuel Infrastructure		45,690	69,454	784	7,785
Amateur Sporting		n/a	n/a	n/a	38,610
Bank Franchise		2,333,619	2,559,444	3,224,212	2,245,779
Bank Tax Credit for S Corporation Shareholders		5,523,276	4,533,837	2,607,870	6,298,018
Brownfield Jobs/Investment		1,660,626	68,693	105,842	89,422
Brownfield Remediation		16,967,400	6,378,613	5,354,819	7,492,114
Business Use Incentives for Large-Scale Development (BUILD)		6,591,948	8,212,533	8,533,926	7,990,466
Business Facility		4,867,041	4,572,711	6,622,467	4,493,611
Certified Capital Business[2]		411,014	590,235	345,678	147,614
Charcoal Producers[1]		59,595	0	0	0
Children in Crisis		629,456	792,368	930,769	999,990
Community Development Corporation[2]		224	231	261	0
Development Tax[1]		3,856,648	3,863,814	3,301,504	3,087,640
Developmental Disability Care Program		0	7,819	92,993	16,794
Disabled Access		24,791	14,603	13,340	16,525
Distressed Areas Land Assemblage		7,558,203	1,651,415	9,491,328	4,018,256
Domestic Violence		988,996	851,517	1,079,795	901,392
Dry Fire Hydrant[1]		3,124	0	264	34
Enhanced Enterprise Zone		7,324,093	6,451,698	7,423,842	5,400,268
Enterprise Zone[1]		232,990	557,312	504,129	147,773
Examination Fees and Other Fees		4,926,191	5,886,105	5,042,337	5,511,518
Family Development Account		10,616	95	0	0
Family Farms Act		53,948	32,032	22,770	24,981
Film Production		4,839,217	56,665	119,800	389,942
Food Pantry		796,156	72,822	840,234	1,118,866
Historic Preservation		133,937,747	78,814,711	59,829,671	47,638,885
Life and Health Guarantee Association		3,306,409	5,664,124	6,520,591	7,208,654
Low Income Housing		164,208,547	144,082,976	155,168,645	140,292,351
Maternity Home		1,354,431	1,138,969	2,051,028	1,511,157
MDFB Infrastructure Development		33,444,754	14,804,416	19,474,878	14,792,341
Missouri Automotive Manufacturing Jobs Act		0	0	5,419,607	16,460,214
Missouri Health Insurance Pool		14,318,218	16,874,865	17,830,771	5,581,543

Appendix B
Tax Credit Redemptions

Program	Year Ended June 30, 2012	2013	2014	2015
Missouri Quality Jobs[1]	35,431,828	39,278,156	46,021,490	56,246,334
Missouri Works	n/a	n/a	146,923	3,588,785
Missouri Works Retained Jobs	n/a	n/a	7,494,768	8,570,164
Neighborhood Assistance	9,757,102	7,392,113	10,848,983	8,230,286
Neighborhood Preservation	2,159,654	1,232,214	1,789,898	1,766,763
New Enterprise Creation[2]	25,000	0	0	0
New Generation Cooperative Incentive	826,953	2,100,091	4,747,230	2,842,870
New Jobs Training	4,090,193	3,081,261	6,236,452	6,319,681
New Market	15,385,989	12,934,464	18,620,744	18,353,742
Pregnancy Resource	1,892,183	1,194,477	1,715,600	1,581,045
Property Tax	117,603,638	113,962,551	107,556,467	104,810,266
Public Safety Officer Surviving Spouse	32,793	78,249	76,533	70,941
Qualified Beef	219,062	522,858	305,552	165,376
Qualified Research Expense	n/a	n/a	n/a	(44,114)
Rebuilding Communities[1]	1,388,190	1,430,329	2,095,225	1,693,099
Residential Dwelling Accessibility	6,501	10,258	6,759	18,190
Residential Treatment Agency	283,501	292,396	490,033	303,112
Retain Jobs	2,403,687	1,960,931	n/a	n/a
Self-Employed Health Insurance	1,847,045	1,811,060	2,959,063	3,418,312
Shared Care	70,004	41,645	64,991	37,056
Small Business Incubator	166,336	68,441	142,685	141,068
Small Business Investment (Capital)[1]	(19,395)	0	0	0
Transportation Development[1]	9,342	12,510	5,415	1,458
Wine and Grape Production	61,598	15,301	26,597	15,527
Wood Energy	2,282,401	3,563,209	2,853,117	2,220,340
Youth Opportunities	4,979,138	3,906,263	5,239,666	4,247,825
Total	$ 629,311,559	512,911,236	549,760,544	513,311,854

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

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