Report of the Vermont State Auditor

June 27, 2012

# VERMONT EMPLOYMENT GROWTH INCENTIVE

## PROGRESS UNDER WAY ON AUDIT RECOMMENDATIONS

**Thomas M. Salmon, CPA, CFE**
**Vermont State Auditor**
**Rpt. No. 12-05**

**Mission Statement**

The mission of the State Auditor's Office is to be a catalyst for good government by promoting professional audits, financial training, efficiency and economy in government and service to cities and towns.

**THOMAS M. SALMON, CPA, CFE**
**STATE AUDITOR**

**STATE OF VERMONT**
**OFFICE OF THE STATE AUDITOR**

June 27, 2012

The Honorable Shap Smith
Speaker of the House of Representatives

The Honorable John F. Campbell
President Pro Tempore of the Senate

The Honorable Peter E. Shumlin
Governor

Mr. Lawrence Miller
Secretary
Agency of Commerce & Community Development

Mr. Stephan Morse
Chair
Vermont Economic Progress Council

Ms. Mary Peterson
Commissioner
Vermont Department of Taxes

Dear Colleagues,

This report presents the results of our office's follow-up on recommendations presented in two previous audit reports of the Vermont Employment Growth Incentive program. The first audit of the program, conducted by our office in 2008, focused on evaluating the controls and management of the application process administered by the Vermont Economic Progress Council (VEPC). The second audit, conducted in 2010, focused on the claims process, which is administered by the Department of Taxes (DOT).

We followed up on the 15 recommendations issued in the two prior reports. We found that many of the process improvement and internal control recommendations were either fully implemented or partially implemented by VEPC and DOT.

I would like to thank the management and staff of the Vermont Economic Progress Council and the Department of Taxes for their cooperation and professionalism during our audit. If you would like to discuss any of the issues raised by this audit, I can be reached at (802) 828-2281 or at auditor@state.vt.us.

Sincerely,

Thomas M. Salmon CPA, CFE

Thomas M. Salmon, CPA, CFE
Vermont State Auditor

cc: Fred Kenney, Executive Director, Vermont Economic Progress Council

# Contents

## Report

# Introduction

Economic development subsidies are various forms of financial assistance given to companies by state and local governments to encourage the growth of business activity and job creation within their borders. Most states have dozens of such programs; in the aggregate they cost taxpayers tens of billions of dollars per year[1].

One of Vermont's economic development incentive programs, the Vermont Employment Growth Incentive program (VEGI) provides companies the opportunity to earn cash incentive payments if annual growth targets are met. Targets are established by a company at the time of application based on its anticipated growth. To be eligible for an incentive, a company must maintain or increase base payroll, meet the payroll target, and attain either of the targets set for job growth or capital investments.

32 V.S.A. § 163(10) requires the State Auditor's Office (SAO) to conduct a biennial audit of the VEGI program. We have previously reported on, and made recommendations pertaining to, the VEGI application and claims processes. This audit has two objectives that provide updated information on progress made in the VEGI program.

The first objective was to determine the extent to which the Vermont Economic Progress Council (VEPC) and the legislature have taken corrective actions to address previous audit recommendations regarding the VEGI application process (SAO Report No. 08-08, "Vermont Employment Growth Incentive: Compliance Audit Pursuant to 32 V.S.A. § 163 (12)(B)").

The second objective was to determine the extent to which the Tax Department (DOT) has taken corrective actions to address previous audit recommendations regarding the VEGI claims process (SAO Report No. 10-04, "Vermont Employment Growth Incentive: Performance Audit of Claims Review Process"). (See the Scope and Methodology for this audit in Appendix I and abbreviations used in this report in Appendix II.)

[1] http://www.goodjobsfirst.org/showusthesubsidies

# Highlights: Report of the Vermont State Auditor

## Vermont Employment Growth Incentive: Progress Under Way on Audit Recommendations

June 27, 2012, Rpt. No. 12-05)

**Why We Did This Audit**

32 V.S.A. §163(10) requires the State Auditor's Office to biennially conduct an audit of the VEGI program.

This report has two audit objectives. The first was to determine the extent to which VEPC and the legislature have taken corrective actions to address previous SAO audit recommendations regarding the VEGI application process (SAO Report No. 08-08).

Our second objective was to determine the extent to which the Tax Department has taken corrective actions to address previous audit recommendations regarding the VEGI claims process (SAO Report No. 10-04).

**Findings**

VEPC and the legislature have taken corrective action to address most of the previous SAO audit recommendations regarding the VEGI application process. Specifically, of the 12 recommendations reported, six were fully implemented and two were partially implemented. For example, VEPC has strengthened and improved the controls over application signatures by company officials, and through statute and administrative rules changes has better defined economic activity commencement dates. The legislature has implemented our recommendation regarding maintaining the annual $10 million cap on the total amount of incentives that may be authorized each year.

VEPC and the legislature did not implement four recommendations pertaining to the application process. For example, VEPC did not change the methodology of using industry averages for background growth rates rate (i.e. the rate used to determine whether a project will produce economic growth above growth that would naturally occur) instead of using a company's actual historical background growth. Using the industry background rate assumed all companies within the same industry were expected to grow at the same rate regardless of the company's size or maturity, allowing for a higher performing company to receive larger incentives. Also, the legislature did not implement our recommendation to change the methodology regarding the calculation of the wage threshold (currently set at not less than 60 percent above the minimum wage at the time of the application).

The Department of Taxes took corrective action to address the three recommendations directed at the claims process. For example, DOT updated its procedures to include a VEGI claims checklist, documented the tax examiner's claim review process, and developed a mechanism to ensure supervisory review of the examiner's work. Our recommendation that DOT have written standards for data validation and audit procedures was partially implemented. DOT uses a sampling program for reviewing the payroll data for large employers, but the procedures could be strengthened regarding the data validation process of qualifying capital investment claims. Capital investment incentive claimants are not required to submit copies of invoices or other supporting documents with the claim. Without such documentation, DOT lacks data needed to validate claims related to qualifying capital investments.

# Background

The VEGI program is jointly administered by VEPC and DOT. VEPC serves as the approval and authorization body for applications to the program and determines the amount of incentive applicants may earn.

DOT is statutorily responsible for evaluating the veracity of the growth activity listed on companies' annual claims for incentives as well as making cash payments to those whose claims have been validated. Further, DOT is responsible for recapturing[2] incentive payments made to companies that have reduced their workforce to 90 percent or less of the jobs in place at the time of application. (Appendix III provides an explanation of the VEGI application, claims and recapture processes.)

Since the inception of the VEGI program in 2007 through December 31, 2010, 64 applications have been considered for incentives, of which 60 were authorized; of those, 22 were subsequently terminated or rescinded. Thirty-eight awards were still active with $29,236,538 in net incentives authorized. VEGI incentives paid out (net of recaptures) as of December 31, 2010 were $654,935.

# VEPC and the Legislature Have Taken Corrective Action Toward Implementing Most of the Recommendations Pertaining to the Application Process

VEPC and the legislature have taken the action to implement most of the recommendations directed at the VEGI application process. Of the 10 recommendations directed at VEPC and the two directed toward the legislature, six were fully implemented and two recommendations were partially implemented. VEPC implemented recommendations pertaining to application signatures by corporation officers, determination of the date of project commencement, verification of calculations related to the cost-benefit model, strengthening the "but for" analysis and the regional adjustment factor. The legislature fully implemented our recommendation to maintain the annual cap of $10 million of VEGI incentives approved, but did not act

[2] Incentive payments made in previous periods to a company may be subject to recapture (i.e., repayment to the state) if certain triggers occur (e.g. business experiences a drop of 90 percent or more in application base jobs during the award utilization period).

on our recommendation for applicants to maintain the qualifying wage threshold through the entire award period. Action has not been taken on three recommendations directed at VEPC in part because VEPC disagreed with our recommendations.

## Application Signatures by Corporate Officers

**Recommendation # 1**

**Prior Finding:** Per the VEGI application instructions, the signature for non-Vermont companies must be from a top officer from corporate headquarters. VEPC rules also required signatures from two top company officials, a higher standard than the statute. During our testing of VEGI applications, we noted on one application that the signatures were obtained from an applicant's plant manager and controller. There was no indication within the application to ensure the controller was a top corporate officer or had the authority to sign in lieu of one.

**Prior Recommendation**: VEPC should include a signed attestation statement on the application that signatories other than the president or CEO are authorized to sign on behalf of the company.

**Current Status**: **Fully Implemented**

Adoption of this recommendation was achieved by VEPC through technology and changes to the VEGI application system. Any person working on a VEGI application on behalf of a company must create a protected user account to access the VEGI program's on-line management system. Each user is assigned a role in the application process. Each role has limited access and permissions that are predefined by the system. Only certain roles can perform certain functions and move the application along in the process. Only the individuals assigned to "Authorizing Official" and "Senior Authorizing Official" roles can complete the "Authorization and Certification" step, complete the electronic signature, and submit the application. The VEPC executive director ensures that the individuals who are assigned these two roles meet the program definitions of "top company officials."

## Date of Project Commencement

**Recommendation # 2**

**Prior Finding:** The VEGI program allowed a preliminary application to be filed which VEPC may approve. A final application must be filed and approval given before incented activity commences. Our report revealed that one application had its incented activity started prior to final approval by VEPC. According to VEPC's executive director, there was an informal policy change regarding using a "commencement date" as the activity start date rather than the date of the approval of the final application. This was not in accordance with the VEGI statute. The Tax Department, which is responsible for processing claims, stated they would follow the statute's language, defining the activity start date to determine eligible incented activity as occurring only after the final approval date.

**Prior Recommendation:** VEPC should consult with the Tax Department as to possible impacts of policy changes. VEPC should recalculate the incentive award to disallow activity occurring prior to the approval date of the final application so as to be in compliance with statute and do so for all affected applications.

**Current Status: Partially Implemented**

The statutes and administrative rules have been changed to better define the controls over activity commencement dates. Per the administrative rules, the activity commencement date (i.e. activity start date) is set in the initial approval and cannot be changed in the final application. The rules also make the applicant aware that the Council can reinvestigate the applicant's adherence to guidelines if there are any changes between the initial and final applications. Initial approvals can be rescinded before the final approval if the applicant's conditions change.

At the time of our audit in 2008, the VEGI statute did not allow for incented activity prior to final approval, however VEPC elected not to recalculate the incentive award for the specific case cited above.

**Recommendation # 3**

**Prior Finding:** Our report determined that there was no formal time limit given to applicants from the point when an initial application was approved to the point when a final application is filed and approved. As the economic activity targets are annual (calendar year) this could allow a company to adjust their targets as close as possible to its year end, ensuring the targets would be met.

**Prior Recommendation:** VEPC should impose a limit on the time an applicant is given to file the final application after initial approval is given.

**Current Status: Fully Implemented**

The legislature changed the statute to require that the final VEPC approval must come before December 31 of the calendar year in which the economic activity commences. This action effectively reduced the risk of a company adjusting incentive targets to ensure targets were met. From an operational perspective, all final applications requiring approval at VEPC's last calendar year meeting in December must be submitted to VEPC in the month of November.

## Consistency of Cost-Benefit Model

**Recommendation # 4**

**Prior Finding:** An important part of the VEGI application process is the utilization of a cost-benefit model, which calculates the economic impacts to the state of a proposed project outlined on the application. The model is managed for VEPC by an outside consulting firm, Economic & Policy Resources Inc., (EPRI) of Williston, under a state contract. Our report reviewed the consistency of the calculations in the application files selected for testing. We noted a lack of consistency across the tested applicants regarding the calculation of incented payroll by EPRI. In three of the applications, the background growth rate[3] was applied against the full-time non-owner payroll, as required by the *Cost-Benefit Modeling Approval Criteria*, to get the dollar amount of background growth in the first year. However, on one application, the background growth rate was applied against incremental qualified payroll targets rather than the full-time non-owner payroll.

[3]The assumption in the model that underlies all calculations of net fiscal costs and benefits is that a project has or will pass the "but for" test – that the project would not proceed without the incentive. Included in the model is a calculation of the expected growth rate of the company without the project. This is a company's "background" growth rate. The purpose of the VEGI program is to incent activity that would not otherwise occur; therefore, the anticipated growth rate indicated on the application must be reduced by the background growth.

The overstatement by EPRI of the amount of payroll considered for the incentive calculation resulted in a higher payroll target than the company needed to meet to claim their award.

**Prior Recommendation:** The verification of the calculations returned by EPRI should be done by VEPC staff to ensure consistent methods are applied.

**Current Status: Fully Implemented**

The VEPC executive director prepares a series of spreadsheets using applicant data and compares the spreadsheets to the inputs and outputs from EPRI.

## "But for" Analysis

**Recommendation # 5**

**Prior Finding:** The purpose of the VEGI program is to incent activity that would not otherwise occur. VEPC must consider and assess the veracity of statements made by a company applying to the program that "***but for***" the incentives offered by the program the company's project would not be occurring or would occur in a substantially different manner. This assessment by VEPC is a pivotal assumption in the program. VEPC will approve or deny an application based on this assessment.

We noted in our report that there was undue reliance on the limited VEPC staff resources in reviewing an applicant's "but for" statements and the supporting documentation. The staff, which actively promotes the program and seeks out applicants, then provides the Council with an independent assessment of the "but for" arguments.

**Prior Recommendation:** VEPC should involve an independent public advocate for the State reviewing an applicant's "but for" statements and supporting documentation.

**Current Status**: **Fully Implemented**

The composition of the board was altered by the legislature after our 2008 audit. The governor appoints nine residents of the state as members of the Council, and the Speaker of the House now selects one legislative member and the Senate Committee on Committees now selects one senator. All 11 members have the right to vote and have the same responsibilities. There are also 22 members from 11 regions of the state who are advisory and do not have voting rights. Adding representatives of the people from the legislative branch should increase the level of review and due diligence, and therefore the SAO believes that the intent of our recommendation has been implemented.

**Recommendation # 6**

**Prior Finding:** Our report acknowledged that each VEGI application must be reviewed with due diligence. The Council relied heavily on the signatures certifying the information is correct while not providing a forum for verifying the data subsequent to the award. Therefore, it was critical that the due diligence was done prior to the approval. This review work was unique to each application and was based on the complexity of the application. With limited resources and short timelines, we found that the staff at VEPC may not have been able to perform all due diligence needed on the "but for" decision.

**Prior Recommendation**: VEPC should consider adopting a policy and process to bill the costs of additional due diligence, when deemed necessary, to a company's first year payments through a reasonable "bill back" provision.

**Current Status**: **Not Implemented**

The Council stated they will consider the recommendation requesting authority to "bill back" to help cover costs. They noted that this would require a statutory change by the legislature. Additionally, VEPC noted due diligence is currently required on all applications but not all applicants receive incentive payments from which to recover costs. While VEPC did not implement our recommendation, the SAO believes our recommendation remains valid and could be a means to minimize the effect any additional due diligence required has on the program's operating budget.

**Recommendation # 7**

**Prior Finding:** According to the *"But For" Application Requirements and Procedures* (January 2006), after an application was received and reviewed by VEPC staff, questions should be sent to the applicant that "will help determine the efficacy of the "but for" statement presented by the applicant." Step No. 5 of the procedures said a "but for" review checklist was to be used. This checklist included names and contact information on incentives offered by other locations. It also included data supporting the documentation of significantly different or less desirable outcomes or financial need. This checklist was not in any of the files we tested. Per VEPC staff, a checklist was not used for the preliminary “but for” review.

**Prior Recommendation**: VEPC should require that all the tools available to the staff be used, adding additional resources if necessary.

**Current Status: Partially Implemented**

In lieu of using a “but for” checklist, in 2009 the VEGI program implemented a web-based software application and claims system which allows applicants to manage and monitor their own application and claim activity.

The process for determining the “but for” starts with applicants entering data into the on-line software. The system is programmed to require all applicants to provide information to answer the fundamental question, “but for the economic incentive to be offered, the proposed economic development would not occur or would occur in a significantly different and significantly less desirable manner.”

Applicants must also provide with the application supporting documents and other relevant data, such as information regarding incentives offered by other states; data documenting significantly different/significantly less-desirable outcomes without the incentive; substantiation for the “but for” questions; press releases, media statements, or news reports about the project; copies of any signed or proposed lease or purchase and sale agreements; and financial statements, business plans, financing plans, and market information.

The applicant’s financial and employment information is input through a cost-benefit model utilized by EPRI to determine the net benefit to the state. The resulting output is reviewed by the VEPC executive director for completeness and accuracy prior to forwarding the final application to the Council for the “but for” approval.

Although this new system addresses our recommendation to make all tools available to VEPC staff, the effective use of this new system is lessened as a result of the VEPC executive director being the only staff member trained to review the technical aspects of the model’s output. Having only one person trained to verify and review the data creates undue reliance on that single key individual. The program’s application volume continues to increase.[4] An

[4] In 2007, initial VEGI incentive authorizations were $2.1 million, 2008 authorizations were $825,000, 2009 authorizations were $5.3 million and in 2010, VEGI authorizations grew to $10.4 million.

additional resource trained to perform the technical review would help mitigate any risks associated with reliance on a single key individual (e.g. illness, employee turnover) and could also allow for additional review and better assurance that the information has been thoroughly verified and assessed.

## North American Industry Classification System Codes

**Recommendation #8**

**Prior Finding:** In 2006, the VEGI cost-benefit model was updated for annual changes to labor data as well as changes that needed to occur because of the transition from the EATI program[5] to the VEGI program. Among the updates for the labor data was the use of North American Industry Classification System (NAICS) codes rather than Standard Industry Classification (SIC) codes to help determine the respective background growth rates used in the incentive calculations.

Secondary to the "but for" test as a fiscal control is the calculation of the background growth rate. To help ensure that only incremental job, payroll and capital investments are incented, a company's anticipated rate of growth is reduced by its background growth rate over the proposed project period. We found that EPRI used an outdated NAICS code when calculating the background growth rate for one applicant. In 2006, the Vermont Department of Labor (DOL) combined the codes for two industries. On April 3, 2007, DOL separated the codes and provided the historical growth detail for each of the codes retrospectively for all years available. However, EPRI used the outdated combined rate rather than the updated information. Overall, the understatement of the amount of industry background growth over the five-year period used to calculate the incentive was $1,480,988. Had they done this properly, the SAO had estimated that the State could have saved approximately $484,000 for this applicant.

**Prior Recommendation:** VEPC should use the correct background growth rate to recalculate the incentive award for this applicant. Also, VEPC should add recalculating the background growth rate as a control to its verification of the data going into the cost-benefit model per applicant and have the data re-run when an obvious discrepancy occurs.

[5]The EATI program, which offered tax credits to qualifying businesses for economic growth, was replaced by the VEGI program as of January 1, 2007 due to significant shortcomings in the EATI program.

**Current Status: Not Implemented**

VEPC declined to re-calculate the specific incentive award because the incentives were subsequently rescinded. It does not recalculate the background growth rate as an additional control to validate the data output from the cost-benefit model. VEPC chose not to update the cost–benefit model more than once annually, citing cost effectiveness and statutory restrictions (which require that a change to the cost benefit model be approved by the Joint Fiscal Committee (JFC)).

## Regional Differential Adjustment Factor

**Recommendation # 9**

**Prior Finding:** Guideline No.1 of 32 V.S.A. §5930a(c) states, "Preference should be given to projects that enhance economic activity in areas of the state with the highest levels of unemployment and the lowest levels of economic activity." VEPC responded to this by building into the cost-benefit model a Regional Differential Adjustment Factor by which counties are grouped by level of unemployment rate. The counties were assigned a differential factor which was applied to the rate used in the Present Value formula for calculation of the pre-incentive cost benefit.

Assigning the different factors provided a means whereby a preference may be given for projects occurring in areas of the state that are underperforming economically. According to the rules of conduct (No. 10) in the Cost-Benefit Modeling approval criterion, the county groupings should be updated every year.

The correct regional differential adjustment county groupings code was applied in the incentive calculations. However, per staff at EPRI, the county adjustment groupings were not updated annually. They were only updated periodically unless a significant change occured in the economic conditions of a region. At the time of our 2008 audit, the latest update was two years old.

**Prior Recommendation**: VEPC should update the grouping annually or revise its operating guidelines to reflect the correct methodology.

**Current Status: Fully Implemented**

The VEGI administrative rules were amended to reflect the best practice suggested. The regional Differential Adjustment Factor has been reviewed annually and updated if economic conditions have changed enough to warrant any update.

## Historical vs. Industry-Average Growth Trends

**Recommendation #10**

**Prior Finding:** The amount of payroll that qualifies as new full-time wages due to a project is reduced by the payroll growth the applicant entity can normally expect. The company's payroll targets over the project period were determined by calculating and deploying the background growth rate correctly. We reported that it would be in the economic interest of the state to use the historical background rate of a company where it is higher than the industry background rate. Using the industry background rate assumed all companies within the same industry were expected to grow at the same rate regardless of the company's size or maturity, allowing for a higher performing company to receive larger incentives.

**Prior Recommendation:** VEPC should use a company's historical rate of growth, if higher than industry average, in the cost-benefit model when it is available.

**Current Status**: **Not Implemented**

In January 2012, the Secretary of the Agency of Commerce and Community Development delivered a report to the legislature regarding the VEGI program. The report contains a discussion on the background growth rate. The current practice is to use 15 years of background growth, representing a standardized approach for all potential companies and providing a level playing field for all companies – large or small, an existing old, existing new, or start-up. The report states that measuring companies against industry benchmark is "*the most equitable and efficient*" solution (emphasis from report). The report contends that using company specific information would require many rules and methodologies for each possible company situation. It also states that it would require subjective analysis because each company would have a different amount of historical data available. The SAO believes that using actual historical background rates is more accurate and ensures that when a company that is outpacing its peers applies for an incentive, a part of the normal growth of the company which can reasonably be expected to occur is not included in the incentive calculation.

## Wage Threshold

**Recommendation #11**

**Prior Finding:** According to Guideline No. 2 of 32 V.S.A. §5930a(c), new jobs created should meet or exceed the prevailing compensation level for the particular employment sector. In order for a new job to be considered a qualifying job on the application[6] the minimum annualized Vermont gross wages and salaries paid must be not less than 60 percent above the minimum wage at the time of the application.[7]

VEPC interpreted this to be the average annualized wage for the year so that companies that boost an individual's pay after a training or probation period to above the qualifying wage would be able to include those jobs in their targets as long as the average wage for the year ends up meeting the qualifying wage level. For example, in 2007 the qualifying wage was $12.05 per hour. If a company hired an individual on January 1 at $11.75 per hour and on July 1st that person began making $12.35 per hour, the wage would average $12.05 per hour for the year. Once a wage qualifies in the first year it must not go below that amount in subsequent years but does not need to go above it. The SAO expressed concern about the wording in the guidelines that allows for the qualifying wage to be at least 160 percent of minimum wage at the time of the application rather than during the entire award period.

**Prior Recommendation:** The legislature should consider revising the statute to require the wage threshold to remain at 160 percent of the current minimum wage through the entire award period.

**Current Status**: **Not Implemented**

The legislature requested a comprehensive study and report on the VEGI program in 2011, which included a review of the appropriate term and use of the wage threshold. In the report,[8] the secretary of Commerce addressed the subject at length discussing the perceived deficiencies in the requirement and suggesting that the legislature either: 1) repeal the statutory wage threshold and rely on program guidelines, or 2) make county or regional adjustments to

[6] 32 V.S.A. §5930b(a)(20) and 32 V.S.A. §5930b(a)(24).

[7] The threshold may be larger for some companies at the discretion of the Council (32 V.S.A. §5930b(b)(3)).

[8] Report to the General Assembly Regarding the Vermont Employment Growth Incentive Program (January 2012).

the threshold, or 3) give the secretary the ability to waive the wage threshold under certain circumstances.

The legislature did not act to change the wage threshold.

## Annual Cap Imposed on Awards

**Recommendation # 12**

**Prior Finding:** The legislature had implemented two safeguards in the VEGI program designed to help protect the state's resources.

- As a fiscal control, the legislature had imposed an annual cap of $10 million on the total amount of incentives that may be authorized each year.
- An incentive ratio of 80 percent was applied to the pre-incentive net fiscal benefit in order to calculate the maximum award amount. This "discount" on all awards helped to offset potential misstatements such as an erroneous determination in the Council's decision that a project would not have occurred without the benefit of state funds or a wrong assumption in the cost benefit model.

**Prior Recommendation:** The legislature should maintain these safeguards for prudent fiscal management of the state's resources.

**Current Status**: **Fully Implemented**

The annual cap was debated during the 2010 session, primarily by the Joint Fiscal Office based upon a request by VEPC for an increase in the cap to accommodate potential projects which if approved would exceed the cap.[9] The JFC agreed to raise the cap for calendar year 2010 only, and the annual $10 million cap and the 80 percent ratio remain in place.

[9]The $10 million cap on total incentives may be exceeded by VEPC with application to, and approval from, the Emergency Board (2005 Act 184 Sec. 11(c)).

# DOT Took Corrective Action Toward Implementing All of the Recommendations Pertaining to the Claims Process.

The Department of Taxes fully implemented two of the three audit recommendations directed at the claims process. For example, they took action to update their procedures to include a VEGI claims checklist, documented the tax examiners claim review processes and developed a mechanism to ensure supervisory review of the examiner's work. In addition, our recommendation that DOT have written standards for data validation and audit procedures for reviewing the information submitted by claimants was partially implemented. DOT uses a sampling program for reviewing the payroll data for large employers, but the procedures related to the data validation process of qualifying capital investment claims could be strengthened. As a result of implementing these recommendations, DOT has made significant improvement in the documentation and supervisory review of its claimant data and recapture procedures.

## Additional Written Procedures

**Recommendation # 1**

**Prior Finding:** DOT had not documented the procedures and level of management review to pursue recapture of previous incentive payments. Although recapture volume was low at the time of our audit and our testing found no errors in recaptures, risk remained that undocumented procedures could lead to poor decisions and recapture inappropriately pursued or not pursued.

**Prior Recommendation:** DOT should develop written procedures and controls over the activities required in the event recapture of a prior payment is required.

**Current Status: Fully Implemented**

DOT has updated their written procedures to include the processes involved once a claim has been identified for recapture as defined in 32 V.S.A. §5930b(c)(9-11) and 32 V.S.A. §5930b(d). Included in the procedures is the process to initiate notification of the supervisor and Tax Department management responsible for review of potential incentive recaptures.

**<u>Recommendation # 2</u>**

**Prior Finding:** DOT had established procedures requiring validation of claimant payroll jobs and capital expenditure detail to assess incremental growth in a company, but had not detailed the extent of validation required for the tax examiner to corroborate the growth claimed. As a result, for certain of the claims we reviewed, it was difficult to discern how the tax examiner and management concluded that adequate data had been validated and growth targets achieved.

**Prior Recommendation:** DOT should develop written standards for the level of data validation that should be performed over information submitted by claimants in order to support approval or denial of a claim.

**Current Status: Partially Implemented**

DOT has written standards for data validation and procedures for reviewing the information submitted by claimants, including a sampling program for reviewing the payroll data for large employers, but the procedures could be strengthened regarding the data validation process for qualifying capital investment claims.

We noted that the Tax Department had developed a workbook for VEGI claimants specifying the itemized information required to be reported annually for qualifying capital investments. This workbook requests information to identify qualifying machinery and equipment including a description of the purchase, physical location, vendor, date purchased and the cost.

However, capital investment incentive claimants were not required to submit copies of invoices or other supporting documentation with the workbook. Without such documentation, DOT lacks data needed to validate claims related to qualifying capital investments.

## Supervisory Review

**<u>Recommendation # 3</u>**

**Prior Finding:** According to the internal audit section chief, decisions made by the tax examiner were reviewed by management. However, DOT's written procedures did not address supervisory review nor was it documented on any of the claims we tested, so it was difficult to determine the nature and scope of management's review.

**Prior Recommendation:** DOT should implement additional controls surrounding management review to ensure systematic review of the tax examiner's work. These should include documenting when supervisory review is required and developing mechanisms to evidence supervisory review.

**Current Status: Fully Implemented**

We reviewed DOT's updated procedures and noted that a VEGI claim checklist was created which documents both the dates the examiner has completed the steps in the review process and the date the supervisor has reviewed the work.

# Conclusion

We commend the efforts of the staff of VEPC and DOT for their commitment to continual process improvement in the VEGI program, evidenced by the significant number of our recommendations that were either implemented or partially implemented. VEPC's use of technology solutions in its application and approvals processes has strengthened most of the internal control issues raised in two previous audits, and DOT has made significant improvement in the documentation and supervisory review of its claimant data and recapture procedures. However, our office continues to believe that the four recommendations which have not been implemented are still valid recommendations and VEPC and the legislature should consider re-visiting these issues.

# Management's Response and Our Evaluation

## Vermont Economic Progress Council

On June 22, 2012, the executive director of VEPC provided written responses on a draft of this report (reprinted in Appendix IV) and we have made some technical changes based on these comments. The executive director provided additional information regarding the recommendation related to the application signatures by corporate officers and addressed four other recommendations which were either partially or not implemented.

Our report indicated that the recommendation regarding application signatures had been fully implemented. In his response, the executive director provided additional information regarding the improvements made in the authorization certification process for application signatures and highlighted this by embedding a copy of the application certification page contained within the VEGI application system in its written response.

Responding to the recommendation for the Council to consider a policy and process to bill back the costs of performing additional due diligence on the "but for" decision, the Council disagreed with this recommendation in the original audit report and continues to oppose the imposition of an application bill-back fee. The executive director in his response stated that only the legislature can impose fees or a bill-back for the VEGI program. The SAO agrees this is correct, but this does not mean the Council could not request that a fee be authorized. The opposition to a fee or bill back is a policy decision, and the response states that it is "antithetical to the purpose of the program." SAO believes this recommendation is still valid and as the number of applicants increases, could minimize the effect any additional due diligence has on the VEGI program's budget.

In the executive director's response, he noted the Council concurs with the SAO's concern to reduce reliance on a single individual to perform review of applicants "but for" analysis, has increased the staff resources available and will be training an individual to provide backup to the executive director in his absence. This individual will also assist the executive director when application volume is high and/or additional verification and review is required.

The executive director commented that VEPC could not re-calculate the incentive award for the applicant identified in the previous audit as the incentives for that company were rescinded subsequent to our audit recommendation. It continues to disagree that the VEGI cost benefit model be updated more than once a year citing that more frequent updates would not be reasonable, efficient or required by statute. The SAO believes that changing the model's data where there is an obvious disparity in information to better calculate an incentive may be adding to the complexity of the program to a minor degree, but would be offset by reducing potential unwarranted incentives if a major change affecting the model occurs more frequently than once a year. Another reason VEPC cites for not implementing the recommendation for this finding is that it would violate statute which requires that all cost-benefit model changes be approved by the Joint Fiscal Committee. VEPC could use the same process currently in place for annual changes to notify the JFC of any additional changes.

The Council continues to disagree with the SAO on the recommendation regarding using the industry rate methodology instead of a company's actual historical rate of growth to determine the normal growth of an applicant company's payroll (i.e. background growth rate). The executive director stated it would be "naïve" to assume that all companies within the same industry were expected to grow at the same rate. He considers the industry method to be the most balanced, equitable and efficient methodology to calculate background growth. The SAO does not make this assumption in our report; we state that by using the industry rate as a company's background growth rate, a company outpacing its peers will experience normal growth which would then be included in the incentive calculation, creating a higher incentive than would otherwise occur.

## Department of Taxes

On June 25, 2012, the commissioner of DOT provided written responses on a draft of this report (reprinted in Appendix V). In the response DOT presented a plan for expanding its review requirements for addressing its one remaining recommendation related to data validation standards, which had been partially implemented.

Our follow-up on this recommendation indicated that DOT has made significant improvements in its data validation process; however incentive claimants are not required to submit copies of invoices or other documentation in support of the claim. DOT feels that the submission of invoices with the claim form is not requisite to achieve the validation necessary for the capital investments. The department stated it is implementing alternative review processes, revising its written claim procedures and strengthening the language in the capital investment section of the claim form regarding the requirement that all qualifying capital investments listed on the claim form must be part of the approved VEGI project. After reviewing the data submitted in the VEGI capital investment workbook, the examiner will decide, on a case by case basis, if it is necessary to request additional documentation. The SAO agrees that if the department adds these additional controls, it will strengthen its overall data validation process.

- - - - -

In accordance with 32 V.S.A. §163, we are also providing copies of this report to the Secretary of the Agency of Administration, Commissioner of the Department of Finance and Management, and the Department of Libraries. In addition, the report will be made available at no charge on the State Auditor's web site, http://auditor.vermont.gov/.

Our first audit objective was to determine the extent to which VEPC and the legislature have taken corrective actions to address previous SAO audit recommendations regarding the VEGI application process (SAO Report No. 08-08, “Vermont Employment Growth Incentive: Compliance Audit Pursuant to 32 V.S.A. § 163 (12)(B)”). Our second objective was to determine the extent to which the Tax Department has taken corrective actions to address previous audit recommendations regarding the VEGI claims process (SAO Report No. 10-04, “Vermont Employment Growth Incentive: Performance Audit of Claims Review Process”).

With respect to our first objective, we examined the administrative rules for the VEGI program and the application and claims instructions and forms provided to companies interested in participating in the VEGI program.

Additionally, we conducted interviews with the executive director of VEPC about the previous audit recommendations and any corrective actions taken regarding the VEGI application process, and performed a walk-though of the application processing procedures, following one application from submission to final acceptance in the program. We also made inquiries of VEPC staff regarding the security features of the IntelliGrants™ system, which is a web-based system used by companies to file information required in the application and claim process. We considered internal controls for information systems only to the limited extent to which they were related to our objectives.

To determine what corrective actions the legislature has taken to address previous recommendations, we reviewed the state’s statutory requirements related to the VEGI program;[10] reviewed legislative testimony presented to various committees; and reviewed the present composition/membership of the Vermont Economic Progress Council. We reviewed required VEGI reports to the legislature and attended legislative hearings on the VEGI program.

In performing work in support of our second objective, we conducted interviews with the director of taxpayer services and Tax Department staff assigned to the VEGI program regarding previous audit recommendations and corrective actions taken with respect to the VEGI claims process. We reviewed, obtained, and evaluated the written procedures and checklists that DOT developed for their internal claim review process. This included authorization procedures, pre-claim procedures, incentive calculation

[10] 32 V.S.A. §5930b; 32 V.S.A. §5930a; 32 V.S.A. §163 (10).

worksheets, issuing installment checks, and follow-up to ensure that claimants maintain prior year target levels. We also reviewed DOT procedures for recapturing previously paid VEGI awards. To review the processes and controls in place at DOT, we performed a walk-though of the claim and data verification process, and the sampling process used for a large and more complex claimant.

We evaluated the processes and procedures developed by DOT for administering the claim selected for our walk-through. We tested the accuracy of DOT's calculations for incentive payment and amount subject to recapture if applicable, reviewing and assessing procedures done by DOT to validate the incremental job growth, payroll growth, and capital expenditure detail. We determined the extent to which the claim was filed completely and evaluated the timeliness of the claim filing and review.

The following ratings were used to evaluate the status of recommendation implementations related to both of our objectives:

**Definitions of Implementation Status**

**Fully Implemented:** The recommendation has been adopted by the audited organization substantially or in its entirety.

**Partially Implemented:** Part of the recommendation has been implemented but the intent of the recommendation has not been fully satisfied.

**Not Implemented:** No part of the recommendation has been implemented.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

# Appendix II
# Abbreviations

| | |
|---|---|
| DOL | Department of Labor |
| DOT | Vermont Department of Taxes |
| EATI | Economic Advancement Tax Incentives |
| EPRI | Economic & Policy Research, Inc. |
| GAGAS | Generally Accepted Government Auditing Standards |
| JFC | Joint Fiscal Committee |
| SAO | State Auditor’s Office |
| VEGI | Vermont Employment Growth Incentive |
| VEPC | Vermont Economic Progress Council |

In 2006, Act No. 184 created the VEGI program (32 V.S.A. §5930b) to support a strong economic development policy for the State. The VEGI program is under the purview of the Vermont Economic Progress Council (the Council), nine Vermonters, appointed by the Governor, plus two legislative representatives, who vote to approve or deny incentive applications according to strict guidelines set by the legislature. In addition there are two non-voting regional representatives from each of 11 economic development regions[11] of the State.

**Application Process**

A web-based software, IntelliGrants™ by Agate Software, Inc., is used as a tool to administer the VEGI program. The on-line VEGI application and claims system allows applicants to manage and monitor their own application and claim activity. The IntelliGrants™ system has been used to process applications and claims since January 2009.

Businesses who wish to apply for an incentive must fill out an application using IntelliGrants™. High-ranking officials of the business must provide information on corporate structure and history, current employment, Vermont resource impacts, infrastructure requirements, and a complete project description including activity commencement date, estimated payroll increase, and estimated capital investment. This information is used to determine a background growth rate; the rate is used to determine whether the project will produce economic growth above growth that would naturally occur. The information is also run through a cost-benefit model utilized by EPRI to determine the net benefit to the state. Reported wages for the project are compared against state averages to ensure that the new jobs created will exceed the prevailing compensation level and are above a wage threshold. The VEPC executive director reviews this information for completeness and accuracy and presents a summary and the original information to the Council for a decision.

According to the VEPC statutes, the Council must use the information provided to ascertain, “to the best of its judgment, that *but for* (emphasis added) the economic incentive to be offered, the proposed economic development would not occur or would occur in a significantly different and significantly less desirable manner.” This “but for” test is the prime fiscal assumption of the program. Without the Council’s approval of an applicant’s “but for” statement, an application cannot be considered for incentives.

[11] Vermont’s 14 counties are represented by 11 economic development regions.

In addition to the "but for" test, the Council is restricted to authorizing a total amount of incentives below a legislatively mandated annual cap.

**Claims Review Process**

Companies authorized to receive an incentive have until the last day of April to file their incentive claims based on the growth activity of the previous calendar year. For instance, for growth activity that occurred in calendar year 2011, companies must file claims for authorized awards by April 30, 2012.

Under 32 VSA §5930b, the Department of Taxes is tasked with verifying base payroll data at the time of application; validating information when an award is claimed; and making the requisite payments to claimants who have met their annual targets. Depending upon the number of employees and the complexity of the data supporting the claims, a claim could take days or months to process, according to DOT's internal audit section chief.

In order to claim an incentive, companies with authorized incentives must submit an annual VEGI claim form. This is the case whether or not a company has met its targets. This is so that DOT can determine:

1. If the base year payroll and jobs have been maintained.
2. The level of shortfall, if the base year jobs have not been maintained.
3. Whether the payroll growth target and either the jobs target or the capital investment target has been met for the current year.
4. Whether targets have been met for previous years and if not, whether the filed claim is still within the grace period allowed by statute. (i.e., targets for years 1, 2 or 3 may be met within the following two succeeding calendar-year reporting periods; targets for year 4 may be met within an additional one-year reporting period.)

Once a claim is filed, DOT reviews the information provided by the claimant for timeliness of filing and completeness. DOT will perform data validation procedures to determine if self-reported data is consistent with other tax filings (such as payroll withholding reconciliations) and is accurate. DOT will approve, deny, or delay a claim based on various factors, as follows:

- <u>Approved</u> – A company's claim is approved, and incentives are authorized, if it has met its annual payroll target, either its annual job or capital investment target, and has maintained the base payroll determined when its application was submitted. As jobs are added through the year rather than on January 1, the first installment will be less than the full amount, however, in years two-five, an approved company will receive a payment of one-fifth of their annual incentive award each year as long as the targets are maintained.

- Delayed –A claim may be delayed under the following conditions:
    - Companies not meeting their payroll targets and either their jobs and capital investment targets in any of the first three years may not claim incentives in that year, but are allowed two succeeding calendar years to meet targets for each of those years and one additional calendar year to meet fourth year targets.
- Denial – An annual claim will be denied when:
    - A company fails to file a claim or files an incomplete claim by the last day of April.
    - Award-year[12] qualifying jobs and payroll levels are not maintained or have not been reestablished to 100 % of award-year levels. (See conditions under "Delayed" above.)
- Withdrawn/Rescinded – When targets are not met within the prescribed period (see conditions under "Delayed" above), DOT is to recommend to VEPC that the Council rescind the company's authorization to earn an award for the specified project.

**Recapture Process**

The DOT is responsible for re-capturing incentive payments made in previous periods to a company (i.e., repayment to the state) if the following triggers occur:

- A business experiences a drop of 90 percent or more in application base jobs during the utilization period[13].
- A business fails to invest the minimum qualifying capital investment as represented on the VEGI application by the end of the five-year

[12]The year in which VEPC approves a company in the program is the award year. An approved company must maintain or increase existing payroll and jobs in future periods to qualify for an incentive payment each year.

[13]The utilization period means the period during which incentives can be claimed, and includes each year of the award period plus the four years immediately following each year of the award period.

award period. The amount recaptured is prorated to the extent of the deficiency in investment.

- If a claim is not filed for each year of the utilization periods.

# Appendix IV
# Vermont Economic Progress Council Response

**Vermont Economic Progress Council**
1 National Life Drive
Montpelier, VT 05620-0501
Fred.Kenney@state.vt.us
www.thinkvermont.com/vepc

[phone] 802-828-5256
[mobile] 802-777-8192

**Agency of Commerce and Community Development**

June 22, 2012

The Honorable Thomas Salmon
Auditor of Accounts
State of Vermont
132 State Street
Montpelier, Vermont 05633-5101

Dear Mr. Salmon:

Enclosed is the Vermont Economic Progress Council management response to the 2012 audit of the Vermont Employment Growth Incentive program.

I want to thank you and your staff for the manner in which this audit was undertaken. Staff was professional, responsive, and committed to program improvements.

Thank you for your consideration.

Sincerely,

Fred Kenney

Fred Kenney
Executive Director

Enclosure

VERMONT

*"Improve the economic vitality of Vermont and support a diverse, sustainable future for Vermonters"*

## VERMONT EMPLOYMENT GROWTH INCENTIVE PROGRAM
## FOLLOW-UP TO 2008 COMPLIANCE AUDIT
## JUNE 2012
## MANAGEMENT RESPONSE:
## *VERMONT ECONOMIC PROGRESS COUNCIL (VEPC)*
## SUBMITTED JUNE 22, 2012

**RESPONSES TO RECOMMENDATIONS**

The following are management (VEPC) responses to the specific recommendations made by the Auditor of Accounts in a June 2012 update to previous audit reports on the Vermont Employment Growth Incentive (VEGI) program. VEPC did not include extensive background facts and information on each issue in the following responses. For more in-depth responses and further information on these issues, readers can refer to the original audit response (Appendix V) and the January 2012 Report to the General Assembly on the VEGI Program by the Secretary of Commerce.

**RECOMMENDATION 1: APPLICATION SIGNATURES BY CORPORATE OFFICERS**

In addition to the changes mentioned by the Audit Report Current Status, the VEGI on-line application system requires several certifications by the two officers that sign the application. One of the certifications is a statement that the person signing the application is duly authorized by the company to represent, and sign on behalf of, the applicant company. Screen Shot of Application Certification Page:

**AUTHORIZATIONS AND CERTIFICATIONS (SENIOR AUTHORIZING OFFICER ONLY)**

You must follow the line-by-line instructions to correctly complete these forms.

TO VIEW SPECIFIC INSTRUCTIONS FOR THIS FORM, Click Here.

☑ **Authorization to Share Confidential Information:** The applicant company authorizes the Vermont Department of Taxes and the Vermont Economic Progress Council, for purposes related to these incentives only, to share with each other confidential tax, application, and other information about the applicant company. This waiver does not affect the protection from public disclosure of confidential financial and business information as provided by Title 32 §5930a(h).

☑ **Certification of Intent:** The applicant company signatories certify that the application they are signing and all attached documents provided by the applicant are true, correct, and complete to the best of their knowledge.

☑ **Certification of But For Statement:** The applicant company signatories certify that the statements included in the application regarding whether the activity for which incentives are sought would or would not occur, or would occur in a significantly different and significantly less desirable manner, but for the incentive, are true, correct, and complete to the best of their knowledge.

☑ **Certification of Program Understanding:** The applicant company signatories certify that they understand the following:
a. That the incentive authorized can only be earned if base payroll and employment is maintained or increased and Annual Performance Measures are met;
b. That installments of earned incentives can be forfeited if performance measures are not maintained;
c. That the total amount of incentive authorized is in part based on the capital investment performance measures included in this application and that if the total capital investment performance measure is not met the incentive amount may be decreased proportionate to the percent of the capital investment that was not completed, including possible recapture, if required;
d. That the first installment of an earned incentive will be adjusted to account for partial year employment of New Qualified Employees and therefore the first installment of each earned incentive, if authorized, as an estimate and the actual first installments will be calculated by the Vermont Department of Taxes when each claim is filed by prorating the first installment by the number of days actually worked by each New Qualifying Employee;
e. That if the applicant company drops employment or payroll below 10% of the employment or payroll levels at the time of application, 100% of the incentives paid will be recaptured; and
f. That if an authorization amendment is required after a Final Application authorization and the amendment is due to an applicant error, the authorized incentive amount will not be increased.

☑ **Certification Regarding Employment:** I certify that in accordance with Title 32, Section 5930a(c)(1), the new jobs to be created by the project included in this application do not include any jobs or employees transferred from another existing operation in Vermont that is a division or subsidiary of any kind of the applicant company and that the new jobs are not replacements for positions within the applicant's business that were vacated or terminated within the past two years, unless such lookback is waived by VEPC.

☑ **Certification of Good Standing:** I certify that the applicant company is in good standing with the State of Vermont as defined by 32 VSA Section 3113(g) and that the company has applied for, received, and attached a Letter of Good Standing from the Vermont Department of Taxes.

☑ **Electronic Signature Notification** Electronic Signature Notification: By checking all the boxes on this form and changing the application status to submit the application to VEPC, the applicant company signatories certify that:
a. They are duly authorized by the applicant company to represent the company, sign this application, and affirm the Authorizations and Certifications contained on this form;
b. They have completely reviewed the application and the program rules and requirements;
c. They are actually the person designated by the applicant business and registered by VEPC in the VEGI Application and Claim System as the Authorizing Official (AO) or Senior Authorizing Official (SAO) for this application (and not a designee); and
d. They understand by clicking each box to enter a checkmark and changing the application status they are affixing their signature to the application and acknowledge that they are responsible for the application content.

**RECOMMENDATION 6: BUT FOR ANALYSIS**

It is correct that the VEGI application process relies, ***in part***, on the signature of two company officials to certify that the information and data are correct and accurate. The Council reiterates that the certification required for the VEGI application is far more robust than any other certification utilized by other state programs involving private sector applicants. Even the submittal of a Vermont tax return relies solely on a single signature and nothing more.

However, the VEGI application process goes far beyond just the requirement of signatures to verify the veracity of the information and data provided. VEPC staff performs due diligence on each application to verify the statements supporting the But For argument made by applicant. Additionally, one of the senior officers who signed the application must appear in person before the VEPC Board when the application is considered.

The Council continues to oppose the imposition of an application fee or bill back. This is an incentive program in which the State is encouraging companies to come to Vermont, expand into Vermont, or expand within Vermont. Charging a fee to determine if a company is eligible for these incentives is antithetical to the purpose of the program. How do you encourage something to occur by charging a fee?

The requirement for statutory approval by the General Assembly to impose a fee or bill-back is not merely something asserted by VEPC, as stated in the report. It is the law (See VSA 32 §601).

**RECOMMENDATION 7: BUT FOR REVIEW**

The Council concurs that having another individual trained to perform the technical review of VEGI applications would help mitigate the risks associated with reliance on a single individual. The Council requested that the Secretary of Commerce consider assigning an Agency staff person to assist VEPC during the monthly application review process. Secretary Miller has agreed to this request and has reallocated several hours of a senior staff person's time each month to assist VEPC with application review, when required. This person will be trained in application review as a back up in the event that the VEPC Executive Director is unavailable and will assist when application volume is high and/or when additional verification and review are required.

**RECOMMENDATION 8: NAICS CODES**

The Council could did not recalculate the incentive award for the specific case cited because the incentives for that company were subsequently rescinded. Using the Auditor's logic, every time there is a change in any data set that is utilized in the model, regardless of when that change occurs, the model should be updated at that instant. This is not reasonable, efficient, or required by statute. The VEGI Cost-Benefit model is updated annually. All changes in NAICS

or other data used in the model are incorporated in the annual update, which is reported to the Joint Fiscal Committee each year.

**RECOMMENDATION 10: BACKGROUND GROWTH CALCULATION**

The current methodology to calculate background growth is the methodology agreed on by the economists and other stakeholders involved in the program design and which was approved by the Joint Fiscal Committee when the transition was made from EATI to VEGI. It is incorrect to state that the industry rate methodology was adopted "assuming that all companies within the same industry were expected to grow at the same rate." That would be naïve. As stated in the response to the original program audit, during several legislative committee sessions, and repeated in the report on the program by the Secretary of Commerce, when ***all*** factors are considered, including the overall design and purpose of the VEGI program, the industry method is the most balanced, equitable and efficient methodology to calculate background growth.

**State of Vermont**
**Department of Taxes**
133 State Street
Montpelier, VT 05633-1401

*Agency of Administration*

June 25, 2012

Thomas M. Salmon, CPA, CFE
State Auditor
132 State Street
Montpelier VT 05633-5101

Dear Mr. Salmon:

Thank you for the opportunity to respond to the draft of the audit report "*Vermont Economic Growth Incentive; Progress Underway on Audit Recommendations*". I have reviewed the report and your findings regarding the three recommendations from the previous audit.

The administration of the VEGI program has presented many challenges to the Department staff. The annual review of the VEGI claims is a complex and involved process. The number of claimants has increased to thirty two for the current claim year. In addition, for each subsequent year that a claimant is in the program, their filing is expanded to include workbooks for both prior and current years. We are continually revising and updating our procedures for reviewing the claims. Each filing year we have new claimants with unique scenarios and questions. During 2011, members of the Tax Department and ACCD formed the VEGI Working Group to jointly review the administration of the application process and the claims filing process. The overall goal of the group was to improve the processing and workflow efficiency of the program. The group recommended statutory language modifications, claim form and application changes and processing improvements. The statutory changes were adopted in the recent legislative season. In addition, we implemented modifications to the VEGI claim form in the Intelli Grants system and made changes to our internal review procedures.

As Recommendations #1 and #3 were fully implemented by the Department, I will address only your finding regarding Recommendation #2.

Your audit found that Recommendation #2—that DOT develop written standards for the level of data validation that should be performed over information submitted by claimants in order to support the approval or denial of a claim was partially implemented by the Department.
We accepted your original recommendation and expanded our procedures to include a sampling program for payroll data verification. In addition, we developed a Capital Investment workbook for the claimants to submit with their claim form. The claimants enter detailed information about their Capital Investment purchases and submit these workbooks with their annual claim form.

VERMONT

http://tax.vermont.gov

Thomas M. Salmon, CPA, CFE
State Auditor
June 25, 2012
Page 2

You have noted in your current findings that claimants are not required to submit copies of invoices or other verification of their capital investment purchases with their workbook submissions. We feel that the submission of multiple invoices and receipts with the claim form is not requisite to achieve the desired level of validation necessary for the capital investments. We are, however, revising the **Claim Review** section of our VEGI Procedures to include further review of the capital investment information. The examiner currently reviews the capital investment information submitted to verify that each purchase is a qualified investment according to statute, i.e., the purchase was made after the Activity Commencement Date. We are adding an instruction in our procedures for the examiner to review the detailed information about the project for which the VEGI incentives were approved found in the "*Notice of Authorization of Economic Incentives*". After reviewing the data submitted in the Capital investment Workbook, the examiner will decide, on a case by case basis, if it is necessary to request additional documentation. The examiner may request further verification of the capital investments from the claimant in the form of purchase agreements and/or invoices. We will add additional language to the capital investment section of the claim form regarding the requirement that all Qualifying Capital Investments listed on the claim form must be part of the approved VEGI project. All claimants are required to certify the accuracy of the information submitted on their annual claim form before submission. In addition, the examiner will also review the dollar amount of capital investments to date to determine if the claimant is on target with their total capital investment requirement.

As I stated earlier, we are continually reviewing and updating our claim review procedures as needed. As the VEGI program expands each year, we are faced with new challenges in administering the program. I would like to thank you and your audit staff for their professional and helpful oversight of the VEGI program.

Sincerely,

Mary Peterson

Mary Peterson
Commissioner of Taxes