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**DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT**  
**Randall A. Deems, Acting Director**

**Marc Wilson, Deputy Director**  
**Ed Nielsen, Chief Auditor**  
**Special Projects and Accountability Division**

**Barstow Enterprise Zone Audit Report**

**June 25, 2013**

# Barstow Enterprise Zone Audit Report

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### Auditors:

*Kelly Moeckly, Auditor-in-Charge*

*Ed Nielsen, Chief Auditor*

### Distribution

*Randall A. Deems, Acting Director*

*Marc Wilson, Deputy Director, Special Projects and Accountability Division*

*Edward Nielsen, Chief Auditor*

*Mark Murphy, Barstow Enterprise Zone Manager*

*John Nunn, Program Manager, HCD EZ Program*

## ENTERPRISE ZONE OVERVIEW

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

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

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

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

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

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

# Barstow Enterprise Zone Audit

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## Introduction

The Barstow Enterprise Zone (EZ) is one of 40 EZs in California providing tax incentives to qualified businesses. The Barstow EZ was designated July 18, 2006 for 15 years, effective February 1, 2006 through February 1, 2021.

## Unique Characteristics of the Barstow EZ

- Processed 161 vouchers certificates in 2011 and 155 in 2012.
- Roughly 84 percent of all vouchers certificates were issued to employers with employees living in a Targeted Employment Area (TEA).
- Twenty plus businesses are actively participating in the EZ vouchering program.
- The EZ charges \$30 per voucher application. Of this fee, \$15 is sent to HCD and \$15 is retained by Barstow.

## Audit Objectives

The HCD auditors evaluated Barstow EZ's performance towards meeting the goals, objectives, and commitments, as stated in their EZ Application and their MOU with HCD. At the conclusion of the audit process, a performance score was determined, based on Barstow's documentation supporting its achievement of goals, objectives and commitments related to EZ administration, marketing, budgeting, vouchering, and other regulatory required activities (CGC Section 7076.1(b)):

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

## Audit Authority and Guidance

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

## Barstow Enterprise Zone Audit (continued)

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### EZ Audit Scope

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

### Audit Methodology

- Review California Government Code Section 7070-7089, California Code of Regulations, and HCD guidance on reporting requirements.
- Review Barstow EZ application and MOU.
- Review Barstow EZ self-evaluation report, Biennial report, and monthly reports to HCD.
- Review program policies and procedures, and EZ website.
- Interview Barstow EZ manager and staff.

### Audit Sampling Methodology

1. **Voucher Program** - Specific parameters were defined for voucher applications that were approved or denied from January to December 2012, to be able to select the testing population.
  - Of the 155 total voucher applications received from January to December 2012, HCD auditors identified 70 applications for all qualifying categories (A-K) for testing. The 70 applications selected were tested to determine if voucher application approvals met regulatory requirements.
  - Sampling Method:
    - For each category with less than five total applications received, all were tested.
    - A category with 5 to 99 applications; 5 applications were tested.
    - A category with 100 to 299 applications; 10 applications were tested.
    - A minimum of 70 applications are tested per EZ.
  - Voucher number sequence was verified to determine if voucher numbers were appropriately issued.
2. **Monthly Reporting** - comparison of January through December 2012 monthly reports and voucher activity log:
  - January to December 2012 monthly reports were compared to the voucher activity log to determine if there were any reporting discrepancies.
  - HCD auditors verified Barstow EZ monthly report dates, comparing that information to the date HCD's EZ Program received the reports, to determine report timeliness.

## Barstow Enterprise Zone Audit *(continued)*

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- HCD auditors verified the accuracy of the information provided in the Barstow EZ monthly reports.
  - Reconcile remittance amounts and the count for voucher applications.
3. **EZ Application, MOU and Self-Evaluation** - support documentation was compared to goals, objectives, and commitments to determine the level of achievement.

## Barstow Enterprise Zone's Performance Score and Adequacy of Controls

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### Performance Score: *Fail*

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

**Note:** The audit score achieved by a G-TEDA (EZ) is governed by CCR Section 7076.1, with the G-TEDA being able to achieve a score of: Superior, Pass or Fail. A G-TEDA audit score of failing will require a formal agreement between HCD and the G-TEDA. The agreement will be for a maximum of 180 days, by the end of which all audit findings must be remediated.

### Adequacy of Controls

The Barstow EZ audit documented areas of weak internal controls that led to the audit findings. This was evidenced by noncompliance with regulations, the EZ application, the EZ MOU and HCD policies and procedures.

Auditors noted noncompliance with the following:

- Budget resources, committed to in the EZ application and MOU, were not provided.
- Monthly reports and fee remittance are not being performed according to regulatory requirements.
- Conflict of Interest statement certifications have not been completed for staff involved in the administration of the vouchering program.
- Support documentation is inadequate to confirm efforts (commitments) have been implemented or completed.
- Tracking mechanisms are inadequate so that commitment efforts or EZ deliverables can be reported.
- Self-evaluations are not being performed to measure progress made in meeting goals, objectives and commitments that were established with the granting of Barstow's EZ designation.
- Inaccuracies in the voucher application approval process.
- Management controls and oversight of the voucher program is not meeting regulatory requirements.

The Barstow EZ audit performance score was determined based on documentation available (at time of audit) about its achievement of goals and objectives related to EZ administration, marketing, budgeting, vouchering, accomplishments, responsibilities, and regulatory related activities.

## Barstow Enterprise Zone Audit Finding Log

### Audit Findings

Barstow EZ log of audit findings includes the compliance or control issue, how the issue was noted and the criteria/risk that should be complied with or managed. Since Barstow EZ received a G-TEDA audit score of “Fail”, no recommendations are suggested for the remediation of audit findings. Instead, a formal written agreement, to address all EZ audit findings, will need to be executed between HCD’s EZ Program and the Barstow EZ.

|   | Finding/Criteria/Recommendation   | Action Plan  | Action Owner                             | Estimated Completion Date             |
|---|---|--|--|---------------------------------------|
| 1 | <p><b><u>Voucher Program Administration</u></b><br/>The administration of the vouchering process is done by the Barstow EZ.</p> <p><b><u>Findings</u></b><br/>The analysis of the voucher process and test samples of the voucher applications supported the following findings:</p> <ul style="list-style-type: none"> <li>• Not all applications were date stamped.</li> <li>• Voucher application documentation did not meet accuracy and timeliness criteria.</li> <li>• The voucher activity log and the G-TEDA monthly reports show a discrepancy in the total amount of vouchers received.</li> <li>• Monthly G-TEDA reports were submitted late.</li> <li>• Voucher Plan did not include an annual affirmative marketing procedure to make businesses aware of the EZ Program and voucher plan.</li> </ul> <p><b><u>Criteria</u></b><br/>CCR Title 25 Section 8463 Administration of a Vouchering Program, Section 8466, HCD Management Memo 8-01, 11-01.</p> | <p><b>Management’s Action Plan:</b></p> <p>Barstow EZ must enter into an agreement, per regulatory requirements, with HCD’s EZ Program that will address all audit findings contained within the “Barstow Enterprise Zone Audit Report”.</p> | <p><i>Barstow<br/>EZ<br/>Program</i></p> | <p><i>Governed<br/>by statute</i></p> |

|   | Finding/Criteria/Recommendation  | Action Plan  | Action Owner                     | Estimated Completion Date         |
|---|--|--|----------------------------------|-----------------------------------|
| 2 | <p><b><u>Business Administration</u></b><br/>           Since October 2011, the EZ Program has not had a full-time manager.</p> <p><b><u>Findings</u></b></p> <ul style="list-style-type: none"> <li>• No full-time EZ manager.</li> <li>• No documentation to verify that their commitments, per their EZ application and MOU, have been implemented or completed.</li> <li>• No tracking goals and objectives for the EZ Program; therefore, unable to report on commitment efforts or EZ deliverables.</li> <li>• Not conducting self-evaluations to determine the progress made towards meeting goals, objectives, and commitments.</li> <li>• Not monitoring the budget to ensure compliance with the MOU.</li> </ul> <p><b><u>Criteria</u></b><br/>           Title 25 CCR Section 8462 Designation of Zone Manager and Staffing; Application/MOU between HCD EZ Program and Barstow EZ.</p> | <p><b>Management's Action Plan:</b><br/>           Barstow EZ must enter into an agreement, per regulatory requirements, with HCD's EZ Program that will address all audit findings contained within the "Barstow Enterprise Zone Audit Report".</p> | <p><i>Barstow EZ Program</i></p> | <p><i>Governed by statute</i></p> |
| 3 | <p><b><u>Budget</u></b><br/>           The funding committed to the Barstow EZ Program not provided.</p> <p><b><u>Finding</u></b><br/>           Funding for Barstow EZ, per application (resolution), is not being allocated to the EZ Program.</p> <p><b><u>Criteria</u></b><br/>           Title 25 CCR Section 8462 Designation of Zone and Manager and Staffing; MOU and MOU Supplemental.</p>  | <p><b>Management's Action Plan:</b><br/>           Barstow EZ must enter into an agreement, per regulatory requirements, with HCD's EZ Program that will address all audit findings contained within the "Barstow Enterprise Zone Audit Report".</p> | <p><i>Barstow EZ Program</i></p> | <p><i>Governed by statute</i></p> |

|   | Finding/Criteria/Recommendation   | Action Plan  | Action Owner                             | Estimated Completion Date             |
|---|---|--|--|---------------------------------------|
| 4 | <p><b><u>Vouchering Fees</u></b><br/>           Barstow EZ receives the voucher application fee checks that are made payable to City of Barstow. Barstow EZ makes a copy of the check to retain with the application and then forwards it to Barstow’s cashier. Barstow EZ issues a fee check, made payable to HCD EZ Program.</p> <p><b><u>Finding</u></b><br/>           Application fees are not submitted to HCD by the 25th of the month, following receipt of voucher application.</p> <p><b><u>Criteria</u></b><br/>           Title 25 CCR Section 8433 Procedure for Remittance of Department Fees (a); EZ MOU.</p>  | <p><b>Management’s Action Plan:</b></p> <p>Barstow EZ must enter into an agreement, per regulatory requirements, with HCD’s EZ Program that will address all audit findings contained within the “Barstow Enterprise Zone Audit Report”.</p> | <p><i>Barstow<br/>EZ<br/>Program</i></p> | <p><i>Governed<br/>by statute</i></p> |
| 5 | <p><b><u>Conflict of Interest</u></b><br/>           Barstow EZ staff involved in the administration of the vouchering program must execute their responsibilities in compliance with all regulatory requirements. This includes processing the voucher applications objectively and securing confidential information.</p> <p><b><u>Finding</u></b><br/>           The Barstow EZ Manager did not certify that they are free of any conflict of interest with the EZ voucher applicants or EZ’s obligations to objectively evaluate and process applications.</p> <p><b><u>Criteria</u></b><br/>           Title 25 CCR Section 8463 Administration of a Vouchering Program.</p> | <p><b>Management’s Action Plan:</b></p> <p>Barstow EZ must enter into an agreement, per regulatory requirements, with HCD’s EZ Program that will address all audit findings contained within the “Barstow Enterprise Zone Audit Report”.</p> | <p><i>Barstow<br/>EZ<br/>Program</i></p> | <p><i>Governed<br/>by statute</i></p> |