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Long Beach Enterprise Zone Audit Report

June 26, 2013

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ENTERPRISE ZONE OVERVIEW

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.

Long Beach Enterprise Zone Audit

Introduction

Long Beach Enterprise Zone (EZ) is one of 40 EZs in California providing tax incentives to qualified businesses. The Long Beach EZ received its first designation January 8, 1992 and was re-designated for another 15 years, effective January 8, 2007 through January 7, 2022.

Unique Characteristics of the Long Beach EZ

- Issued almost 4,300 voucher applications during the audit period, January 1, 2012 through December 31, 2012.
- Partners with Pacific Gateway, Los Angeles Economic Development Corporation, EDD, and Long Beach City College to market the program and/or provide services.
- Marketing brochures are sent to businesses that apply for a business license.
- Charges \$70 per voucher application that has a hire day less than 18 months prior to the receipt of the application. For applications that have a hire date more than 18 months prior to the receipt of application, the fee is \$108, which is called retroactive processing. An extra fee of \$25 is charged for expedited processing. Fifteen dollars is sent to HCD and the remaining is retained by Long Beach. Funds are used to pay for vouchering activities.

Audit Objectives

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

- Determine whether the Long Beach EZ program is effective in the delivery of EZ program goals, objectives, and commitments.
- Determine whether the Long Beach EZ is submitting reports timely and is 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 Long Beach EZ program performance.

Audit Authority and Guidance

- Government Code Section 7070
- California Code of Regulations, Title 25, Division 1, Chapter 7, Subchapter 21, Articles 1-14
- California RTC Code Section 17053.74
- HCD Management Memos

Long Beach Enterprise Zone Audit *(continued)*

- Application for Designation Guidebook; Long Beach EZ Application for Designation; HCD EZ Monitoring Guidebook;
- Long Beach EZ established policies and procedures; and
- Internal control best practices.

EZ Audit Scope

- Long Beach EZ application, MOU, and MOU Supplement
- Long Beach EZ performance reports
- Long Beach EZ Biennial report
- Voucher process and periodic monthly reports
- Activities and documentation available for audit period

Audit Methodology

- Review Government Code Section 7070-7089, California Code of Regulations, and HCD guidance on reporting requirements
- Review Long Beach EZ application, MOU, MOU Supplement, and corresponding tables
- Review Long Beach EZ self-evaluation report, Biennial report, and monthly reports to HCD
- Review program policies and procedures
- Interview Long Beach EZ and Pacific Gateway personnel
- Review Long Beach EZ website and partner websites

Audit Sampling Methodology:

1. **Voucher Program** – To select the sample for testing, specific parameters were defined for voucher applications that were approved or denied January to December 2012.
 - Of the 4,175 total voucher applications received from January to December 2012, HCD auditors identified 104 applications for all qualifying categories (A-K) for testing. The 104 applications selected were tested to determine if applications met regulatory requirements.
 - Sampling method:
 - For each category with less than five total applications, all were tested.
 - Category with 5 through 99 applications; 5 applications were tested.
 - Category with 100 through 299 applications; 10 applications were tested.
 - Category with 300 or more applications; 30 applications were tested.
 - Voucher number sequence was verified to determine if voucher numbers were appropriately issued.
 - Date of hire was verified to determine if application was from expired or current zone.
2. **Monthly Reporting** - comparison of January to December 2012 monthly reports to cashier logs, to determine if fees submitted were accurate. HCD auditors verified the monthly report due dates and compared that information to the actual submittal date, to determine report timeliness.
3. **MOU Supplement and Self-Evaluation** - support documentation was compared to MOU goals, objectives, and commitments to determine the level of achievement.

Long Beach Enterprise Zone's Performance Score and Adequacy of Controls

Performance Score: Pass

The audit performance score was based on Long Beach EZ documentation supporting the achievement of its goals, objectives, and commitments relative to EZ administration, marketing, budgeting, vouchering, accomplishments, responsibilities, and control measures.

Note: The audit score achieved by a G-TEDA (EZ) is governed by CCR § 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 audit of the Long Beach EZ showed there are areas of operations that can be improved. This is evidenced by the level of compliance with regulations, the MOU, and HCD policies and procedures.

Auditors noted that the following controls exist:

1. All voucher applications are approved by the EZ manager or designees; roles and responsibilities of the EZ staff are defined.
2. Voucher processing policies and procedures exist, are being followed and complied with; voucher records are retained for five years.
3. Voucher applications are reviewed by two EZ staff to ensure processing accuracy.
4. Adequate controls in place for safeguarding and processing application remittance fees.
5. Long Beach EZ, who partners with Pacific Gateway and Los Angeles Economic Development Corporation for business expansion, attraction, retention, and marketing/sales strategies, is tracking achievements made in these areas and reporting this information for compliance with the MOU.

Long Beach EZ could improve operations in the following areas:

1. Revised commitments, goals, and objectives.
2. Biennial Reporting compliance.
3. Timely monthly reports and the corresponding fees are sent to HCD.
4. Voucher log data accuracy.
5. Improved In-kind commitment tracking.

Long Beach Enterprise Zone Audit Finding Log

Audit Findings

This is Long Beach EZ’s log of audit findings. An audit finding includes the compliance or control issue, how the issue was noted, the criteria/risk that should be complied with or managed, and the suggested recommendation. The Audit Finding Log records Long Beach EZ’s action plan, documentation requirements, the action owner, and the estimated Action Plan completion date.

An audit of “Pass” will require the HCD EZ Audit team to track all audit findings for resolution and submission of completion documentation. The EZ Audit team may also perform follow-up testing.

Audit Finding Log

#	Finding/Criteria/Recommendation	Action Plan	Action Owner	Estimated Completion Date
1	<p>MOU Supplement: Goals, Commitments, and Objectives</p> <p>Long Beach EZ was not able to fulfill all of their commitments, as set forth in the MOU Supplement contract with HCD. Long Beach has provided documentation that links both the economic downturn and the demise of the Economic Development Bureau and the Redevelopment Agency as the major reason for this audit finding.</p> <p><u>Criteria:</u></p> <ul style="list-style-type: none"> • Long Beach MOU, Section #A, <i>Performance</i> • MOU Supplement: 1) <i>Marketing Strategy and 2) Planning and Local Incentives</i> <p><u>Finding:</u> Long Beach EZ has achieved meeting the regulatory requirement of its contractual commitments. However, the following commitments were identified as no longer being implemented or tracked:</p>	<p>Management’s Action Plan:</p> <p>The Long Beach EZ is currently reassessing its MOU and Supplement to determine the most efficient modifications to fully ensure it will meet or exceed the goals, objectives, and commitments of the EZ program.</p> <ul style="list-style-type: none"> • Outline attainable goals and objectives; • Identify measurable benchmarks to demonstrate appropriate levels of EZ activities; • Clarify commitments; • Continue to secure partnership reports; • Identify attainable areas of achievement; • Identify continuous improvement strategies. 	<p>Craig Johnson, Long Beach EZ Manager</p> <p>Karla Olivas, Voucher Coordinator</p>	<p>December 31, 2013</p> <p>The Long Beach EZ requested a visit by HCD to discuss the changes of the MOU. HCD agreed to come in August to provide technical assistance. Once the MOU is completed it may need City Council approval, in which case would have to wait until the December 2013 Agenda.</p>

#	Finding/Criteria/Recommendation	Action Plan	Action Owner	Estimated Completion Date
	<p>A.1 - Commercial Expansion and Retention: Item # 3, 9, 11, 12, 13, 14, 16, 17, and 18.</p> <p>A1.b - Industrial Expansion and Retention: Item # 1, 3, 5 and 6.</p> <p>A.2 - Sales Plan: Item # 1, and 4.</p> <p>D - Planning and Local Incentives</p> <p><u>Recommendations:</u> Long Beach EZ should work with HCD's EZ Program to modify their MOU Supplement, to the degree permitted by regulation. These modifications should be structured so that goals, objectives, and commitments are quantifiable and outcomes are measureable.</p>			
2	<p>Biennial Report</p> <p>Although Biennial Reporting is a requirement, HCD issued guidance that allowed the EZ to not fully comply with EZ regulatory requirements.</p> <p>Long Beach EZ provided supporting documentation on achievements and specific activities that the EZ have completed, are ongoing, and plan on doing towards their MOU requirements. This information, however, was not included in the biennial report.</p> <p>Criteria: 7085.1(a)(1) and (2)</p> <p><u>Finding:</u> 1. Long Beach EZ's 2010/11 and 2011/12 biennial reports did not include the required regulatory components.</p>	<p>Management's Action Plan:</p> <p>Once the MOU has been revised, it will serve as the basis to develop the framework for the Biennial Report. Therefore, ensuring all required components of the biennial report complies with the MOU and all compliance regulations.</p> <p>The revised commitments, goals, and objectives will be periodically reviewed to ensure accurate reporting.</p>	Craig Johnson, Long Beach EZ Manager	<p>October 31, 2014</p> <p>This coincides with the next due date of the Biennial Report.</p>

#	Finding/Criteria/Recommendation	Action Plan	Action Owner	Estimated Completion Date
	<ul style="list-style-type: none"> The report lacked information relative to the efforts towards goals, objectives, and commitments for business retention/expansion/attraction, financing programs, and job development as outlined in the MOU Supplement. <p><u>Recommendation:</u></p> <ol style="list-style-type: none"> Long Beach must ensure that required components of the biennial report, all parts of their MOU, are addressed and reported to meet regulatory requirements. Government Code requirements and regulations should be periodically reviewed to ensure accurate reporting. 			
3	<p>Reporting of G-TEDA and Remittance Fee</p> <p>Regulations require EZs to submit the G-TEDA and remittance fees to HCD by the 25th of each month for voucher applications and fees received in the prior month.</p> <p><u>Criteria:</u> Title 25 CCR §8433 <i>Procedure for Remittance of Department Fees</i></p> <p><u>Finding:</u> December's G-TEDA report and fee remittance was due January 25, 2013, but was not submitted until February 2013.</p> <p><u>Recommendations:</u> Process remittance fee check requests earlier in the month to ensure timeliness of the G-TEDA/remittance fees.</p>	<p>Management's Action Plan:</p> <p>Corrective action has been implemented. The Direct Payment request is now processed in the first week of the month by the Voucher Coordinator* and submitted to City Hall Accounts Payable for check processing. This will ensure payment is mailed no later than the 20th of the month.</p> <p>*Due to this 2012 Audit finding of the G-TEDA, an internal assessment of the 2013 G-TEDA was conducted and found a delay in the February 2013 payment. The request for payment was submitted to the fiscal clerk on 03/05/13, however, was not posted in the City's financial system until 3/21/13 causing a delay on the check being issued. As a result, the HCD received their payment late. In order to ensure future discrepancies do not occur, the EZ Voucher Coordinator will now be posting the "Voucher" into the City's financial system concurrently to preparing the Direct Payment form to request the check. This process bypasses the fiscal clerk.</p>	<p>Craig Johnson, Long Beach EZ Manager</p> <p>Karla Olivas, Voucher Coordinator</p>	<p>Completed.</p> <p>The corrective action has already been implemented.</p>

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4	<p>Voucher Administration</p> <p>Voucher processing procedures:</p> <ul style="list-style-type: none"> • Voucher applications are processed by the voucher clerk and voucher coordinator. • Voucher numbers are assigned sequentially. • Voucher applications needing additional documentation are held open. • Voucher numbers can be reassigned or retired. • The number of vouchers processed is taken from the voucher activity log and then summarized on the vouchers issued log. • Regulation requires specific language to be included in enterprise zones vouchering plan. <p><u>Criteria:</u></p> <ul style="list-style-type: none"> • Long Beach EZ's MOU, Section E. <i>Vouchering #1.</i> • Title 25 CCR §8463 <i>Administration of a Vouchering Program, #5 and #6.</i> <p><u>Findings:</u></p> <ul style="list-style-type: none"> • An unassigned voucher number was not listed on the retired voucher log. • Two vouchers were on the retired voucher log but were assigned to other voucher applications. • Discrepancy in the number of vouchers processed in 2012 between the voucher activity log and voucher issued log. • Voucher plan lacked annual certification that vouchering policies and procedures are administered consistently and an annual affirmative marketing procedure is in place to make businesses aware of the opportunities to participate in the EZ Program and of the vouchering plan. 	<p>Management's Action Plan:</p> <p>The Policy Memorandum: EZ-01A has been modified to include the following language to ensure that procedure based errors are eliminated.</p> <p>“The voucher codes must be issued in sequential order. A voucher code may be held open on a first come, first serve basis for an application which appears to have a short and reasonable solution and turnaround for processing approval. However, if the client has not responded in a reasonable timeframe, the voucher code must be retired (no longer available for use).”</p> <p style="text-align: center;">-and –</p> <p>“All Enterprise Zone (EZ) application packets must be certified and administered consistently. All application packets shall be date stamped when received and processed as soon as possible.”</p> <p>Please see Voucher Application Policy EZ-01A attached.</p> <p>The Policy Memorandum: EZ-04 Affirmative Marketing has been developed procedures to ensure businesses are aware of the opportunities to participate in the enterprise zone program and is available to all persons-regardless of their race, color, national origin, age, religion, sex, disability or familial status.</p> <p>Please see Affirmative Marketing Policy EZ-04 attached.</p>	<p>Craig Johnson, Long Beach EZ Manager</p> <p>Karla Olivas, Voucher Coordinator</p>	<p>Completed.</p> <p>A revised policy was provided with response to the referral.</p>

#	Finding/Criteria/Recommendation	Action Plan	Action Owner	Estimated Completion Date
	<u>Recommendations:</u> <ul style="list-style-type: none"> • Modify vouchering policy and procedures to ensure that procedure based errors are either eliminated and/or detected timely. • Amend the vouchering plan to address the certification issues identified. 			
5	<p>Staffing</p> <p>EZ staff has changed since their designation in 2007, due to the demise of the Economic Development Bureau and employment changes. All staff changes must be approved by HCD.</p> <p><u>Criteria:</u> Long Beach MOU, #8 D. <i>Enterprise Zone Budget/Maintenance of Effort.</i></p> <p><u>Finding:</u> Long Beach Enterprise Zone's staff changed without the approval of HCD.</p> <p><u>Recommendations:</u> Submit to HCD the current staffing and obtain written approval.</p>	<p>Management's Action Plan:</p> <p>Obtain retroactive letter of the approval for the increase in staffing levels.</p>	Craig Johnson, Long Beach EZ Manager	<p>Completed.</p> <p>Please see HCD letter of approval.</p>

Audit Observation

The Long Beach EZ provided support documentation as evidence of activities that are ongoing or have been completed by the EZ towards meeting its goals, objectives and commitments. Long Beach EZ tracking reports, performance metrics, and other MOU related documentation demonstrates that the Long Beach EZ is meeting over 75 percent of its goals, objectives, and commitments. The Long Beach EZ has identified areas of noncompliance with commitments due to the economic downturn and the demise of the Economic Development Bureau and Redevelopment Agency.

HCD auditors noted the significant participation by the Pacific Gateway, a major partner of the Long Beach EZ, in providing most of the support documentation for Long Beach EZ's achievement of its MOU commitments. Pacific Gateway provides Long Beach EZ with comprehensive marketing materials, as part of its strategic approach for businesses to take full advantage of the array of services provided in a one-stop shop. This one-stop shop offers job seekers and businesses the core service of providing collaboration in matching needs, with resources. Employers also benefit from access to knowledge and information about community based business services and opportunities, including the EZ benefits.