

Office of the Auditor General

Follow-Up Report on Prior Audit Recommendations

Renaissance Zone Program

Michigan Economic Development Corporation

October 2016



The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

Article IV, Section 53 of the Michigan Constitution



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Report Summary

Follow-Up Report

Renaissance Zone Program

Michigan Economic Development Corporation (MEDC)

Report Number:
271-0425-11F

Released:
October 2016

We conducted this follow-up to determine whether MEDC had taken appropriate corrective measures in response to the two material conditions noted in our January 2013 audit report.

Executive Order No. 2014-12 transferred the Michigan Strategic Fund (MSF) from the Department of Treasury to the Department of Talent and Economic Development effective March 2015. Under the amended and restated interlocal agreement effective April 1999, MSF created MEDC. Under a memorandum of understanding with MSF, MEDC provides administrative services associated with the Renaissance Zone Program.

Prior Audit Information	Follow-Up Results		
	Conclusion	Finding	Agency Preliminary Response
<p>Finding #1 - Material condition</p> <p>Establishment of benchmarks, gathering of program cost data, and compiling of complete and accurate outcome data is needed in order to evaluate the effectiveness of the Renaissance Zone Program.</p> <p>Agency agreed.</p>	Not applicable	Not applicable	Not applicable
<p>Finding #3 - Material condition</p> <p>Improved monitoring is needed to ensure that Renaissance Zones stay in compliance with the requirements of their development agreements.</p> <p>Agency agreed.</p>	Partially complied	A new reportable condition exists. See <u>Finding #3</u> .	Agrees

A copy of the full report can be
obtained by calling 517.334.8050
or by visiting our Web site at:
www.audgen.michigan.gov

Office of the Auditor General
201 N. Washington Square, Sixth Floor
Lansing, Michigan 48913

Doug A. Ringler, CPA, CIA
Auditor General

Laura J. Hirst, CPA
Deputy Auditor General



OAG

Office of the Auditor General

201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • www.audgen.michigan.gov

Doug A. Ringler, CPA, CIA
Auditor General

October 6, 2016

Mr. Steven Arwood, Director
Department of Talent and Economic Development
300 North Washington Square
Lansing, Michigan

Dear Mr. Arwood:

I am pleased to provide this follow-up report on the two material conditions (Findings #1 and #3) and two corresponding recommendations reported in the performance audit of the Renaissance Zone Program, Michigan Economic Development Corporation (MEDC). That audit report was issued and distributed in January 2013. Additional copies are available on request or at www.audgen.michigan.gov.

In March 2015, subsequent to our performance audit, Executive Order No. 2014-12 transferred the Michigan Strategic Fund (MSF) from the Department of Treasury to the Department of Talent and Economic Development. The prior audit findings were addressed to MEDC, and MSF provided the agency responses.

Our follow-up disclosed that our recommendation regarding establishing a comprehensive process to evaluate the effectiveness of the Renaissance Zone Program is no longer applicable and that MEDC partially complied with our recommendation regarding monitoring Renaissance Zones' compliance with the requirements of their development agreements. A reportable condition exists related to the inclusion of site visits as part of compliance monitoring (Finding #3). Therefore, we have issued one new recommendation.

Your agency provided a preliminary response to the recommendation at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days of the date above to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We appreciate the courtesy and cooperation extended to us during our follow-up. If you have any questions, please call me or Laura J. Hirst, CPA, Deputy Auditor General.

Sincerely,

A handwritten signature in black ink that reads "Doug Ringler". The signature is written in a cursive, flowing style.

Doug Ringler
Auditor General

TABLE OF CONTENTS

RENAISSANCE ZONE PROGRAM

	<u>Page</u>
Report Summary	1
Report Letter	3
Introduction, Purpose of Follow-Up, and Program Description	6
Prior Audit Findings and Recommendations, Agency Plan to Comply, Follow-Up Conclusions, New Recommendation, and Follow-Up Agency Response	8
Findings:	
1. Renaissance Zone Program Evaluation	8
3. Overall Compliance Monitoring Process	9
Follow-Up Scope and Period	11
Glossary of Abbreviations and Terms	13

INTRODUCTION, PURPOSE OF FOLLOW-UP, AND PROGRAM DESCRIPTION

INTRODUCTION

This report contains the results of our follow-up of the two material conditions* (Findings #1 and #3) and two corresponding recommendations reported in our performance audit* of the Renaissance Zone Program, Michigan Economic Development Corporation (MEDC), issued in January 2013.

In March 2015, subsequent to our performance audit, Executive Order No. 2014-12 transferred the Michigan Strategic Fund (MSF) from the Department of Treasury to the Department of Talent and Economic Development.

Under the amended and restated interlocal agreement effective April 1999, MSF created MEDC. Under a memorandum of understanding with MSF, MEDC provides administrative services associated with the Renaissance Zone Program. The prior audit findings were addressed to MEDC, and MSF provided the agency responses.

PURPOSE OF FOLLOW-UP

To determine whether MEDC had taken appropriate corrective measures to address our corresponding recommendations.

PROGRAM DESCRIPTION

The Michigan Renaissance Zone Act (Public Act 376 of 1996, as amended) established the Michigan Renaissance Zone initiative to foster economic opportunities in the State; facilitate economic development; stimulate industrial, commercial, and residential improvements; prevent physical and infrastructure deterioration of defined areas; and provide for the reuse of unproductive or abandoned industrial properties.

There are eight major types of Renaissance Zones in the State of Michigan: Agricultural Processing, Border Crossing Facility, Forest Products Processing, Geographic, MSF Designated, Next Michigan, Renewable Energy Facility, and Tool & Die Recovery.

As of December 31, 2015, there were 83 subzones designated within the 18 Geographic Renaissance Zones. In addition, there were approximately 40 specialty Renaissance Zones and 29 Tool & Die Recovery Zones consisting of approximately 270 companies. In general, the maximum duration of a Renaissance Zone is 15 years. Legislative authority to designate geographic zones or subzones and allow for time extensions expired on December 31, 2011.

In its 2015 annual report to the Legislature, MEDC attributed the creation of approximately 6,800 jobs and \$4.5 billion of

* See glossary at end of report for definition.

capital investment to activity within the Renaissance Zones from the beginning of the Program through December 31, 2015.

The Renaissance Zone Program is an economic development incentive program offered by MEDC and MSF to retain, expand, and attract business in Michigan. Originally, Michigan Renaissance Zones were regions of the State designated as virtually tax free for any business or resident presently in or moving into specified subzones for a period of up to 15 years. Since then, the Michigan Renaissance Zone Act has been expanded, shifting away from geographic area designations, and now focuses on company-specific, parcel-specific designations.

Projects are first vetted to determine eligibility before an application is released for consideration of a Renaissance Zone designation under the specialty zones: Agricultural Processing, Forest Products Processing, MSF Designated, or Renewable Energy Facility Renaissance Zones.

All Renaissance Zones receive the same tax abatement benefits which may include:

- Michigan Business Tax
- Michigan Individual Income Tax
- Michigan State Education Tax
- Local real and personal property tax
- Local income tax
- Utility users tax (Detroit only)

Taxes still due are those mandated by the federal government, local bond obligations, school sinking fund, and any special assessments. Also, companies and residents are not exempt from paying Michigan sales or use tax. In all cases, the tax benefits provided to Renaissance Zones are phased out in 25% increments during the last three years of the zone designation.

In addition to forgone State tax revenue, the State of Michigan reimburses intermediate school districts, local school districts, community college districts, and public libraries where taxes are abated. The State does not replace the tax revenue lost to the local governmental unit, and the reimbursements made by the State are subject to annual appropriation.

PRIOR AUDIT FINDINGS AND RECOMMENDATIONS, AGENCY PLAN TO COMPLY, FOLLOW-UP CONCLUSIONS, NEW RECOMMENDATION, AND FOLLOW-UP AGENCY RESPONSE

FINDING #1

Audit Finding Classification: Material condition.

Summary of the January 2013 Finding:

MEDC did not establish benchmarks*, gather cost data associated with the program, or compile complete and accurate outcome* data for the Renaissance Zones. As a result, MEDC could not effectively evaluate the Renaissance Zone Program.

Recommendation Reported in January 2013:

We recommended that MEDC establish a comprehensive process to evaluate the effectiveness* of the Renaissance Zone Program.

AGENCY PLAN TO COMPLY*

On March 25, 2013, MSF responded that MEDC would establish a comprehensive process to evaluate effectiveness and identify any improvements. The response also stated that MEDC would establish a tracking system and collect mandatory reporting and attempt to collect voluntary reporting. MSF indicated that MEDC would be in compliance by August 31, 2013.

FOLLOW-UP CONCLUSION

The recommendation is no longer applicable. Effective January 1, 2012, legislation ended the issuance of new Geographic Renaissance Zones, and in 2013, MSF discontinued the use of Tool & Die Recovery Zones.

* See glossary at end of report for definition.

FINDING #3

Audit Finding Classification: Material condition.

Summary of the January 2013 Finding:

MEDC did not adequately monitor the requirements in the Renaissance Zones' development agreements* and, therefore, could not ensure that the Renaissance Zones were in compliance.

Recommendation Reported in January 2013:

We recommended that MEDC adequately monitor Renaissance Zones' compliance with the requirements of their development agreements.

AGENCY PLAN TO COMPLY

On March 25, 2013, MSF responded that MEDC would develop a structured process for tracking and identifying noncompliance to ensure noncompliance is appropriately addressed. MSF indicated that MEDC would be in compliance by May 31, 2013.

FOLLOW-UP CONCLUSION

MEDC partially complied.

Our follow-up noted:

- a. Partially complied. We verified that MEDC did not complete any site visits for the 11 development agreements (applicable to 10 Renaissance Zones) reviewed. We noted that MEDC validated jobs created for 10 (91%) of the 11 annual progress reports reviewed and validated the capital investments reported for 10 (91%) of the 11 annual progress reports reviewed. We also noted that MEDC validated jobs created and capital investment requirements for all 5 (100%) of the 5 milestone audits reviewed.

MEDC implemented compliance process procedures in 2014 to monitor compliance with reporting requirements and development agreements for the Renaissance Zones. We noted improvements in tracking noncompliance and validating economic data.

- b. Complied. We noted that MEDC properly identified all 11 (100%) of the 11 development agreements reviewed as being in compliance with their job creation and/or capital investment requirements.
- c. Complied. We reviewed 11 annual progress reports submitted by those Renaissance Zones with development agreements. We noted that all 11 Renaissance Zones

* See glossary at end of report for definition.

received notification from MEDC of upcoming annual progress report due dates. Of the 11 reports reviewed, 2 were overdue. MEDC followed up on both of the overdue annual reports in a timely manner.

- d. Complied. We reviewed 5 noncompliant or revoked development agreements. We noted that all 5 (100%) of the development agreements reviewed were appropriately documented as noncompliant and compliance procedures were applied according to the status of the development agreement. We also noted that proper notification of revocation was delivered to the Department of Treasury and the local governmental unit for 2 (100%) of the 2 revoked Renaissance Zones.
- e. Complied. We compared Salesforce* (MEDC's database) and the 2014 and 2015 annual legislative reports and determined that MEDC compiled aggregated job creation and capital investment data in one centralized location. For 11 (100%) of the 11 development agreements with requirements, we noted that the jobs created and capital investment totals reported in Salesforce were cumulative and accurately reported in the annual legislative reports.

**NEW
RECOMMENDATION**

We recommend that MEDC include site visits as part of monitoring compliance with requirements in the Renaissance Zones' development agreements.

**FOLLOW-UP
AGENCY
RESPONSE**

MEDC provided us with the following response:

The MEDC agrees with the recommendation and will incorporate more site visits into its compliance and monitoring processes. The MEDC will develop a set of factors to use in determining when a site visit is necessary and appropriate to identify and/or address compliance issues. The MEDC anticipates that the revised site visit policy will be implemented within the first quarter of the 2017 fiscal year.

* See glossary at end of report for definition.

FOLLOW-UP SCOPE AND PERIOD

FOLLOW-UP SCOPE

We interviewed MEDC personnel and reviewed the results of MEDC's corrective action plan to determine the status of compliance with the recommendations related to the material conditions.

We randomly selected and tested 6 Geographic and 7 non-Geographic Renaissance Zones to determine whether MEDC requested, compiled, and accurately reported program outcome data. We also randomly selected 7 Geographic Renaissance Zones without development agreements or reporting requirements to determine if MEDC requested the Geographic Zones to voluntarily submit an annual progress report. In addition, we validated the annual progress report data submitted by these Geographic Zones to MEDC's 2014 and 2015 annual legislative reports.

We reviewed MEDC's compliance monitoring procedures, which include:

- Approving, amending, and revoking Renaissance Zones.
- Tracking and monitoring annual progress report submissions.
- Completing milestone and annual compliance reviews.
- Compiling the annual legislative report.

We reviewed and validated the data in the 2014 and 2015 Michigan Renaissance Zone Act Legislative Reports created by MEDC to the annual progress reports submitted by the Renaissance Zones.

We examined MEDC's Renaissance Zone data and determined that there were 109 active development agreements during the period October 1, 2014 through May 31, 2016. We randomly and/or judgmentally selected the following number of development agreements to determine whether MEDC adhered to the compliance monitoring procedures. We selected:

- 11 development agreements to review for verification of job creation and capital investment data and completion of site visits.
- 5 development agreements to review to determine if milestone audits were properly conducted.

- 11 development agreements to review for proper identification of noncompliance if requirements in the development agreement were not met.
- 5 development agreements to review the controls over noncompliance and Renaissance Zone revocation.
- 11 development agreements to review to determine if job creation and capital investment data was reported cumulatively and accurately in both the Salesforce database and the annual legislative reports.

PERIOD

Our follow-up was performed during April through July 2016.

**AGENCY
RESPONSES**

Our follow-up report contains 1 finding and 1 corresponding recommendation. MEDC's preliminary response indicates that it agrees with the recommendation.

The agency preliminary response that follows the recommendation in our report was taken from the agency's written comments and oral discussion at the end of our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days after release of the report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

GLOSSARY OF ABBREVIATIONS AND TERMS

agency plan to comply	The response required by Section 18.1462 of the <i>Michigan Compiled Laws</i> and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100). The audited agency is required to develop a plan to comply with Office of the Auditor General audit recommendations and submit the plan within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.
benchmark	A criterion, or standard, by which to measure something.
development agreement	A written agreement between MSF and the owner of the property located within the Renaissance Zone. Development agreements define obligations that include, but are not limited to, job creation, job retention, and capital investment thresholds.
effectiveness	Success in achieving mission and goals.
material condition	A reportable condition that could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
MEDC	Michigan Economic Development Corporation.
MSF	Michigan Strategic Fund.
outcome	An actual impact of a program or an entity.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

reportable condition

A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.

Salesforce

A customer relationship management (CRM) system used by MEDC to manage, monitor, track, and administer economic development programs and projects. It is the single tool used internally and externally to gather the information and necessary data to fulfill reporting needs and requirements.

