OBM | Office of Internal Audit

Development Services Agency

Tax Credits Audit

Audit Period: July 2012 through February 2013

Results Summary:

Objective	Conclusion
Awarding Process	**Well-Controlled with Improvement Needed**
Communication of Program Requirements	**Well-Controlled with Improvement Needed**
Project Monitoring Process	**Major Improvement Needed**
Issuance Process	**Improvement Needed**
Reporting Process	**Well-Controlled with Improvement Needed**

Report number: 2013-DSA-02 **Issuance date: March 21, 2013**

Executive Summary

Background

The Development Services Agency (DSA) has a variety of bonds, grants, loans and tax credits that can assist Ohio companies as they grow and create jobs in Ohio. The Ohio Tax Credit Authority (Authority) is an independent, five-member board, consisting of taxation and economic development professionals from throughout the state. With the assistance of DSA staff, the Authority reviews and approves applications for Job Retention and Job Creation tax credit (JRTC and JCTC, respectively) assistance submitted by companies proposing to retain existing full-time jobs, or create new income tax revenue in the state. Once a project is determined eligible for tax credits, the Authority determines the level of assistance contingent upon the scope of a proposed project.

DSA is responsible for administration of the tax credit programs after the projects have been approved by the Authority. Participating companies can receive refundable and non-refundable tax credits, equaling up to 75 percent of Ohio income taxes withheld from eligible employees, for a term of up to 10 to 15 years. As of December 31, 2011, 2,413 economic development projects have received approval for the JCTC assistance, securing commitments of 18,214 new jobs and retention of 23,968 existing jobs in the State. Furthermore, 31 projects have received approval for the JRTC assistance as of December 2011, which led to commitments to retain a total of 14,147 jobs within Ohio.

During the audit, OIA identified opportunities for DSA to strengthen internal controls and improve business operations. This audit conforms with the *International Standards for the Professional Practice of Internal Auditing*. A summary, along with detailed observations, have been provided.

OIA would like to thank DSA staff and management for their cooperation and time in support of this audit. This report is solely intended for the information and use of agency management and the State Audit Committee. It is not intended for anyone other than these specified parties.

Scope and Objectives

OIA staff was engaged to perform assurance work related to the JCTC and JRTC programs. This work was completed between October 2012 through March 2013. The scope of the audit did not include the application or project approval processes which are the responsibility of the private entity, JobsOhio, and the Ohio Tax Credit Authority, nor did the scope include a review of the IT applications used by DSA to maintain the tax credit projects.

The following detailed audit objectives included:

- Evaluate the design and effectiveness of controls over the awarding process.
- Evaluate the design and adequacy of communication related to program requirements to recipients.
- Evaluate the design and effectiveness of controls over the project monitoring process.
- Evaluate the design and effectiveness of controls over the issuance of the tax credit certificate.
- Evaluate the design and adequacy of the tax incentive reporting.

Due to the limited nature of our audit, we have not fully assessed the cost-benefit relationship of implementing the observations and recommendations suggested below. However, these observations reflect our continuing desire to assist your department in achieving improvements in internal controls, compliance, and operational efficiencies.

* Refer to Appendix A for classification of audit observations.

Observations and Recommendations

The Observations and Recommendations include only those risks which were deemed high or moderate. Low risk observations were discussed with individual agency management and are not part of this report. However, the low risk observations were considered as part of the audit objective conclusions.

Observation 1 - Inadequate Monitoring

Ohio Revised Code Sections 122.17(D)(7) and 122.171(E)(6) require DSA to perform annual reviews of information reported by Job Creation and Job Retention tax credit (JCTC and JRTC) companies. If the company's performance complies with the tax credit agreement, "the director issue(s) a certificate to the taxpayer stating that the information has been verified, and identifying the amount of the credit that may be claimed."

DSA does not have procedures in place to verify information submitted by JCTC and JRTC recipient companies. DSA instead relies on self-reported data submitted annually from an authorized company representative. Limited testing of documentation available revealed one instance where the annual report data did not agree to the attached supporting documentation, and another instance where a system error utilized an incorrect credit percentage to calculate the credit issuance amount. These two errors represented 20% of the testing population (10 issued tax credits), and resulted in those companies being issued $2,353 in unearned tax credits. Additionally, one company in the post-reporting phase did not submit a 2011 annual report nor did DSA take any action on this company. For another company, remedial action was

recorded in the system for only the first year enacted, though the change was to impact all remaining years. Insufficient monitoring of a company's self-reported annual reports can lead to errors or improper allowance of tax credits. Furthermore, failure to follow-up on non-reporting companies in the post-reporting phase should result in review for remedial or clawback action.
Recommendation
Establish monitoring procedures to validate the accuracy of information reported by recipient companies, ensure post-reporting companies fulfill reporting requirements, and emphasize the importance of updating systems when issues arise. Consider enlisting assistance from the Department's external audit function or selecting a sample of recipients to submit additional documentation each year to support items reported. Consider other agencies' with company information to corroborate annual data reported. Investigate and ensure the cause of the system error did not transfer to the new Salesforce system; additionally, take measures to ensure the current year credits issued for the two companies noted are reduced for the amount incorrectly issued during 2012, and appropriate action is taken on the non-reporting company.
Management Response
To increase accuracy and reduce data errors associated with the issuance of tax credit certificates, DSA is implementing Salesforce, a customer relationship management (CRM) system. With the almost real-time integration between JobsOhio and DSA, there will be additional confirmation of relevant project and program data from the deal offering to the deal servicing stages. DSA will continue to evaluate controls to ensure the accuracy of the certificate before it is ready to be released to the company. Additionally, the Reporting and Quality Assurance Section will establish processes for conducting desk/field audits, and/or reviewing company data to ensure companies are in compliance during the award and post-reporting phase. DSA will adjust the identified companies' 2012 tax credit certificates for the difference over-issued on the 2011 certificates, as well as, review the non-reporting to determine the appropriate action necessary.

Risk	Remediation Owner	Estimated Completion Date
High	Assistant Deputy Chief, Office of Strategic Business Investments	September 2013

Observation 2 – Inadequate Communication with Department of Taxation

In accordance with the Ohio Revised Code Sections 122.17(D)(7) and 122.171(E)(6), DSA issues tax credit certificates to approved taxpayers who have met the requirements set forth in the JCTC and JRTC tax credit agreements.

DSA's Office of Strategic Business Incentives issues JCTC and JRTC tax credit certificates to eligible recipients. The Department of Taxation (TAX) accepts and processes these certificates with the taxpayer's return, yet DSA does not notify TAX of the issued certificate. For reissued tax credit certificates, the information received from TAX is inadequate for DSA to assess if the certificate was previously redeemed, in part or in whole. Also, unique numbers are not assigned to each certificate.

Inadequate communication increases the risk that ineligible taxpayers may receive tax credits or credits may be for inaccurate amounts. Without unique certificate numbers, the risk of a certificate being claimed more than once increases.

Recommendation

Coordinate with TAX to develop an acceptable communication process where necessary information is shared to issue, process, and re-issue tax credits. Consider copying TAX on the email DSA sends to recipient companies, with the electronic copy of the tax credit certificate attached. Implement procedures to assign unique numbers to each tax credit certificate issued. Ideally, this could be automatically generated by the Salesforce system to prevent duplication of certificate numbers. If certificates are reissued or amended, ensure the updated certificate retains the original certificate number.

Management Response

DSA will schedule a meeting with the Department of Taxation's business and legal units to ensure proper procedures are in place and adequate information is being shared. Additionally, DSA currently holds bi-weekly conference calls with Taxation to discuss issues relating to tax incentive programs. As part of the ongoing conversation, DSA will add issued certifications to the agenda and provide a monthly update on all of the issued certifications, including entity name, FEIN, amount issued, date issued, tax credit year, and tax certificate number. With the implementation of Salesforce, unique identifiers will be assigned to new tax credit certificates.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Assistant Deputy Chief, Office of Strategic Business	June 2013

Appendix A – Classification of Conclusions and Observations

Classification of Audit Objective Conclusions

Conclusion	Description of Factors
Well-Controlled	The processes are appropriately designed and/or are operating effectively to manage risks. Control issues may exist, but are minor.
Well-Controlled with Improvement Needed	The processes have design or operating effectiveness deficiencies but do not compromise achievement of important control objectives.
Improvement Needed	Weaknesses are present that compromise achievement of one or more control objectives but do not prevent the process from achieving its overall purpose. While important weaknesses exist, their impact is not widespread.
Major Improvement Needed	Weaknesses are present that could potentially compromise achievement of its overall purpose. The impact of weaknesses on management of risks is widespread due to the number or nature of the weaknesses.

Classification of Audit Observations

Rating	Description of Factors	Reporting Level
Low	Observation poses relatively minor exposure to an agency under review. Represents a process improvement opportunity.	Agency Management; State Audit Committee (Not reported)
Moderate	Observation has moderate impact to the agency. Exposure may be significant to unit within an agency, but not to the agency as a whole. Compensating controls may exist but are not operating as designed. Requires near-term agency attention.	Agency Management and State Audit Committee
High	Observation has broad (state or agency wide) impact and possible or existing material exposure requiring immediate agency attention and remediation.	Agency Management and State Audit Committee