# Report Highlights

**Department of Economic Development**
**Business Tax Incentives**

**May 2002**

Louisiana
department of economic development

Louisiana Legislative Auditor

This audit focused on the business tax incentive programs administered by the Business Incentives Division (BID) of the Department of Economic Development (DED). We concentrated our work on the two largest programs, the Industrial Property Tax Exemption Program and the Enterprise Zone Program. The Industrial Property Tax Exemption Program exempts new and expanding manufacturing plants from local property taxes, while the Enterprise Zone Program provides state corporate income and franchise tax credits and state and local sales tax rebates for businesses that create jobs in enterprise zones. We also reviewed factors that affect economic development.

## Audit Results

- Based on BID's estimates, approximately $2.2 billion of tax relief was provided to businesses during the audit period covering fiscal years 1997 through 2001 through the various incentive programs BID administers. BID does not determine the actual cost and benefits of the incentive programs. Therefore, the state has no way of knowing if it receives adequate returns for the incentives it awards.
- Only 6% of the Industrial Property Tax Exemption contracts active during the audit period were awarded to new manufacturing businesses and only 32% were awarded for plant additions, although the program was created to induce manufacturing establishments to locate or expand in Louisiana.
- BID did not administer the Industrial Property Tax Exemption and Enterprise Zone contracts we reviewed in accordance with all program requirements. In addition, critical management controls, which would help prevent abuse of the programs, are not in effect for either program.
- The State Board of Commerce and Industry does not always consider all required elements when approving applications for industrial property tax exemptions.
- The constitutional provisions governing the Industrial Property Tax Exemption Program contain overly broad terms related to program requirements, which have resulted in questionable awards of exemptions to businesses. The statutes and rules governing the Enterprise Zone Program contain outdated and unnecessary language.
- Recent research places Louisiana among the bottom states in terms of economic development. Site location consultants rank public education and skilled workforce as the most important factors businesses consider when deciding where to locate or expand. Louisiana ranks low in these factors. This point is important because the largest tax incentive program BID administers exempts businesses from paying property taxes, which help fund the public education system, which, in turn, affects the quality of the state's workforce.

Daniel G. Kyle, Ph.D., CPA, CFE

Legislative Auditor

## Were tax incentive contracts awarded and administered in conformity with the state constitution, state laws, and established rules?

### What We Found

### Industrial Property Tax Exemption Program

- The contracts we reviewed were not awarded and administered in conformity with all program requirements.

- The three requirements businesses must meet to qualify for property tax exemptions are broadly defined in the constitution. No additional statutory guidance exists, and the program rules provide little clarification. This situation has led to some questionable awards of incentives.

- Seven percent (7%) of the businesses that received exemptions in fiscal years 1997 through 2001 were not manufacturers according to the businesses' Standard Industrial Classification codes.

- Fifty-nine percent (59%) of the exemption contracts awarded during fiscal years 1997 through 2001 were for miscellaneous capital additions, a category of addition not found in state law.

- The State Board of Commerce and Industry does not conduct formal "best interest of the state" analyses, nor does it consider all three program requirements, when deciding whether to approve applications for exemptions.


- DED does not request local input on decisions to grant exemptions, even though the exemptions impact local property tax revenues.

- The State Board of Commerce and Industry does not receive all information necessary to make informed decisions on whether to approve Industrial Property Tax Exemption applications.

- Renewal of exemption contracts is often automatic.

### Enterprise Zone Program

- The contracts we reviewed were not awarded and administered in conformity with all program requirements.

- BID uses outdated census data for administering and monitoring the program.

- Businesses are not required to retain equipment for which they receive sales tax rebates; thus they could buy the equipment, obtain the rebates, then transfer the equipment to businesses that are not eligible for the rebates.

- Some program rules are outdated and unnecessary.

### Both Programs

- BID does not enforce deadlines established in the program rules. During the audit period, BID allowed businesses to disregard numerous mandated deadlines without penalty.

- BID does not require businesses to submit critical information that would help ensure their eligibility.

- BID does not verify other information submitted by businesses to ensure that they are truly eligible for the tax incentives.

- BID does not enforce rules regarding name changes and transfers of ownership.

- The legislature has little involvement in the awarding of incentive contracts.

- Program rules and statutes contain references to a rule that has been declared unconstitutional.

- BID does not conduct inspections with sufficient frequency and thoroughness.

- BID has not documented its database of business tax incentives, and data entered in some fields are not reliable.

## Recommendations

- ✓ DED and the State Board of Commerce and Industry should adopt rules to provide for clear, specific definitions of the terms "manufacturing establishment" and "addition" and develop criteria to consider when determining whether applications for industrial property tax exemptions are in the best interest of the state.
- ✓ BID should analyze whether each Industrial Property Tax Exemption application is in the best interest of the state and include the analyses, along with the Breakdown of Purchases forms, in the information packets it sends to the State Board of Commerce and Industry members.
- ✓ The State Board of Commerce and Industry should consider all three required elements for each Industrial Property Tax Exemption application.
- ✓ BID and the State Board of Commerce and Industry should encourage more local government input on applications for Industrial Property Tax Exemptions.
- ✓ Either BID should enforce established deadlines for the Industrial Property Tax Exemption and Enterprise Zone Programs or the State Board of Commerce and Industry should amend the rules to reflect the alternative deadlines currently used by BID.
- ✓ BID should require businesses participating in the Industrial Property Tax Exemption and Enterprise Zone Programs to submit all necessary eligibility information.
- ✓ BID should verify all critical eligibility information it receives from businesses participating in the Industrial Property Tax Exemption and Enterprise Zone Programs.
- ✓ DED should ensure that BID has sufficient resources to conduct all required inspections and change the focus of the Enterprise Zone inspections to employment records.

- ✓ BID should repeal all unnecessary and outdated program rules and enforce the ones that remain.
- ✓ BID should implement necessary database controls.

## Matters for Legislative Consideration

The legislature may wish to:

- ✓ Either pursue an amendment to the constitution or enact supplemental legislation to clarify the intent and meaning of key terms for the Industrial Property Tax Exemption Program and to require the State Board of Commerce and Industry to request local government input on exemption applications
- ✓ Strengthen BID's inspection function
- ✓ Adopt legislation requiring Enterprise Zone Program participants to retain equipment purchased under the program and provide penalties for noncompliance
- ✓ Increase its participation in the oversight of tax incentive programs
- ✓ Determine which incentive programs provide the most benefit to the state as compared to their cost

## How much state and local tax relief was provided during fiscal years 1997 through 2001 as a result of business tax incentive programs administered by the Business Incentives Division?

### What We Found

- ➲ According to BID's estimates, businesses received approximately $2.2 billion in tax relief from fiscal year 1997 through 2001.
- ➲ BID does not determine the actual cost of the three largest business tax incentive programs it administers.
- ➲ BID's estimates of the cost for some programs are broad and unreliable because they rely on numbers reported by businesses, use outdated millage rates, and do not consider depreciation.
- ➲ BID cannot obtain accurate information on the actual cost of incentive programs because the Departments of Revenue and Labor cannot share pertinent confidential information filed with those departments by businesses participating in the programs.

- BID does not conduct cost/benefit analyses for any of the tax incentive programs it administers.
- Since no cost/benefit analyses are conducted, performance indicators are not as meaningful as they could be.
- Contracts with businesses for tax incentives do not always contain clawbacks.

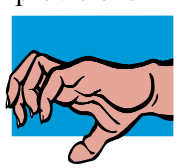
## Recommendations

✓ DED should develop means to determine the actual cost of tax relief provided to businesses through each incentive program or improve its estimates of the cost.

✓ DED or an independent entity should develop and implement procedures to compare the actual cost of each incentive program to the benefits derived from each.

✓ DED should develop and report efficiency and outcome indicators for each incentive program.

✓ DED should include "clawback" provisions in all applicable incentive contracts to provide recourse to the state if the businesses do not meet their contractual obligations.



## Matters for Legislative Consideration

The legislature may wish to consider:

✓ Allowing DED to have access to confidential records at the Departments of Revenue and Labor

✓ Giving the Department of Revenue authority to recapture tax benefits from companies that do not meet contractual clawback provisions

## What factors are most important to a state's economic well-being, and how does Louisiana compare to other states?

### What We Found

- Louisiana is among the bottom ranking states in terms of economic development.
- Business site location consultants rate education-related factors first when advising businesses where to locate or expand. Louisiana ranks near the bottom of the states in public education.
- The largest tax incentive program BID administers exempts manufacturers from paying property taxes, which help fund the public education system.
- Louisiana ranks poorly in other factors important to business site location consultants such as skilled labor, transportation infrastructure, and crime rate.
- Incentive programs rank high among the factors that site location consultants consider important.

### Recommendation

- DED should continue to move forward with a well-rounded, targeted economic development approach.

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**Questions? Call Dan Kyle at 225-339-3800.**

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# STATE OF LOUISIANA
# LEGISLATIVE AUDITOR

**Department of Economic Development**
**Business Tax Incentives**
Baton Rouge, Louisiana

May 2002

## Performance Audit

**Daniel G. Kyle, Ph.D., CPA, CFE**
**Legislative Auditor**

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# Department of Economic Development Business Tax Incentives

**May 2002**

**Performance Audit**
**Office of the Legislative Auditor**
**State of Louisiana**

**Daniel G. Kyle, Ph.D., CPA, CFE**
**Legislative Auditor**

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May 8, 2002

The Honorable John J. Hainkel, Jr.,
President of the Senate
The Honorable Charles W. DeWitt, Jr.,
Speaker of the House of Representatives

Dear Senator Hainkel and Representative DeWitt:

This report gives the results of our performance audit of the Department of Economic Development - Business Tax Incentives. The audit was conducted under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended.

The report contains our findings, conclusions, and recommendations. We have also identified 14 matters for legislative consideration. Appendix C contains the department's response to the audit. Appendix D contains comments on the State Board of Commerce and Industry's response to the audit. I hope that this report will benefit you in your legislative decision-making process.

Sincerely,

Daniel G. Kyle, CPA, CFE
Legislative Auditor

DGK/dl

[DED02]

# Office of Legislative Auditor

**Performance Audit**
**Department of Economic Development**
**Business Tax Incentives**
**Executive Summary**

This audit focused on the business tax incentives administered by the Business Incentives Division (BID) of the Department of Economic Development. We concentrated our work on the two largest incentive programs BID administers--the Industrial Property Tax Exemption Program and the Enterprise Zone Program. The audit also reviewed economic development factors for Louisiana as compared to other states. The results of the audit are as follows:

- Based on BID's estimates, approximately $2.2 billion of tax relief was provided to businesses during fiscal years 1997 through 2001 through the various incentive programs BID administers. However:
  - BID does not determine the actual cost and benefits of the incentive programs. Therefore, the state has no way of knowing if it receives adequate returns for the incentives it awards. The lack of coordination and sharing of data among various state departments and local governmental entities is a primary cause of this problem. *(See pages 60 through 67 of the report.)*
  - Because data on the impact of each incentive program is not collected and analyzed, the performance indicators reported for the programs do not communicate the cost effectiveness of each program. *(See pages 68 through 69 of the report.)*
  - The Industrial Property Tax Exemption and Enterprise Zone contracts we reviewed were not administered in accordance with all program requirements. In addition, critical management controls, which would help prevent abuse of the programs, are not in effect for either program. The lack of controls includes BID's failure to enforce deadlines, collect critical eligibility information, verify other eligibility information, and inspect businesses that receive incentives. *(See pages 34 through 40 and 41 through 49 of the report.)*
  - Only 6% of the Industrial Property Tax Exemption contracts active during the audit period were awarded to new manufacturing businesses, and only 32% were awarded for plant additions, although the program was created to induce manufacturing establishments to locate or expand in Louisiana. *(See page 27 of the report.)*
  - The State Board of Commerce and Industry does not always consider all required elements when approving applications for Industrial Property Tax Exemptions. *(See pages 32 through 33 of the report.)*
- The constitutional provisions governing the Industrial Property Tax Exemption Program contain overly broad terms related to program requirements. This lack of clarity has resulted in questionable awards of exemptions to businesses. In addition, the statutes and rules governing the Enterprise Zone Program contain outdated and unnecessary language. *(See pages 21 through 32 and 49 through 50 of the report.)*
- According to recent research, Louisiana ranks among the bottom states in terms of economic development. The major factors contributing to these rankings relate to technology, research and development, education, working poor, and employer health coverage. Louisiana is also rated low in the two factors site location consultants consider most important in determining where businesses should locate or expand--skilled labor and the public education system. This point is important because the largest tax incentive program BID administers exempts businesses from paying property taxes, which help fund the public education system, which, in turn, affects the quality of the state's workforce. *(See pages 71 through 83 of the report.)*

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*Phone No. (225) 339-3800*

# Introduction

## Audit Initiation and Objectives

Louisiana Revised Statute 24:522 requires, in part, that the legislative auditor establish a schedule of performance audits to ensure that at least one performance audit is completed for each executive branch department within a seven-year period beginning with the 1998 fiscal year. In accordance with this requirement, the Office of Legislative Auditor developed a plan, which has been updated periodically as needed, that scheduled an audit in the Department of Economic Development to begin in 2001. This plan was approved by the Legislative Audit Advisory Council in August 1999.

In this audit, we focused on the tax incentives administered by the Business Incentives Division, which is located in the Resource Services Section of the Office of Business Development in the Department of Economic Development. We concentrated our work in the Business Incentives Division on the Industrial Property Tax Exemption Program and the Enterprise Zone Program. We also reviewed economic development factors for Louisiana and other states. The scope and methodology for this audit are described in Appendix A. The audit objectives were to determine the following:

1. **Were tax incentive contracts awarded and administered in conformity with the state constitution, state laws, and established rules?**

2. **How much state and local tax relief was provided during fiscal years 1997 through 2001 as a result of business tax incentives administered by the Business Incentives Division?**

3. **What factors are most important to a state's economic well-being, and how does Louisiana compare to other states?**

## Agency Overview

## Purpose and Statutory Authority

The Department of Economic Development (DED) was created to foster the growth of industry and other commercial enterprises in Louisiana that will contribute to the overall improvement of the economy of the state. To accomplish this purpose, the department is to promote the advantages of Louisiana to out-of-state businesses and industries, facilitate the expansion of new and existing enterprises, and coordinate with other state agencies and units of local government. The DED is composed of three offices, including the Office of Business Development. The Office of Business Development is responsible for attracting new industrial and business investments to Louisiana by conducting activities such as providing financial inducements for new investments.

Various statutes describe the business inducements overseen by the Office of Business Development. These inducements include business tax incentives such as exemptions, credits, rebates, and abatements that the Office of Business Development administers, monitors, reviews, or promotes. The Business Incentives Division (BID) within the Office of Business Development has adopted and uses various sets of rules to administer the individual programs. BID currently administers the six active programs shown in Exhibit 1. Other business incentive programs in state law are inactive, as discussed on pages 54 through 55.

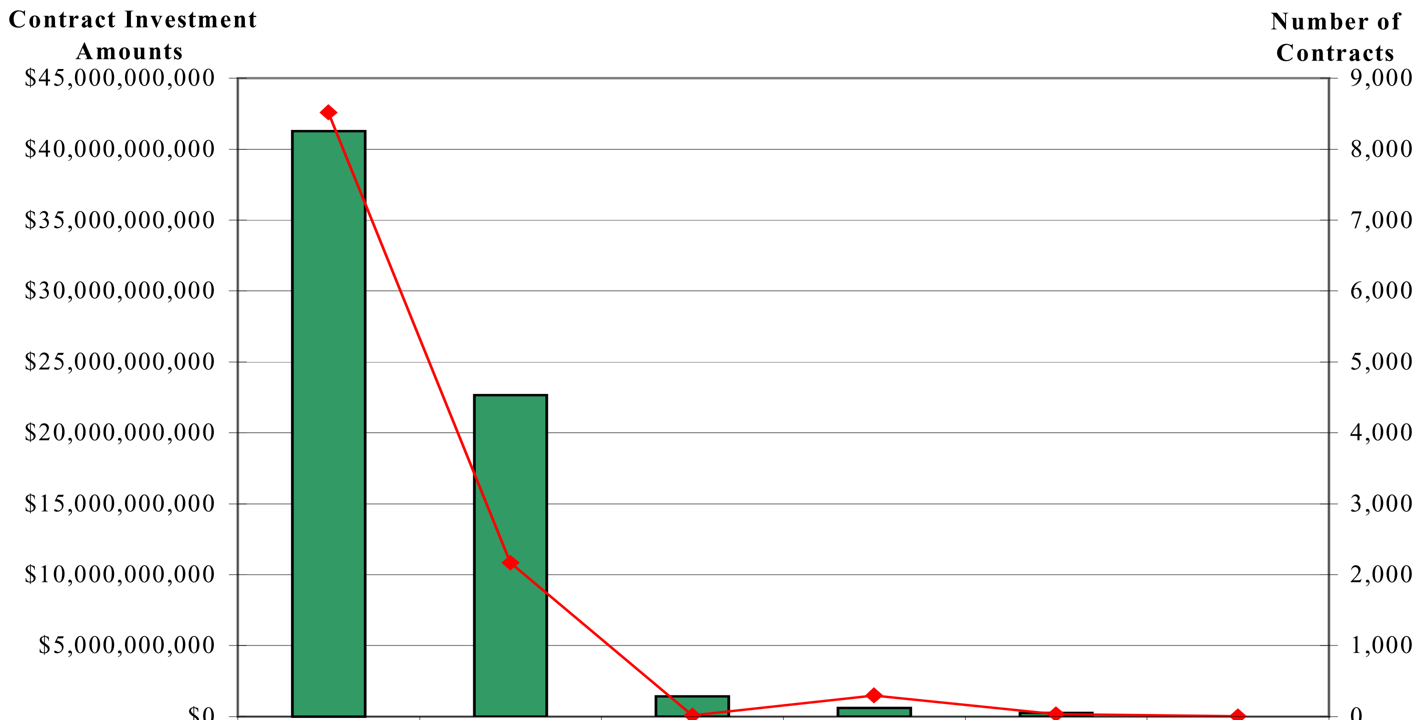
**Exhibit 1**
**Overview of Active Business Tax Incentive Programs**
**Administered by BID**

| Name of Incentive Program | Constitutional and Statutory Citation(s) | Year of Creation | Description |
|---|---|---|---|
| Industrial Property Tax Exemption | Article 7, §21(F) Louisiana Constitution | 1936 | Exempts new and expanding manufacturing plants from local property taxes. |
| Enterprise Zone | R.S. 51:1781-1791 | 1981 | Provides state corporate income and franchise tax credits and state and local sales tax rebates for businesses that create jobs in enterprise zones. |
| Tax Equalization | R.S. 47:3201-3205 | 1966 | Uses various state tax credits, exemptions, and rebates to equalize the total taxes a Louisiana company would pay if the company was located in a competing state that has a lower tax burden. |
| Restoration Tax Abatement | Article 7, §21(H) Louisiana Constitution; R.S. 47:4311-4319 | 1983 | Excludes renovations of existing structures located in downtown, historic, or economic development districts from local property taxation. |
| Quality Jobs | R.S. 51:2451-2461 | 1997 | Provides industries with refundable state corporate income and franchise tax credits if they comply with the program's quality job creation and payroll requirements. |
| Industry Assistance | R.S. 47:4301-4306 | 1982 | Provides various state tax credits, exemptions, and rebates to ailing manufacturing companies located in Louisiana. |

**Source**: Prepared by legislative auditor's staff using information obtained from BID, the 1974 Louisiana Constitution, and the Louisiana Revised Statutes.

As previously stated, we focused our work on the Industrial Property Tax Exemption and Enterprise Zone Programs. As can be seen in Exhibit 2 on the following page, these two programs comprise the vast majority of contract investment amounts and active incentive contracts administered by BID during the audit period. The contract investment amounts represent the dollars invested by businesses in Louisiana for which tax incentives were granted. A portion of these businesses' state and local taxes will not be collected because of the incentives granted.

**Exhibit 2**
**Contract Investment Amounts and Number of Active Incentive Contracts**
**Fiscal Years 1997 Through 2001**




| Incentive Programs | Industrial Property Tax Exemption | Enterprise Zone | Tax Equalization | Restoration Tax Abatement | Quality Jobs | Industry Assistance * |
|---|---|---|---|---|---|---|
| Investment Amounts | $41,276,114,840 | $22,651,917,256 | $1,396,757,000 | $628,047,516 | $252,669,312 | $0 |
| Number of Contracts | 8,518 | 2,170 | 14 | 299 | 36 | 3 |

* The Industry Assistance Program has no contract investment amount because this program grants tax relief to ailing businesses that are already in existence, thus there is no new investment.

**Source**: Prepared by legislative auditor's staff using information obtained from BID's database.

## Organization, Staffing, and Funding of Business Incentives Division (BID)

In September 2001, DED underwent reorganization. The Office of Commerce and Industry was eliminated, and the Office of Business Development was created. At the same time, BID was reorganized. For the three fiscal years before the reorganization (1999-2001), BID's staff consisted of a director, a supervisor, six economic development specialists, and three clerical positions, a total of 11 positions. BID's staff now consists of nine positions: seven economic development specialists and two administrative services assistants/secretaries. See Appendix B for BID's organizational chart.

According to DED's 2001-2002 budget request, BID is fully funded through fees and self-generated revenues. R.S. 51:936.2(A) authorizes the secretary of DED to collect certain fees from persons and businesses that apply for the tax incentives that the department administers. According to the budget request, BID's average annual expenditures were $767,000 for fiscal years 1999 through 2001. For fiscal year 2002, BID requested $884,000. Although BID's expenditures average $767,000 per year, BID is responsible for administering tax incentives amounting to a much greater figure. According to BID's estimates, it administered tax incentives resulting in approximately $2.2 billion in tax relief provided to businesses during fiscal years 1997 through 2001. Because of the magnitude of this fiscal impact, we focused our audit on BID's administration of the major tax incentive programs rather than on the amount BID spends to operate.

## Overview of BID's Administration of Business Tax Incentive Programs

BID performs several functions designed to develop Louisiana's economy. BID's staff works with businesses throughout the state that are interested in tax incentives and guides them through the application process. According to DED's 2000 Annual Report, BID is also responsible for administering and auditing business tax incentives that are approved or rejected by the State Board of Commerce and Industry (SBCI). The types of tax incentives administered by BID include exemptions, credits, rebates, refunds, and abatements. The definition for each of these terms is as follows:

- **Incentive:** An economic development program that assists businesses without providing direct financial assistance

- **Exemption:** An incentive that provides freedom from payment of certain taxes

- **Credit:** An incentive that provides a reduction in taxes to reward businesses for certain behaviors

- **Rebate:** An incentive that discounts or reduces the price of a product or interest, and that is not given in advance but is handed back later because of prompt payment or other reason

- **Refund:** An incentive whereby taxes that have been paid are returned to the taxpayer

- **Abatement:** An incentive that reduces or decreases the assessed valuation of ad valorem taxes, which include real and personal property taxes, to foster investment in certain industries or in certain activities

Businesses may apply for more than one type of tax incentive. For most of the six active tax incentive programs that BID administers, the process works as follows. If a business wants to apply for an incentive, it must initiate the process by sending an Advance Notification form and a fee to BID before work on the project for which an incentive is requested begins. BID logs this information on its database. BID then sends the business a packet of information, which includes an application. BID assists the business with any questions or concerns and helps the business determine which incentives it qualifies for and which incentives are best for it. The business then submits the application and a corresponding fee, and BID's staff updates the database. BID ensures that all paperwork is in order and prepares a brief analysis of the estimated impact of the incentive.

The SBCI must approve or deny each application. The SBCI relies on information provided by BID to make its determinations on whether to approve applications. The SBCI consists of 20 members, 15 of whom are appointed by the governor from among representatives of the major economic groups within Louisiana. The other five members are the governor or his/her designee; the lieutenant governor or his/her designee; the secretary of DED or his/her designee; an elected municipal official; and an elected police juror, councilman, commissioner, or parish president. Every other month, BID's staff presents all applications it has received at the SBCI's public Screening Committee meeting. The Screening Committee may either defer an application to the board with no recommendation or send it to the board with a recommendation of approval or denial. BID then compiles the results of the Screening Committee meeting onto an agenda and provides the agenda to all board members for its meeting the following month. The agenda shows all applications deferred and all applications recommended for approval or denial by the Screening Committee. The board then conducts a public hearing to discuss and recommend approval or denial of the applications.[1]

State law requires the SBCI to forward its recommendations to the governor for all incentives and also to the Joint Legislative Committee on the Budget for certain incentives. If these officials approve the applications, the companies enter into individual

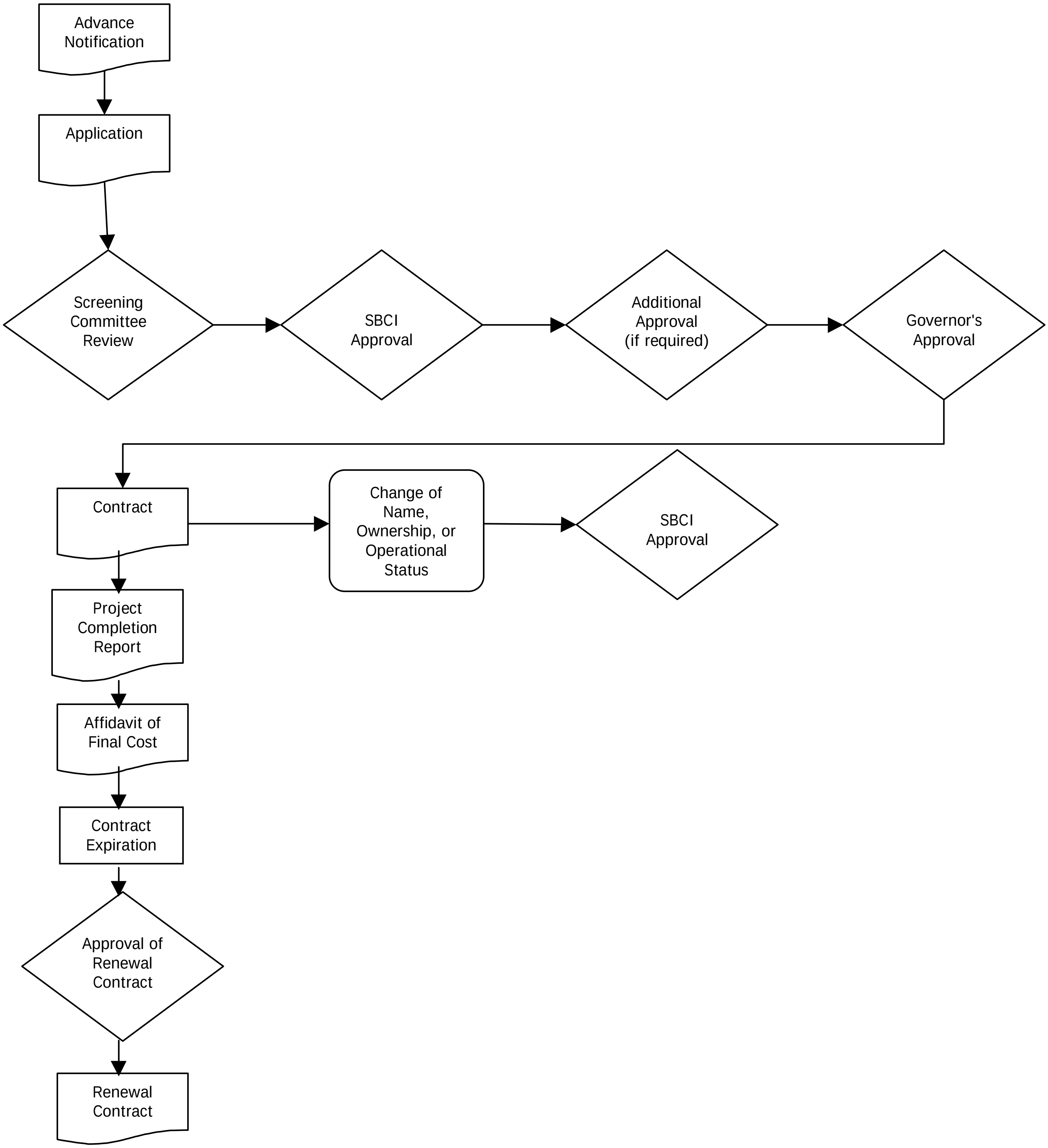
[1] In February 2002, the SBCI decided to do away with the Screening Committee and conduct board meetings monthly instead of holding Screening Committee meetings one month and board meetings the following month.

contracts with DED. State law requires the SBCI and the governor to approve the contracts. If the companies maintain their contractual requirements, they remain eligible for the tax incentives until their contracts expire. During the contract terms, BID corresponds with the businesses and maintains a file of documentation related to each incentive that each business received. Any change in a business's name, any transfer of ownership, or any change in operational status during the contract term must be approved by the SBCI. In most cases, when the projects are completed or business operations have begun, whichever occurs last, the businesses are required to submit a Project Completion Report and an Affidavit of Final Cost to BID. State law requires an inspection fee to be submitted with the Affidavit of Final Cost.

Most of the major tax incentive contracts are for five years. The legal provisions governing some of the programs allow for an additional five years, if approved. The laws vary by incentive as to who must approve contract renewals. Businesses must pay a renewal fee when they apply for contract renewals.

A flowchart of the general administrative process for obtaining business tax incentive contracts is shown in Exhibit 3 on the following page.

## Exhibit 3
## Administrative Process for Obtaining Business Tax Incentives




**Source:** Prepared by legislative auditor's staff using information obtained from BID.

## Issues for Further Study

This section contains important issues that we identified during this audit but that were not within the scope of the audit. Future audits or studies should be conducted to address these concerns.

**1. Assessment Procedures Regarding Industrial Property Tax Exemptions and Property Valuation**

The Industrial Property Tax Exemption Program affects local property taxes. Property taxes help fund the public education system. Public education is the factor that site location consultants consider most important when helping businesses decide where to locate or expand. For this reason, we suggest that future study and review should be done in this area. We have three primary concerns related to assessment procedures for Industrial Property Tax Exemptions and subsequent property valuation.

First, the Industrial Property Tax Exemption contracts, which are supposed to be for new plants and additions, should not affect the value of existing property already subject to taxation. However, some assessments may include a reduction of the value of existing property already subject to taxation. If this occurs, businesses may receive tax relief for a different amount than intended.

Our second concern deals with the values placed on the tax rolls after industrial property tax exemption contracts expire. The assessors we spoke with told us that they use figures supplied by the businesses and that they do not verify those figures. If the businesses report figures that are lower than the actual values, parishes will receive less property tax revenue than is due from the businesses.

Our third concern is that although the maximum life of each industrial property tax exemption contract should be 10 years, some businesses may not pay property taxes for at least 11 years because R.S. 47:1952 requires assessments to be made on the basis of the condition of things existing on the first day of January of each year. If a business reports that it completed construction and began operations after January 1, it will not have to pay property taxes on the building for that particular year. The Industrial Property Tax Exemption will begin after that year is over. In our review of 30 files, at least three businesses appeared to have escaped taxation for longer than the maximum of 10 years allowed under the program.

**2. Department of Revenue's Administration of Business Tax Incentives**

As a part of this audit, we planned to review the Department of Revenue's records to determine what occurs once incentives involving state taxes have been awarded to applicants. However, department officials said that they were not certain they had the authority to provide us with the information because the Department of

Revenue was not the primary focus of the audit. They said that they believed providing us with access to the records may violate the department's statutory duty to maintain the confidentiality of taxpayer records found in R.S. 47:1508. We informed the department that R.S. 24:513 allows the legislative auditor's staff access to all records of all state departments. The department then requested an opinion from the attorney general on this matter. The attorney general recently issued the opinion, and it confirms that we do have access to the records. Although the department expressed its willingness to provide us with the requested information after the attorney general opinion was issued, we decided not to pursue the issue so that we could issue the audit report in a timely manner. However, we still feel that it is very important to determine whether state tax incentives are being properly applied and administered by the Department of Revenue.

Furthermore, Rule 931 for the Enterprise Zone Program requires businesses that violate rules or statutes governing the program to remit any rebates or credits received through the program. Further work should be conducted to determine if the Department of Revenue has policies and procedures in place by which these rebates and credits are recouped. Also, further work should be conducted concerning the department's tracking of the tax credits businesses receive under the Enterprise Zone Program.

### 3. Centralized Database for Business-Related Tax Incentives

During our preliminary audit work, we found hundreds of statutes that provide for various types of business-related tax incentives. Some of these incentives may be outdated or may not meet their intended purpose. The legislature may wish to consider directing the Division of Administration or some other entity to review these provisions and create and maintain a centralized database of all business tax incentives. The database could be used to store the actual amounts of tax relief provided through each incentive, as well as the benefits derived from each. The legislature could then review this information and determine which incentives to keep, modify, or abolish based on the direction Louisiana is heading in terms business development. The database would also provide valuable information for reports and studies.

## Were tax incentive contracts awarded and administered in conformity with the state constitution, state laws, and established rules?

The Industrial Property Tax Exemption contracts we reviewed were not awarded and administered in conformity with all program requirements. We could not determine whether the contracts were administered in conformity with the constitutional provisions that govern the program. However, we did determine that the contracts were not administered in conformity with all established rules. The constitution contains overly broad terms related to program requirements, and no statutes that would provide clarity on the meaning of the terms in the constitution exist.

The Enterprise Zone contracts we reviewed were also not administered in accordance with all governing statutes and rules. The constitution contains no provisions related to the Enterprise Zone Program.

Both the Industrial Property Tax Exemption and the Enterprise Zone Programs lack critical management controls. This lack of controls coupled with the absence of clear definitions for important program requirements creates a significant risk that fraud and/or abuse of the programs could occur undetected. These deficiencies should be addressed to provide accountability for the billions of dollars in tax relief that are provided through these programs.

**Recommendation 1:** If the constitution is not amended and laws are not passed to clarify the broad terms in the constitutional provisions governing the Industrial Property Tax Exemption Program (as suggested in Matters for Legislative Consideration 1 and 2 on pages 18 through 19), the SBCI and the DED should adopt rules to provide the following:

- A clear, specific definition of manufacturing/manufacturer
- Definition of addition and guidelines on the types of items that are acceptable as plant additions, as well as a specific determination on whether items currently accepted as miscellaneous capital additions fit the intended definition of plant additions
- Criteria or guidelines for elements that should be considered when determining whether applications for tax exemptions are in the best interest of the state. The criteria or guidelines may include some or all of the following:

- Cost and resulting benefit to the state
- Businesses' environmental records
- Effects the businesses have or will have on other businesses in the area
- Jobs created and jobs retained by the businesses
- Whether the businesses offer health insurance plans to their employees
- Record of the businesses' Occupational Safety and Health Administration (OSHA) violations
- Local government input
- Determination of whether the businesses would locate or expand in Louisiana regardless of the exemptions

(*See pages 21 through 32.)*

**Summary of Department of Economic Development Response:**
**The department partially agrees with the recommendation.** The department will work with the SBCI's Rules Committee to define companies that meet the stated definition of a manufacturer, develop rules governing assets that will be considered additions (which will be applicable to both plant additions and miscellaneous capital additions), and develop criteria that may be used to determine whether applications for tax exemptions are in the best interest of the state. *(See Appendix C for full text of the department's response.)*

**Recommendation 2:** BID staff should review each Industrial Property Tax Exemption application closely for items that appear to be replacement equipment. BID should investigate all cases where it appears that businesses are claiming exemptions for replacing old equipment with new equipment. If BID finds that businesses have included replacement equipment in their applications, BID should require the businesses to amend their applications by subtracting the value of the obsolete equipment from the cost of the new equipment. BID should also adopt a rule that formalizes this process. (*See pages 28 through 29.*)

**Summary of Department of Economic Development Response:**
**The department agrees with the recommendation.** A rule will be developed with the approval of the SBCI to implement a review system that will determine items that appear to be replacement equipment. The new procedure will include a follow-up with the applicant on questionable items and a reduction of the

application amounts if items are determined to be replacement items. *(See Appendix C for full text of the department's response.)*

**Recommendation 3:** BID should use the criteria suggested in Recommendation 1 to analyze whether each Industrial Property Tax Exemption contract is in the best interest of the state. BID should include its analyses in the information packets it sends to the SBCI members. (*See pages 29 through 32.*)

**Summary of Department of Economic Development Response:** **The department agrees with the recommendation**. In conjunction with the SBCI, BID will develop a system to perform best interest of the state analyses and will include those analyses in the packets it delivers to the board members. *(See Appendix C for full text of the department's response.)*

**Recommendation 4:** The SBCI should adopt a rule requiring it to consider all three elements for each Industrial Property Tax Exemption application, as follows:

- Whether the business is truly a manufacturer
- Whether expenditures for which exemptions are requested are truly additions to plants
- Whether granting the exemptions would be in the best interest of the state

(*See pages 32 through 33.*)

**Summary of Department of Economic Development Response:** **The department agrees with the recommendation**. BID will develop rules for the SBCI to ratify for determining whether applicants meet all three criteria. *(See Appendix C for full text of the department's response.)*

**Recommendation 5:** BID and the SBCI should encourage more local government input regarding applications for Industrial Property Tax Exemptions. Some options are to post notices of SBCI meetings and agendas on DED's Web site, mail announcements of SBCI meetings and copies of meeting agendas to local officials, and/or request letters of no objection from local officials for all applications in their parishes. (*See page 33.)*

**Summary of Department of Economic Development Response:** **The department agrees with the recommendation**. BID staff and the SBCI will encourage more local government input by implementing all three options presented in the recommendation. *(See Appendix C for full text of the department's response.)*

**Recommendation 6:** BID should either enforce the rules on filing deadlines for the Industrial Property Tax Exemption Program or the SBCI should amend the rules to reflect the alternative deadlines currently used by BID. (*See pages 34 through 35.)*

**Summary of Department of Economic Development Response:**
**The department agrees with the recommendation.** BID will notify the SBCI of all missed deadlines and include them as an agenda item at the board's meetings. *(See Appendix C for full text of the department's response.)*

**Recommendation 7:** BID should implement a control over the legitimacy of expenses submitted by businesses for Industrial Property Tax Exemptions. Some options may be for BID to require businesses to submit supporting invoices with their applications, require businesses to have supporting invoices on hand and then conduct random audits of the invoices, or coordinate with local tax assessors and have the assessors' staffs confirm whether the expenses are legitimate. (*See page 36.)*

**Summary of Department of Economic Development Response:**
**The department agrees with the recommendation.** BID staff, with the SBCI, will work to implement adequate controls to verify and support the actual costs of assets for which exemptions are requested. *(See Appendix C for full text of the department's response.)*

**Recommendation 8:** BID should include the Breakdown of Purchases form for each Industrial Property Tax Exemption application in the SBCI members' information packets that the board members receive before each meeting. The SBCI should use the information on the forms to help determine whether to award exemption contracts. (*See pages 36 through 37.*)

**Summary of Department of Economic Development Response:**
**The department agrees with the recommendation**. The BID staff will include copies of the Breakdown of Purchases forms with the copies of the applications that are delivered to each SBCI member before the board meetings. BID will also encourage the board members to use the information. *(See Appendix C for full text of the department's response.)*

**Recommendation 9:** BID should adopt formal procedures for scheduling and documenting Industrial Property Tax Exemption Program inspections and should report the results of the inspections to the SBCI. BID should use a risk-based approach to prepare the inspection schedule. BID should also include local tax assessors when it conducts inspections. (*See pages 37 through 40.)*

**Summary of Department of Economic Development Response:**
**The department agrees with the recommendation**. BID will adopt formal procedures for scheduling and documenting inspections to allow for their completion in a timely and orderly manner. BID will also report inspection results to the SBCI, extend an invitation to the local assessors to attend the inspections, and regularly update the database to reflect the completion of inspections. *(See Appendix C for full text of the department's response.)*

**Recommendation 10:** DED should review how the filing fees submitted by businesses applying for and participating in the Industrial Property Tax Exemption Program and the other tax incentive programs BID administers are used. If DED finds that the fees are not used to cover BID operations, DED should determine if the department could reallocate resources to strengthen BID's inspection function. If DED finds that all fees are used for BID operations, DED should request additional funding in its Budget Request to strengthen BID's inspection function. This cost could be at least partially funded by increasing the filing fees businesses pay to BID. (*See pages 37 through 40.*)

> **Summary of Department of Economic Development Response:**
> **The department agrees with the recommendation.** DED will review the fees currently assessed and the expenses incurred in administering the programs. The results will be shared with the SBCI, and appropriate action will be taken to provide the necessary resources to administer the tax incentive programs in an efficient and effective manner. *(See Appendix C for full text of the department's response.)*

**Recommendation 11:** The SBCI should consider each request for renewal of an Industrial Property Tax Exemption contract individually on its own merits and not automatically grant contract renewals. BID staff should also document in the SBCI minutes the reasons why renewals were granted or not granted. In addition, if items currently considered miscellaneous capital additions are determined to be legitimate plant additions that are eligible for exemptions, the SBCI should consider adopting a rule stating that no contract renewals will be allowed for them. (*See page 40.*)

> **Summary of Department of Economic Development Response:**
> **The department partially agrees with the recommendation**. BID staff will develop procedures for reviewing each contract that comes up for a five-year renewal to determine whether it should be recommended to the SBCI for renewal. The package delivered to the members of the SBCI will include the reasons supporting each recommendation. BID staff will also develop rules for the SBCI to consider that will limit the life of miscellaneous capital addition contracts to five years. *(See Appendix C for full text of the department's response.)*

**Recommendation 12:** BID should either enforce the current Enterprise Zone Program rules on deadlines or the SBCI should amend the rules to reflect BID's current procedures. (*See pages 42 through 44.*)

> **Summary of Department of Economic Development Response:**
> **The department agrees with the recommendation.** BID staff will notify the SBCI of applicants and participants of the Enterprise Zone Program who have missed deadlines. This information will be included as an agenda item for discussion at each SBCI meeting. *(See Appendix C for full text of the department's response.)*

**Recommendation 13:** BID should ensure that the Enterprise Zone Program employment certification forms are updated to include the following three eligibility criteria:

1. Employees' work status (either full-time or part-time)
2. Number of hours the employees work each week
3. How long the employees have been residents of Louisiana

(*See pages 44 through 45.*)

**Summary of Department of Economic Development Response:** **The department agrees with the recommendation**. BID staff will update the employment certification forms to include the length of time employees have been residents of Louisiana, each employee's work status (full-time or part-time), and the number of hours the employees work each week during the year. *(See Appendix C for full text of the department's response.)*

**Recommendation 14:** BID should independently verify the information on the annual certifications submitted by businesses with Enterprise Zone contracts to prevent businesses from claiming tax relief for unqualified or nonexistent employees. BID may be able to accomplish this by using data maintained at the Department of Labor, as discussed on page 62. (*See pages 45 through 46.)*

**Summary of Department of Economic Development Response:** **The department agrees with the recommendation.** BID staff will coordinate with the Departments of Revenue and Labor to develop a system for verification of employees for which credits are claimed. *(See Appendix C for full text of the department's response.)*

**Recommendation 15:** BID should amend Rule 951(E) of the Enterprise Zone Program to refocus the required inspections on employee records instead of buildings and equipment. BID should also adopt a risk-based approach for scheduling inspections of businesses participating in the program. BID should either reallocate current resources or request increased funding in its budget request to strengthen the inspection function. DED may need to suggest legislation to increase filing fees to cover this cost. (*See pages 46 through 49.*)

**Summary of Department of Economic Development Response:** **The department agrees with the recommendation.** BID staff will revise its inspection procedures to include more thorough reviews of companies' employee records to verify the accuracy of credits claimed. The revised procedures will include random reconciliations of information received from the Department of Labor. *(See Appendix C for full text of the department's response.)*

**Recommendation 16:** BID should work with the SBCI to determine if the following rules for the Enterprise Zone Program should be amended or repealed:

- **Rule 901(C )(3)**: This rule needs to be either amended to change "Aid to Families with Dependent Children" to "Family Independence Temporary Assistance Program" or repealed in its entirety if it is not needed.

- **Rule 939**: BID and the SBCI need to determine whether this rule dealing with multi-tenant operations should be repealed. If they decide not to repeal the rule, BID should institute procedures for determining whether each business is a multi-tenant operation. These procedures could consist of requiring multi-tenant information on the applications and then verifying what the businesses report.

- **Rule 919**: This rule regarding the due date of applications should be amended to delete the reference to "beginning of operations."

- The rules need to be updated to reflect the 1999 amendment made to R.S. 51:1787, which allows businesses located outside the boundaries of enterprise zones or economic development districts to participate in the Enterprise Zone Program.

(*See page 50.*)

**Summary of Department of Economic Development Response:**
**The department agrees with the recommendation.** BID staff will recommend to the SBCI Rules Committee amendments to Rules 901(C)(3), 939, and 919 as well as incorporation of new rules for the 1999 amendment to R.S. 51:1787. *(See Appendix C for full text of the department's response.)*

**Recommendation 17:** BID should enforce Rule 17 of the Industrial Property Tax Exemption Program and Rule 951(G) of the Enterprise Zone Program. These rules require businesses to notify BID of name changes and changes in ownership on a timely basis. BID should also institute a procedure that compares addresses of businesses participating in the programs in order to detect whether single addresses are claimed by multiple businesses. (*See page 51.*)

**Summary of Department of Economic Development Response:**
**The department agrees with the recommendation.** BID staff will enforce the rules and develop penalties for noncompliance for the SBCI to ratify. *(See Appendix C for full text of the department's response.)*

**Recommendation 18:** BID and the SBCI should review the rules in the Administrative Code for all business tax incentive programs BID administers and remove all provisions requiring compliance with Rule 1. (*See page 52.*)

**Summary of Department of Economic Development Response:**
**The department agrees with the recommendation**. BID staff will make appropriate recommendations to the Rules Committee of the SBCI to repeal all provisions of the rules that require compliance with Rule 1. *(See Appendix C for full text of the department's response.)*

**Recommendation 19:** BID should document its database to include information on systems, programs, operations, and user information. In addition, BID should work with the appropriate DED officials to establish written policies and procedures regarding the approval of changes made to the database and documentation of these changes. (*See pages 52 through 53.*)

**Summary of Department of Economic Development Response:**
**The department agrees with the recommendation.** The department plans to contract for the assistance necessary to implement the recommended changes. *(See Appendix C for full text of the department's response.)*

**Recommendation 20:** BID should develop and implement access, input, and output control procedures to ensure the integrity of its database. (*See pages 53 through 54.)*

**Summary of Department of Economic Development Response:**
**The department agrees with the recommendation**. BID staff will work with DED's Information Technology professionals and contract resources to ensure that the recommended safeguards are put into place during the redevelopment of the databases. *(See Appendix C for full text of the department's response.)*

**Matter for Legislative Consideration 1:** The legislature may wish to consider a constitutional amendment to add clarifying language to the provisions of Article 7, Section 21(F) that contain broadly defined terms related to the Industrial Property Tax Exemption Program. The constitutional amendment should accomplish the following:

- Provide a clear, specific definition of the term manufacturing/ manufacturer. This may be accomplished by specifying the Standard Industry Classification Codes that are considered acceptable.
- Provide a clear, specific definition of the term addition and clarification on whether items currently allowed as "miscellaneous capital additions" are eligible for tax exemption.
- Provide criteria for determining whether each application for exemption is in the best interest of the state. The criteria may include the following items as well as others deemed important by DED and the legislature:
    - Cost and resulting benefit to the state
    - Business's environmental record

- Effects the business have or will have on other businesses in the area
- Jobs created and jobs retained by the business
- Whether the business offers health insurance plans to its employees
- Record of the business's Occupational Safety and Health Administration (OSHA) violations
- Local government input
- Determination of whether the business would locate or expand in Louisiana regardless of the exemptions

If the legislature deems such detail not necessary, it may wish to consider adding the phrase "and in accordance with procedures and conditions provided by law" after "with the approval of the governor" in Article 7, Section 21(F) of the constitution instead. By adding this language, the legislature would have clear authority to amend the Industrial Property Tax Exemption Program by statute. (*See pages 21 through 32.*)

**Matter for Legislative Consideration 2:** If a constitutional amendment concerning the Industrial Property Tax Exemption Program does not occur, the legislature may wish to consider adopting legislation to accomplish the following:

- Define and clarify the broad language in the constitution dealing with the terms "manufacturing" and "manufacturer"
- Define and clarify the term "addition" and include criteria on the types of costs that are allowable as plant additions
- Provide criteria and guidelines specifying what should be considered when determining if applications for exemptions are in the best interest of the state (*See pages 21 through 32.*)

**Matter for Legislative Consideration 3:** The legislature may wish to consider amending the constitution or passing a statute requiring the SBCI to request input from local government officials in the parishes in which businesses apply for Industrial Property Tax Exemptions. Such input would help SBCI members decide whether to approve applications for the exemptions. (*See page 33.*)

**Matter for Legislative Consideration 4:** The legislature may wish to consider increasing funding to strengthen BID's inspection function for the tax incentive programs it administers. The legislature may wish to increase the filing fees that DED may charge program applicants under R.S. 51:936.2 (A)(4) to cover this cost. (*See pages 37 through 40 and pages 46 through 49.*)

**Matter for Legislative Consideration 5:** The legislature may wish to amend R.S. 51:1784(C) dealing with the Enterprise Zone Program to change the language requiring the use of the 1990 Census data to "the most recent U.S. census data available." (*See page 49.)*

**Matter for Legislative Consideration 6:** The legislature may wish to adopt legislation requiring businesses participating in the Enterprise Zone Program to retain equipment purchased under the program and to provide penalties for noncompliance. (*See page 49.)*

**Matter for Legislative Consideration 7:** The legislature may wish to more fully participate in the oversight of the Industrial Property Tax Exemption and Enterprise Zone Programs, as well as any other DED tax incentive programs it feels are appropriate. The legislature may gain oversight by requiring the programs to participate in periodic Sunset reviews, requiring the programs to report to the Joint Legislative Committee on the Budget, or some other means. (*See pages 51 through 52.)*

**Matter for Legislative Consideration 8:** The legislature may wish to consider reviewing the enabling legislation for the various tax incentive programs administered by BID and removing all requirements to comply with Rule 1, which has been declared unconstitutional. (*See page 52.*)

**Matter for Legislative Consideration 9:** The legislature may wish to consider reviewing all business tax incentive programs and determining which ones to retain unchanged, which ones to amend, and which ones to delete. The legislature may also wish to consider adding new incentives, such as incentives designed for business retention. All incentive programs offered should be based on the current tax code in use at the time. They should also be designed so that cost and benefits can be measured and tracked. (*See pages 54 through 55.*)

# Industrial Property Tax Exemption Program

As explained in Exhibit 1 on page 2 , the Industrial Property Tax Exemption Program was created in 1936 to induce manufacturing establishments to locate or expand in Louisiana. According to BID's statistics, for fiscal years 1997 through 2001, the program accounted for over 8,500 contracts, $41 billion in contract investment, and $1.7 billion in estimated tax relief provided to businesses. However, only 6% of these contracts were for new businesses or new facilities and only 32% were for plant additions (see Exhibit 6 on page 27). Although the program is a state program, it exempts businesses from paying local ad valorem (i.e., property) taxes. Our findings related to the administration of this program are presented in this section.

## Constitutional Provisions Governing Program Are Overly Broad

Article 7, Section 21(F) of the 1974 Louisiana Constitution provides the legal framework for the Industrial Property Tax Exemption Program. According to the constitution, business establishments must meet three requirements to qualify for tax exemptions under the program. These requirements are broadly defined in the constitution. No additional legislation exists for this program, thus there is no statutory guidance regarding how these terms should be applied. In addition, the rules adopted for the program provide little clarification. This lack of guidance has led to awards of questionable contracts and concerns about consistency in the awards process.

The constitution contains three terms that are broadly defined. Specifically, it states:

> . . . the State Board of Commerce and Industry or its successor, with the approval of the governor, may enter into contracts for the exemption from ad valorem taxes of a new *manufacturing establishment* or an *addition* to an existing manufacturing establishment, on such terms and conditions as the board, with the approval of the governor, deems in *the best interest of the state* (emphasis added).

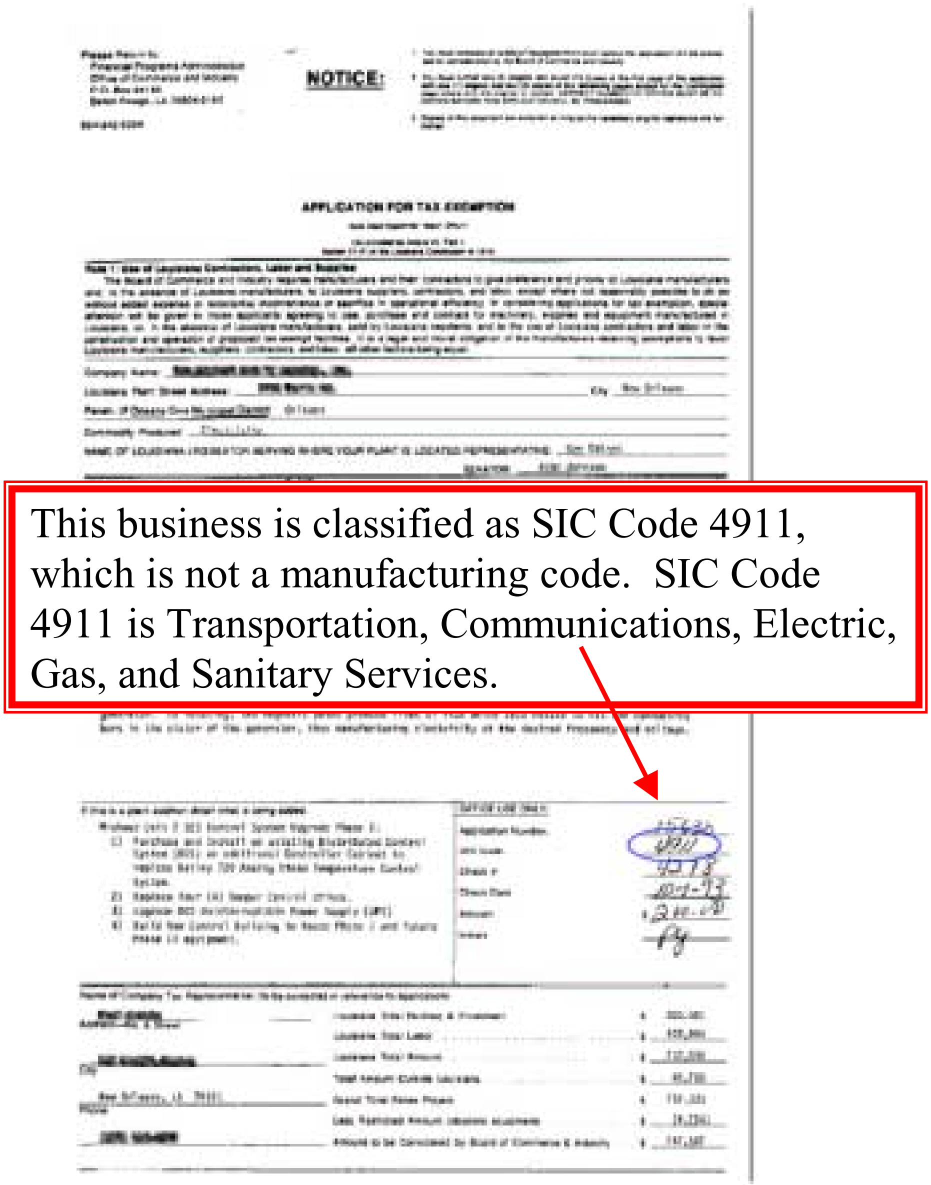
The exact meaning of the italicized terms is unclear. The constitution also says that the terms "manufacturing establishment" and "addition" mean "a new plant or establishment or an addition or additions to any existing plant or establishment which engages in the business of working raw materials into wares suitable for use or which gives new shapes, qualities or combinations to matter which already has gone through some artificial process."

**Definition of Manufacturing/Manufacturer.** The broadly defined terms "manufacturing" and "manufacturer" in the constitution have led to differing views on what constitutes a manufacturer. BID requires businesses to include Standard Industrial Classification (SIC) codes on their exemption applications to help determine if the businesses are manufacturers. The federal government adopted the SIC codes to categorize businesses into various classifications such as manufacturing, mining, and construction. Businesses with codes from 2011 through 3999 are considered manufacturers. However, some businesses whose SIC codes are not within the manufacturing range have obtained exemption contracts.

For example, in three of the 30 (10%) contract files we reviewed, the businesses' SIC codes were not in the 2011 through 3999 range. One of these businesses was classified as SIC Code 4911, which is the category for Transportation, Communications, Electric, Gas, and Sanitary Services: Electric, Gas, and Sanitary Services. A picture of this application can be seen in Exhibit 4 on the following page. The other two businesses were classified as SIC Code 1321, which is the category for Mining: Oil & Gas Extraction. These three businesses were awarded property tax exemptions on expenditures totaling \$42,415,034.[2] According to BID's estimates, the contracts resulted in direct tax relief to the businesses of \$4,816,764.

[2] This is not the amount of property taxes exempted. This is the amount of money that the businesses spent on their projects. The exemption amount is less than this amount. The exemption amount is calculated by applying 15% of the amount the businesses spent, multiplying it by the parish's average millage rate, then multiplying that amount by 10 years.

**Exhibit 4**
**Example of Non-Manufacturing SIC Code**
**Industrial Property Tax Exemption Program**




**Source**: Business's contract file at BID.

Federal regulations for the SIC codes say that there are some borderline cases between manufacturing and other divisions of the classification system such as mining. This fact may be the reason why the latter two contracts were approved. However, we were not able to determine whether this was the case or not because there was no documentation in the files addressing this issue.

In BID's database, 591 of 8,463 (7%) contracts active during our audit period have SIC codes that are not in the 2000 through 3999 range.[3] According to BID's calculations, which assume 10-year contract terms, these contracts account for approximately $570,000,000 in total estimated tax relief provided to businesses. Although we question how accurate BID's estimates of tax relief are, this figure does give an idea of the magnitude of the problem.

We discussed the problems with the definition of "manufacturing" with members of the BID staff. They agreed that the definition is unclear. They also provided us with a copy of a memorandum they presented to the SBCI in November 2000, which questions the definition of manufacturing. The memorandum contains a lengthy list of businesses that would not be considered manufacturers under the traditional meaning of the term but that have successfully acquired tax exemption contracts. The list includes dairy farms; photographic studios; plumbing, heating, and air conditioning contractors; farm product warehousing and storage companies; towing and tugboat service companies; wholesale steel materials supply outlets; petroleum bulk stations and terminals; and salt mining companies. The memo also says that other businesses considered to be manufacturers by the federal Office of Management and Budget have been deemed non-manufacturers by the SBCI.

Some of the SBCI members we interviewed also said that the definition of "manufacturing" is unclear. One member added that the definition is difficult to understand. They also agreed that the definition has been broadly interpreted. They said that this is partly because the Industrial Property Tax Exemption Program is outdated, and that they must sometimes "stretch" the definition to fit today's business climate. When the program was created in 1936, the types of plants that were locating in the state consisted primarily of traditional manufacturing plants such as chemical plants. The program has not changed along with the changing business climate.

In addition, the lack of a clear definition of "manufacturing" has resulted in litigation, both in the past as well as in the present. In *Robinson v. Ieyoub*, 727 So.2d 579 (La. App. 1st Cir. 12/28/98), the First Circuit Court of Appeal found that the operator of a hazardous waste incineration facility that had received an exemption did not meet the constitutional definition of the word "manufacturing." This case did not resolve the issue of defining "manufacturing." Another lawsuit

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[3] Another 55 contracts do not have SIC codes in the database.

was recently filed that questions the application of this definition. This lawsuit challenges the constitutionality of granting exemptions to merchant power plants and other businesses such as salt mining operations.

**Definition of Addition.** The constitution states that "addition" means an addition or additions to any existing plant or establishment that meets the definition of a manufacturing establishment. Webster's dictionary defines an addition as "a part added (as to a building or residential section)." This definition implies that supplemental space or equipment must be added to a plant to qualify for the exemption. However, differing opinions exist on what constitutes an addition.

When we asked BID what qualifies as an addition, one official replied that any item a manufacturing business purchases that remains "inside the fence" of a plant qualifies. For example, she said that a business could receive a 10-year exemption for a lawnmower purchased by the business. However, if BID found that the lawnmower was removed from inside the fenced premises of the business, it would be disallowed. Another official said that anything purchased for the construction of an addition to a manufacturing plant qualifies for an exemption. Several board members we interviewed said that any capital improvement paid for by a manufacturer is acceptable, although some board members said that the items should be directly related to the manufacturing process. One board member said that the exemption should only be allowed for items that are necessary for a manufacturer to operate.

In our review of 30 contract files, we noted several cases where businesses received exemptions for up to 10 years for items that may not have been capital additions to plants. For instance, in some cases, the businesses appeared to have replaced old equipment. In addition, some items may not be related to the manufacturing process. Also, many of the cases appear to be maintenance projects necessary because of normal wear and tear instead of new capital additions to plants. See Exhibit 5 on the following page for an example of a case we reviewed that appears to be a maintenance project.

## Exhibit 5
## Example of Contract With Maintenance Projects
## Industrial Property Tax Exemption Program

[illegible]
IPTEP 1998 MCA APPLICATION
[illegible]

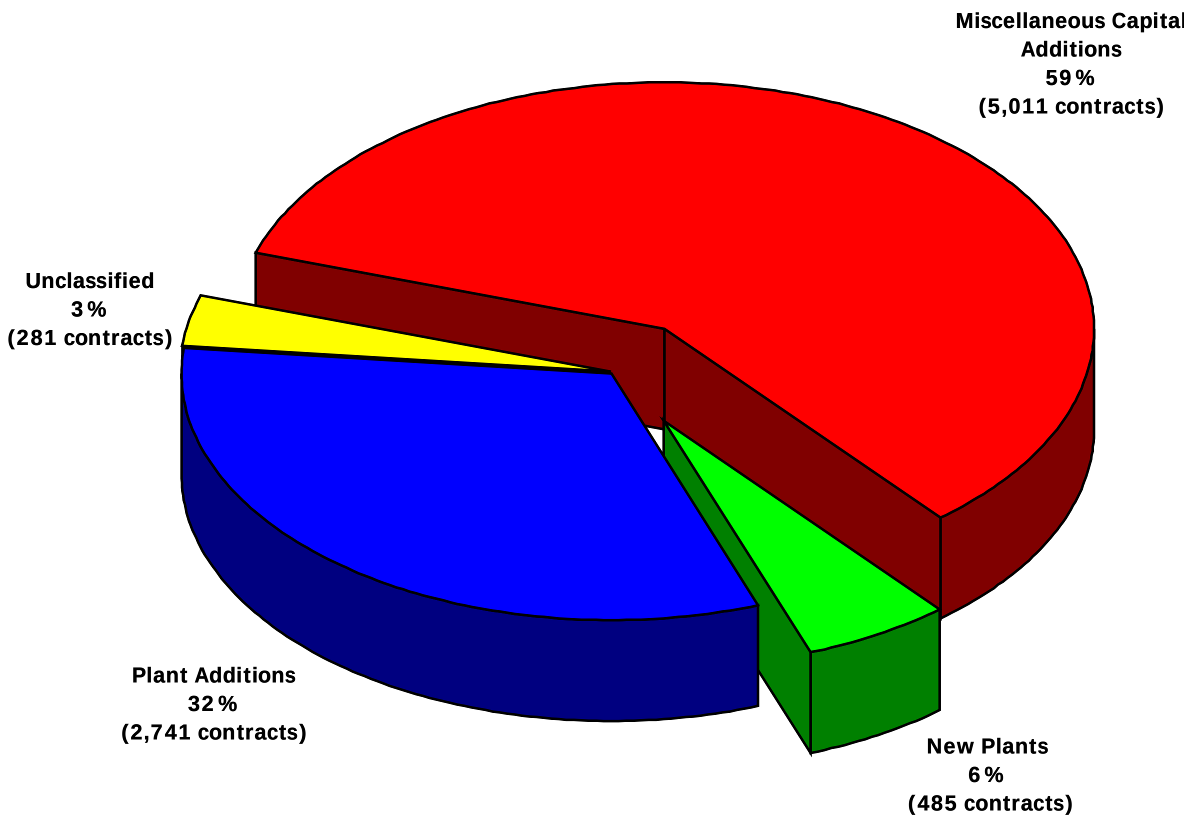
| VENDOR | CITY | STATE | COMMODITY CODE | | AMOUNT |
|---|---|---|---|---|---|
| GRAND SCAFFOLD BUILDERS | KENNER | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $323 |
| GRAND SCAFFOLD BUILDERS | KENNER | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $58 |
| GRAND SCAFFOLD BUILDERS | KENNER | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $289 |
| GRAND SCAFFOLD BUILDERS | KENNER | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $179 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $93,033 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $3,618 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $1,280 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $4,860 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $5,361 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $344 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $503 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $56,560 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $2,895 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $3,863 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $13,388 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $5,412 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $54,772 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $159 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $99 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $1,812 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $44,579 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $5,644 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $32,633 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $34,253 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CONTRCT-COST PLUS/TIME & MATLS | LABOR | $692 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $1,879 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $890 |
| BROWN & ROOT INDUSTRIAL SERVIC | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $2,154 |
| BROWN & ROOT INDUSTRIAL SERVICES | NORCO | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $39,110 |
| C&M CONSTRUCTING INC | METAIRIE | LA | MAINT CNTRCT-COST PLUS/TIME & MATLS | LABOR | $314,980 |
| COOPERHEAT | GONZALES | LA | STRESS RELIEVING SERVICES | LABOR | $1,489 |
| COOPERHEAT | GONZALES | LA | STRESS RELIEVING SERVICES | LABOR | $1,188 |
| COOPERHEAT | GONZALES | LA | STRESS RELIEVING SERVICES | LABOR | $440 |

This company has numerous items listed on the Breakdown of Purchases form as maintenance work. We could not determine from examination of documents in the contract file whether these claims were for routine maintenance. These maintenance items account for approximately one-half of the contract value.

**Source:** Business's contract file at BID.

Another issue concerning the term "addition" is the "miscellaneous capital addition." According to the program rules, "a miscellaneous capital addition is an accumulation over a 12-month period of small capital outlay purchases totaling a maximum of $5,000,000 dollars." In our sample of 30 contracts, 20 (67%) contracts were for miscellaneous capital additions. Also, as shown in Exhibit 6, approximately 59% of all contracts approved during fiscal years 1997 through 2001 were for miscellaneous capital additions. Only 6% were for new plants or facilities. Only 32% were for plant additions.

**Exhibit 6**
**Distribution of Active Contracts**
**Fiscal Years 1997 Through 2001**
**Industrial Property Tax Exemption Program**




**Source:** Prepared by legislative auditor's staff using information obtained from BID's database.

When we asked BID what type of expenses qualify as miscellaneous capital additions, one official said that miscellaneous capital additions are more properly classified as miscellaneous capital expenses since they are merely accumulations of businesses' capital expenses. He also said that in many cases, miscellaneous capital additions are replacements, not additions. Also according to a BID official, the only difference between regular additions and miscellaneous capital additions is the dollar amount. He said that miscellaneous capital additions are used to reduce the amount of paperwork for BID and the businesses. Paperwork is reduced because BID does not require businesses to file advance notifications for miscellaneous capital additions.

When we asked SBCI members what qualifies as a miscellaneous capital addition, they gave differing views. One member said that any capital improvement made by a plant is acceptable. Another said that only items necessary for operations should be allowed. For instance, he questioned the propriety of allowing exemptions for items such as flagpoles. A third board member said that any cost that is ordinary and reasonable and that furthers the manufacturing process is acceptable.

Some examples of expenses listed as miscellaneous capital additions we noted in our review of contract files are as follows:

- Computers
- Computer equipment
- Radios
- Office furniture
- Surge protectors
- Name tags
- Engraved nameplates
- Speed bumps
- Screensaver program
- Dictaphone
- Restaurant/catering services

Some of the items in the list may be capital expenses, but it is questionable whether they are additions to plants. If expenses are not truly capital expenses that expand or add to a plant facility, it is questionable whether associated exemptions should be allowed.

Another problem with miscellaneous capital additions is that businesses do not always report obsolete equipment when they claim exemptions for miscellaneous capital additions. Businesses that apply for tax exemptions on purchases of new equipment that is to replace obsolete equipment are required to report the cost of the obsolete equipment to BID. The businesses should subtract the cost of the obsolete equipment from the cost of the new equipment and request an exemption on the difference between the two figures. If they do not make this calculation, businesses receive larger property tax exemptions than the program allows. According to a BID official, this area has the greatest potential for abuse by businesses because BID does not have sufficient time or personnel to conduct frequent and repeated inspections of businesses that receive exemptions. (We discuss weaknesses in the inspection process on pages 37 through 40 of this report.) In one of the 30 (3%) contract files we reviewed, the business submitted a piece of replacement equipment for exemption but did not subtract the cost of the obsolete equipment from the cost of the replacement equipment. We found no evidence in the file showing that BID followed up on this situation. In six other cases (20%), it appears that the businesses claimed exemptions for replacement equipment without subtracting the cost of the obsolete equipment, but clear documentation was not available to allow us to make a final determination. We found no evidence that BID had followed up on any of these cases, either.

Perhaps most important is the issue of the authority for granting exemptions on miscellaneous capital additions. Neither the constitution nor the revised statutes mention “miscellaneous capital additions.” Rule 3 of the program rules provides the only authority for these additions. However, Rule 3 appears to go beyond what is allowed in the constitution, although it is difficult to draw a final conclusion. This point is important because, as illustrated in Exhibit 6 on page 27, 59% of the contracts approved over the last five fiscal years were for miscellaneous capital additions.

We asked several SBCI members what they believe to be the authority for granting exemptions for miscellaneous capital additions. One member said that the board does not have the authority to approve non-manufacturing expenses and that any expenses not related to the manufacturing process should not be allowed. Another said that the board should think about reducing the time period for which exemptions on miscellaneous capital additions are allowed. A legislative staff attorney we interviewed said he does not believe the constitution gives the authority to allow exemptions for miscellaneous capital additions.

**Definition of Best Interest of the State.** Neither the constitution nor the program rules contain criteria that define what “best interest of the state” encompasses. According to our legal counsel, best interest of the state should at least be a situation in which one can conclude that the state is in a materially better situation after the transaction than before. Also, the SCBI does no formal analysis to determine whether each application for exemptions is in the best interest of the state. As a result, limited assurance exists that all contracts granted are truly in the best interest of the state.

BID staff informed us that they consider the staff comments form they prepare for each application to be a “best interest of the state” analysis. This form shows BID’s estimate of economic impact that would result from approval of each contract. The economic impact section of the form includes the following information:

- BID’s estimate of property taxes exempted as a result of the contract

- BID’s estimate of local sales taxes paid by the business for the purchases included on the application

- BID's estimate of state sales taxes paid by the business for the purchases included on the application

- Number of permanent and construction jobs created

- BID's estimate of payroll for permanent jobs for 10 years

The form also includes the amount invested by the business and BID's recommendation on whether the business is eligible for exemption.

The information on the form is not comprehensive and does not include a complete analysis of the total impact the exemption will have if granted. For example, it does not show the amount of state corporate income and franchise taxes that the business generates. An example of a staff comments form can be seen in Exhibit 7 on the following page.

Also, the SBCI does not conduct a formal analysis to determine if awarding property tax exemptions for each individual application is in the best interest of the state. In addition, according to some board members and our observations of board meetings, often the board's only concern is whether a business is a manufacturer. Once a determination is made that a business is a manufacturer, the board does not consider any further factors.

One board member said that the board sometimes uses the "best interest of the state" language to approve applications for businesses that would otherwise be considered unqualified. For instance, if a business is not truly a manufacturer, the board may justify awarding the business a contract by concluding that it is in the best interest of the state to do so. On the other hand, if a business is a manufacturer, the board may vote to award the business a contract even though it may not be in the best interest of the state. An example would be a manufacturing business that would locate in Louisiana even if it did not receive the property tax exemptions available under the program.

We asked several SBCI members if they thought criteria should be established for determining whether applications for exemption are in the best interest of the state. Some members said that criteria should be developed, and others said that it would hamper the decision-making process. One member also said that criteria would be difficult to determine because each person has a different idea of what constitutes "best interest of the state."

## Exhibit 7
## Example of Staff Comments Form
## Industrial Property Tax Exemption Program

STAFF COMMENTS BY: **John Jernigan** BOARD MEETING: **April 12, 1995**

COMPANY: [redacted]

APPLICATION NO: 959015

LOCATION: Pineville

SIC CODE: 2631

PARISH: Rapides

TYPE: MCA

APPLICATION AMOUNT: $4,013,851.00

PROJECT DESCRIPTION:

1994 Miscellaneous Capital Additions

These figures for estimated taxes are rough estimates.

ECONOMIC IMPACT:

| PURCHASES | | | ESTIMATED TAXES | | |
|---|---|---|---|---|---|
| LOUISIANA | $ | 1,700,703.00 | AD VALOREM TAX | $ | 740,276.00 |
| OUT-OF-STATE | $ | 512,530.00 | LOCAL SALES TAX | $ | 83,036.00 |
| | | | STATE SALES TAX | $ | 83,036.00 |

| JOBS | | PAYROLL | | |
|---|---|---|---|---|
| PERMANENT | 0 | $ | 0.00 | (10-Years) |
| CONSTRUCTION | 60 | $ | 1,800,620.00 | |

TOTAL LOUISIANA EXPENDITURES: $3,501,321.00

PERCENTAGE OF OUT-OF-STATE EXPENDITURES: 13%

RESTRICTIONS:

None

RECOMMENDATION:

The subject application is eligible for tax exemption on the amount of $4,013,851.00

This recommendation does not explain why this tax exemption would be in the best interest of the state. It only states that the application is eligible with no further explanation.

**Source:** Business's contract file at BID.

We also asked BID staff, legislative staff, and SBCI members what factors should be considered in a "best interest of the state" analysis. The items they suggested are as follows:

- Cost and resulting benefit to the state
- Business's environmental records
- Effect on other businesses in the area
- Jobs created and jobs retained by the business
- Whether the business offers health insurance plans to its employees
- Business's safety records
- Local government input
- Determination of whether the business would locate in Louisiana even if it did not receive the exemptions
- Non-participation in gaming activities

Furthermore, according to BID staff and board members, they sometimes use the term "best interest of the state" to engage in business retention. That is, the board votes to approve applications to keep businesses in Louisiana. While retaining businesses in the state is a positive goal, the Industrial Property Tax Exemption Program was not created for that purpose. The program was created to induce industry to locate and expand in Louisiana, not to retain businesses that are already here.

*(See Recommendations 1 through 3 on pages 11 through 13 and Matters for Legislative Consideration 1 and 2 on pages 18 and 19.)*

## All Constitutional Requirements Are Not Considered

The SBCI does not consider all three elements--whether the business is a manufacturing establishment, whether the application is for an addition or additions, and whether awarding a contract would be in the best interest of the state--for each application. The constitution does not give a choice as to which element or elements must be considered. It requires that all three elements be considered.

As previously mentioned, although consideration of all three elements is required, often the SBCI's sole consideration is whether or not businesses are manufacturing establishments. Once that determination is made, applications are generally approved without considering the other two elements, namely whether the applications are for actual "additions" and whether the exemptions would be in the "best interest of the state." As a result, contracts could be awarded for items that are not truly additions and/or not in the best interest of the state.

*(See Recommendation 4 on page 13.)*

## No Local Input Is Required for Approval of Exemptions

Although the Industrial Property Tax Exemption Program exempts businesses from paying local property taxes, local governing authorities generally do not provide input on decisions regarding exemptions in their parishes. The SBCI and the governor are the only parties who can approve the exemptions. Without local input, the full impact of the exemptions on the parishes may not be understood.

Dr. James A. Richardson, a local economic consultant, recently completed a study of Louisiana's tax incentives. According to the study, in most states with industrial property tax exemption programs, state government does not award exemptions for local property taxes. Rather, local governments make the decision because it is the local governments that will sustain the fiscal impact.

R.S. 51:923, which governs the composition of the SBCI, does require one member of the board to be an elected municipal official and another member to be an elected police juror, councilman, commissioner, or parish president. Currently, one mayor and one parish president serve on the board. However, no requirement exists for local government officials in each parish where exemptions are being considered to provide input to the board.

BID does notify applicable local officials of SBCI meeting dates and times by sending them a copy of the letter it sends to the businesses announcing this information. These officials include the following:

- Assessor
- Police jury
- School board
- Mayor

BID also notifies the applicable state representative and senator of the meeting dates and times. However, in our observations of board meetings, we saw limited participation by any local officials. Also, some of the local assessors we interviewed expressed a desire for more local involvement in the process.

*(See Recommendation 5 on page 13 and Matter for Legislative Consideration 3 on page 19.)*

## Management Controls Over Program Are Weak

We identified various weaknesses in management controls over the Industrial Property Tax Exemption Program. For instance, BID does not enforce filing deadlines, which can lead to abuse of the program rules and inconsistent treatment of businesses that apply for the exemptions. BID also does not verify the costs or dates of purchases submitted by businesses for exemptions. In addition, the SBCI does not receive all information it needs to make meaningful decisions on granting tax exemptions. Also, the inspection process, which is critical for maintaining the integrity of the program, is weak. A final concern is the automatic renewal of tax exemption contracts, which can lead to overuse and overextension of the program. These weaknesses in controls can result in abuse and misuse of the program.

**Filing Deadlines Are Not Enforced**. In all 30 contract files we reviewed, many forms required in the process were not submitted by the deadlines established in the program rules. The rules provide a specific deadline for each form as follows:

- **Advance Notification**: Due before construction begins.
- **Application:** Due no later than three months after the beginning of operations or, if the project is a miscellaneous capital addition, by March 31 of the year following the calendar year in which the purchases were made.
- **Project Completion Report**: Due no later than three months after the beginning of operations or 30 days after the completion of construction, whichever occurs last.
- **Affidavit of Final Cost**: Due within six months of the completion of construction or after receipt of the fully executed contract by the company, whichever occurs last.
- **Renewal Contract Application**: Due no more than six months prior to and no later than the expiration of the initial contract.

The table in Exhibit 8 on the following page shows the number and percentage of each form that was late in the sample of 30 contracts we reviewed.

**Exhibit 8**
**Sample Forms Filed Late**
**and Projections to Population**
**Industrial Property Tax Exemption Program**

| Name of Form | Number | Percentage | Projection to Population of All Active Contracts |
|---|---|---|---|
| **Advance Notification*** | 4 | 40.0% | Could not determine |
| **Application** | 13 | 43.0% | 512 (6.0%) to 2,901 (34.0%) |
| **Project Completion Report** | 28 | 93.0% | Could not determine |
| **Affidavit of Final Cost** | 7 | 23.0% | 682 (8.0%) to 3,243 (38.0%) |
| **Renewal Contract Application** | 1 | 4.0% | Could not determine |

*Only 10 of the 30 contracts we reviewed required submission of Advance Notification forms. The other 20 contracts were for miscellaneous capital additions, for which advance notifications are not required.

**Source:** Prepared by legislative auditor's staff using information obtained from reviews of BID's contract files. Projected figures in last column are based on a 95% confidence level, which means that we are 95% confident that the applicable filing deadlines were not met for the number and percentage of all active contracts cited.

Despite the fact that one or more forms were submitted late in each file we reviewed, BID assessed a penalty against a business in only one case. When we asked a BID official why so many forms were filed late, he said that BID informs applicants to follow informal alternative deadlines established by BID instead of the deadlines in the rules. He said that they do this to prevent loss or misplacement of the forms, which results from a shortage of staff necessary to file the large volume of paperwork. He also said that the deadlines established by the rules are largely unnecessary because property is eligible for exemption as long as it is not placed on the tax rolls, regardless of whether the deadlines are met. The only time the deadlines are helpful, he said, is when BID needs to use them as an enforcement mechanism to convince businesses to take some form of action. Currently, BID is revising the deadlines in the rules to make them more accurately reflect its current process.

In addition, BID does not inform the SBCI when businesses miss filing deadlines, so the board does not know that it may need to intervene. Poor enforcement of deadlines can give the perception that the program is poorly administered, which can create the potential for abuse. Poor administration can weaken Louisiana's image in the eyes of businesses considering locating here. Not enforcing official deadlines for all businesses can also result in inconsistent treatment of businesses.

*(See Recommendation 6 on page 13.)*

**No Verification of Costs or Dates of Purchase Submitted by Businesses**. BID does not require businesses to submit invoices or any other type of proof supporting the costs or dates of purchase for the items the businesses submit for tax exemptions. In addition, BID performs no type of verification of the information submitted by the businesses. The businesses simply list all the items they say they have purchased along with their cost, and BID processes the applications. Without proof to substantiate these claims, a critical control over the program's integrity is missing. Without controls over this aspect of the program, businesses could claim property tax exemptions on expenses they did not actually incur, for items that were not purchased within the proper time period, and/or for items that are not eligible for exemption without detection.

The chairman of the SBCI Policy and Rules Committee recently asked in a public meeting how BID would know if costs that are not eligible for exemption were included in a business's application. A BID official responded that some items get through, but they would be identified later when inspections are conducted. He further stated that if they catch anything at inspection time, they subtract the appropriate amount from the businesses' contracts. In other words, BID depends on inspections on the back end to detect false or ineligible costs submitted on the front end.

However, we found that the inspections are not an effective control for ensuring that all costs for which exemptions are granted are proper and eligible. Once a project has been constructed, identifying all individual parts and costs that went into the construction through a brief, visual inspection is difficult. Also, as discussed on pages 37 through 40, the inspection process is weak. Inspections are not done regularly, and when they are done, all items are not inspected. In addition, according to BID's data, BID has not conducted any inspections at all for some contracts.

A BID official also told us that the fact that businesses must submit an Affidavit of Final Cost when projects are completed is sufficient assurance that the costs are substantiated because supplying false information on an affidavit amounts to perjury. Although the affidavits provide some degree of protection, review of invoices or some other verification procedure would provide a more effective control to prevent abuse of the program. Furthermore, the risk of abuse increases if businesses know that thorough inspections will not be conducted.

*(See Recommendation 7 on page 14.)*

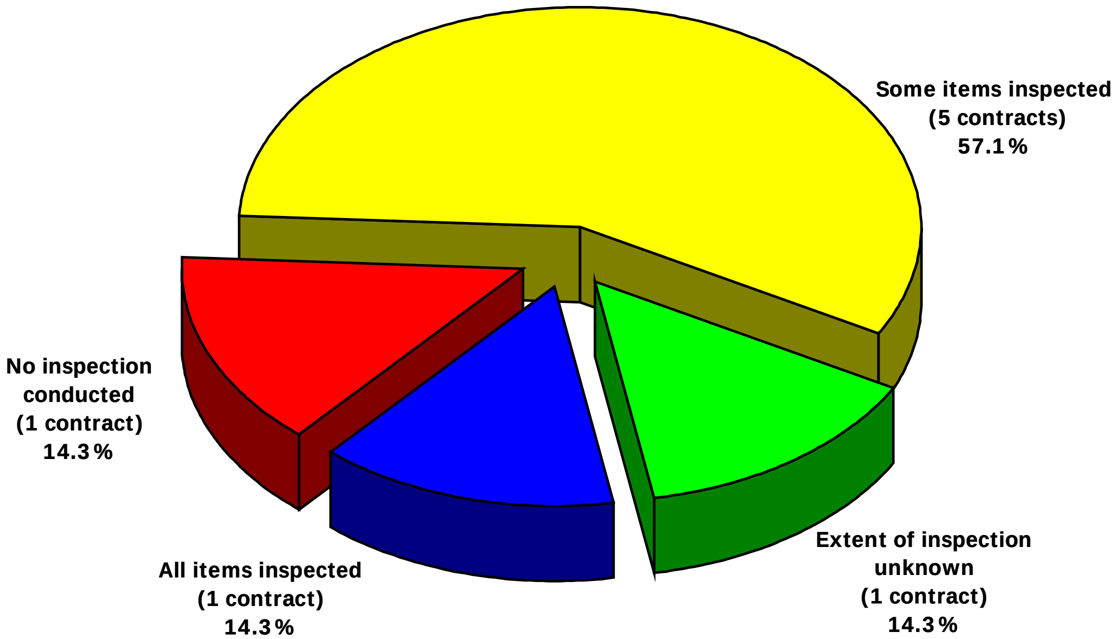
**Board Does Not Receive All Pertinent Information**. We found that the SBCI does not receive sufficient information to make meaningful decisions about applications for exemptions. BID requires all applicants to submit a Breakdown of Purchases form, but BID does not provide copies of these forms to the board members. The forms list all purchases for which exemptions are requested. Therefore, the board members do not know the specific items for which exemptions are requested. As discussed on pages 25 through 29, some of these purchases may not be eligible for exemption. Thus, an important control to detect abuse of the program is missing.

*(See Recommendation 8 on page 14.)*

**Inspection Process Is Inadequate**. BID is required to conduct inspections of businesses that have received tax exemptions to ensure that the buildings and equipment that were exempted from property taxation actually exist. R.S. 51:936.2(A)(4) and Rule 14 of the program rules authorize BID to collect from businesses a $100 fee to be filed with each Affidavit of Final Cost and to be used for on-site inspections. Despite this requirement, we found that BID does not conduct inspections regularly and that the inspections that are done are not always thorough. Also, according to BID's data, BID has not conducted any inspections at all for some contracts.

BID officials informed us that inspections are conducted for all contracts before the contracts expire. For seven of the 30 (23.3%) contract files we reviewed, BID should have completed inspections because these contracts had expired. For one of these seven (14.3%) contracts, we found evidence that BID inspected all items listed on the Affidavit of Final Cost. For four other contracts (57.1%), we found evidence that BID inspected some, but not all, of the items listed on the Affidavit of Final Cost. For another contract (14.3%), we found evidence that BID conducted an inspection, but we could not determine the extent of the inspection. However, for the other contract (14.3%), we found no evidence of inspection at all. These figures are based on BID's database as well as documentation we reviewed from each contract file. Exhibit 9 on the following page shows the results of this analysis.

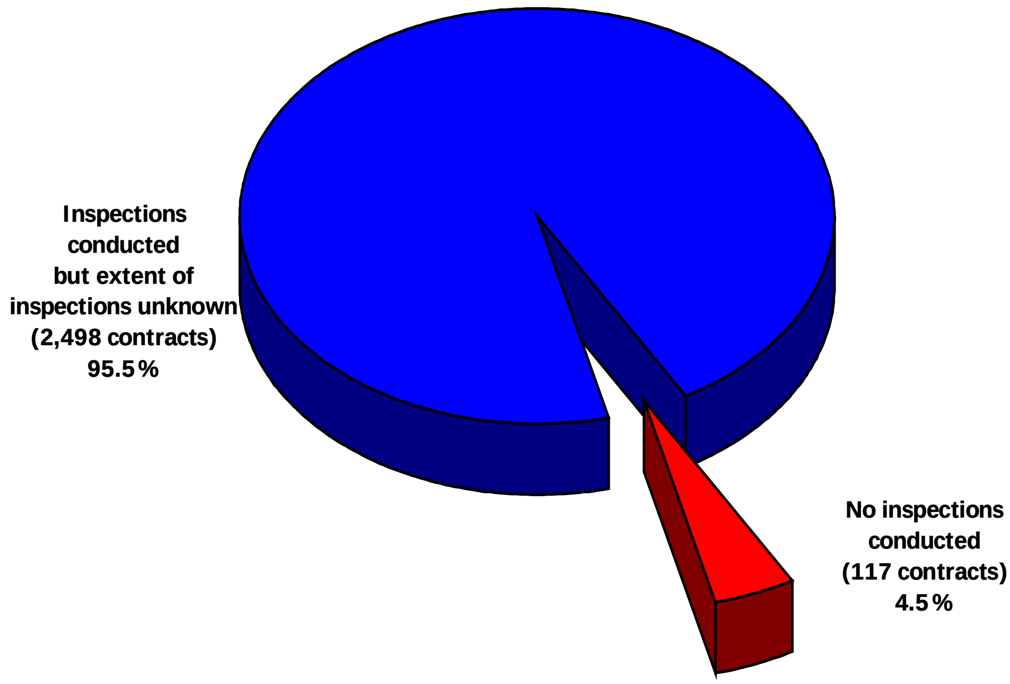
**Exhibit 9**
**Inspections for Expired Sample Contracts**
**Fiscal Years 1997 Through 2001**
**Industrial Property Tax Exemption Program**




**Source:** Prepared by legislative auditor's staff using information obtained from reviews of BID's contract files and other data obtained from BID.

We also conducted a computer analysis using BID's database on all contracts that expired during fiscal years 1997 through 2001 to see if inspections had been conducted for those contracts. We could not determine the number of inspections in which some, but not all, items were inspected because this data is not available on BID's database. Also, BID does not prepare a formal report that details inspection results. However, our analysis shows that for 117 of 2,615 expired contracts (4.5%), no inspections were conducted. While an inspection percentage of 95.5% is commendable, BID is required to conduct inspections and collects inspection fees for all contracts. Also, although we suspect that some of the database fields dealing with inspections may not be 100% accurate, these figures do demonstrate that a problem exists in the inspection process. Exhibit 10 on the following page shows the results of this analysis.

**Exhibit 10**
**Inspections for All Expired Contracts**
**Fiscal Years 1997 Through 2001**
**Industrial Property Tax Exemption Program**




**Source:** Prepared by legislative auditor's staff using information obtained from reviews of BID's contract files and other data obtained from BID.

We discussed the issue of inspections with BID staff. They told us that a backlog of inspections exists and that they do not have sufficient time or staff to conduct inspections regularly or completely. According to BID's database, BID has not conducted inspections on 2,170 of 5,811 open contracts (37.3%). This backlog is in addition to the 117 expired contracts for which BID has not conducted inspections. For 92 contracts, BID's database did not contain contract expiration dates, thus we did not include them in this analysis.

BID officials also said that because of the shortage of time and staff, they try to conduct inspections while they travel to other locations to attend SBCI meetings. They have no regular schedule for conducting inspections. In addition, they said that when they conduct inspections, they often do not have time to inspect all individual items submitted for exemption. Therefore, they inspect only certain items, although they do try to include the higher-cost items. Because of these problems, the inspection process is not as effective as it should be to maintain the integrity of the program.

In addition, BID does not notify the SBCI of the results of inspections conducted. Therefore, the board does not know if problems exist that would justify cancellation of any contracts or implementation of other penalties. Also, according to the assessors we interviewed, BID does not notify them of upcoming inspections or include them in the inspections. The assessors said that including them in inspections would help them to better monitor the individual plants and property tax situation in their parishes. BID staff informed us that local assessors are included in inspections, but we found no evidence to support either position.

*(See Recommendations 9 and 10 on pages 14 through 15 and Matter for Legislative Consideration 4 on page 19.)*

**Renewal of Exemption Contracts Is Often Automatic.** According to the Louisiana Constitution, exemption contracts have a term of five years with a renewal option for an additional five years. Although the renewal is optional, the SBCI often approves all renewals as long as the businesses remain manufacturers. Therefore, it is typical for businesses to obtain property tax exemption contracts for a period of 10 years. Since contracts are often automatically renewed, the program is commonly referred to as the “10-Year” Exemption Program. As a result of automatic renewals, the exemption may be overused and overextended.

Of the 24 contracts in our sample that were eligible for renewal, all were renewed. However, granting automatic renewals may result in renewal of contracts that should not be renewed. For instance, in many cases, items in renewal contracts have useful lives of less than 10 years. Many of these assets, such as computers and computer equipment, become obsolete and are put out of service long before the 10 years is over. When items become obsolete, businesses often claim additional exemptions for new (replacement) assets they purchase. Therefore, long-term exemptions are granted on short-term assets.

*(See Recommendation 11 on page 15.)*

## Enterprise Zone Program

As shown in Exhibit 1 on page 2, the Enterprise Zone Program was created by statute in 1981. The program provides state corporate income and franchise tax credits and state and local sales tax rebates for businesses that hire at least 35% of their employees from certain targeted populations and that also create a specified number of new jobs. Previously, businesses located in two types of zones, enterprise zones and economic development zones, were eligible for the benefits of this program. Enterprise zones are areas with high unemployment, low income, or a high percentage of residents receiving some form of public assistance. Economic development zones are specific areas designated by law to receive Enterprise Zone Program benefits, such as research and industrial parks. Recent legislation enabled businesses not located in such zones to receive enterprise zone benefits, provided that the businesses hire employees from enterprise zones, with certain restrictions.

According to BID's statistics, for fiscal years 1997 through 2001, BID administered over 2,100 enterprise zone contracts worth over $22 billion in investment. The estimated amount of tax relief for these contracts is over $325,000,000. Our findings related to the administration of this program are presented in this section.

### Management Controls Over Program Are Weak

We identified major weaknesses in the management controls over the Enterprise Zone Program. These weaknesses deal primarily with BID's failure to enforce deadlines, collect critical eligibility data from businesses, verify other eligibility information submitted by businesses, and inspect all businesses as required. Since critical data are not collected and other data are not verified, and because inspection procedures are weak, little assurance exists that the businesses receiving tax breaks through the program are actually qualified to receive them. This situation impacts the integrity of the program because it creates a significant risk that fraud and abuse could occur without detection.

**Deadlines Are Not Enforced.** R.S. 51:1787 (B)(5)(a) requires businesses to file advance notifications either before construction or improvement of buildings begins or installation of equipment occurs. However, we found that in four of the 30 (13.3%) contract files we reviewed, the businesses filed the advance notifications late. In another eight cases (26.7%), the businesses filed the advance notifications late, but BID allowed the businesses to change the dates reported on the forms so that it appeared that the deadlines were met. In total, businesses filed the advance notifications late in 12 of the 30 (40.0%) contract files we reviewed.

In addition, Rules 919 (A) and (I) require project construction periods to be two years or less. However, in six of the 30 (20.0%) contract files we reviewed, the construction dates were longer than two years. A BID official told us that BID allows an automatic six-month extension to the period established in the rules. She also said that BID is currently revising the rules to include the six-month extension.

Rules 919 (E) and 951 (E) require each business participating in the program to file an affidavit of final cost within six months after completion of construction or when the signed original contracts were returned to BID, whichever is later. However, the affidavits were filed late in six of the 27 (22.2%) files we reviewed for which affidavits should have already been filed.[4] In another two cases (7.4%), the affidavits were not filed at all. In total, businesses filed the affidavits late or not at all in eight of the 27 (29.6%) applicable files we reviewed.

In addition, BID requires all program participants to submit annual employment certifications so that BID can verify that the tax relief provided through the program is actually for jobs that meet program requirements. Rule 933 requires each business to file an affidavit certifying that it is still qualified by February 15 of each year it participates in the program. However, we found that businesses often file the annual certifications late. For example, in 12 of the 26 (46.2%) files we reviewed for which an annual certification was required each year for five years, all of the certifications were either filed late or were not filed at all.[4] In addition, for another eight (30.7%) contract files, some of the certifications were filed late while others were filed on time. BID did not assess penalties in any of these cases. All annual certifications were filed on time for only six (23.1%) of these contract files.

[4] For the other contract files in our sample, the deadlines for the required information had not yet expired.

The BID official in charge of administering the program informed us that she uses March 1 instead of February 15 as the deadline for the certifications. She said that BID plans to amend the rules accordingly. She also said that almost all certifications are late because the program is understaffed. She said that BID needs additional staff to follow up with businesses to obtain their certifications when they are due.

Since BID does not enforce deadlines, BID does not know whether it should cancel contracts for failure to file forms timely. According to the BID official, the due dates are used as a guideline only. She said that enforcing deadlines would make it difficult for small businesses to participate in the program because they have limited resources to allocate for administrative purposes. However, poor enforcement of deadlines can give the perception that the program is poorly administered, which can create the potential for abuse. Poor enforcement could also weaken Louisiana's image in the eyes of businesses considering locating here. In addition, not enforcing official deadlines for all businesses can result in inconsistent treatment of businesses.

Exhibit 11 on the following page shows the number and percentage for each filing requirement not met for the sample contract files we reviewed. The exhibit also shows the projected number and percentage of each filing requirement not met for all contracts active during the audit period.

*(See Recommendation 12 on page 15.)*

**Exhibit 11**
**Filing Requirements Not Met for Sample Files and Projections to Population**
**Enterprise Zone Program**

| Filing Requirement | Number | Percentage | Projection to Population of All Active Contracts |
|---|---|---|---|
| **Advance notifications:** Filed late | 4 | 13.3% | 490 (22.6%) to 1,246 (57.4%) |
| **Advance notifications:** Filed late but businesses were allowed to change dates on forms | 8 | 26.7% | |
| **Construction Period** | 6 | 20.0% | 126 (5.8%) to 742 (34.2%) |
| **Affidavits of Final Cost:** Filed late | 6 | 22.2% | 239 (11.0%) to 920 (42.4%) |
| **Affidavits of Final Cost:** Not filed | 2 | 7.4% | |
| **Annual Certifications**: All certifications required for 5-year period either filed late or not filed | 12 | 46.2% | 490 (22.6%) to 1,246 (57.4%) |
| **Annual Certifications**: Some certifications required for 5-year period filed late; others filed on time | 8 | 30.7% | 239 (11.0%) to 920 (42.4%) |

**Source**: Prepared by legislative auditor's staff using information obtained from reviews of BID's contract files. Projected figures in last column are based on a 95% confidence level, which means that we are 95% confident that the applicable filing requirements were not met for the number and percentage of all active contracts cited.

**BID Does Not Collect Critical Eligibility Information.** R.S. 51:1787(A)(3) says that tax credits are only applicable to new jobs for Louisiana residents that work either full-time or at least 20 hours per week for at least six months during the taxable year. BID defines a Louisiana resident as someone who has lived in Louisiana for at least 30 consecutive days. However, BID does not require businesses participating in the program to report critical eligibility information on the employment certification forms they submit. For instance, BID does not require businesses to report information showing whether the businesses' employees are full-time or part-time employees. BID also does not require them to provide the hours worked by the part-time employees. In addition, BID does not require information showing whether new employees have been residents of Louisiana for at least 30 days.

We found evidence of full-time versus part-time status for only two of 27 (7.4%) applicable contract files we reviewed.[5] BID did not collect this information for the other 25 (92.6%) applicable contract files. For eight of these 25 (32.0%) files, the information was not reported because the businesses did not file annual certifications, as required. For the other 17 files, the businesses filed annual certifications, but the full-time versus part-time information was not included on the forms.

In addition, BID did not require businesses to report important information on the annual certifications. For instance, BID did not require the businesses to report the number of hours worked by part-time employees in any of the 27 (100%) applicable contract files we reviewed.[5] Also, only one of these (3.7%) files contained evidence of length of residency.[5] Eighteen of the 27 (66.7%) files had Louisiana addresses listed for the employees, but no information was available showing how long they had been Louisiana residents. For eight of the 27 (29.6%) files, BID had not received the certifications.

When we discussed this issue with a BID official, she agreed that collecting this information is necessary to ensure compliance with program requirements. She also said that BID would amend the applicable forms to require businesses to submit this information. Requiring the businesses to submit eligibility information is a critical first step toward ensuring program integrity. Verification of that information is also necessary, as discussed in the next section, to ensure that the information submitted is accurate.

*(See Recommendation 13 on page 16.)*

**No Verification of Information Received From Businesses.** BID relies on businesses' statements as to whether new employees meet program requirements instead of conducting independent verifications of this information. For example, BID does not independently verify whether employees reported as new employees are indeed in new positions that did not previously exist. In addition, BID does not verify the hours worked by part-time employees or the length of time they are employed. BID also does not verify employee certification requirements, such as whether employees receive public assistance or if employees are considered unemployable by traditional standards. Finally, BID does not verify employees' addresses to determine if they live in enterprise zones.

BID did not independently verify the employment data reported by the businesses on the annual certifications in any of the 26 applicable contract files we reviewed.[5] BID did conduct desk audits of the information. In the desk audits, BID used the information reported by businesses on the annual certifications to determine whether the businesses met the number of jobs requirement and the

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[5] For the other contract files in our sample, the certifications were due after the audit period.

35% requirement, as well as how many tax credits the businesses should receive. In addition, BID ensured that the enterprise zones shown on the annual certifications agreed with BID's records showing the established enterprise zones in the state. BID reported the number of tax credits due, as determined by the desk audits, to the businesses and the Department of Revenue. However, the desk audits did not ensure that the information reported by participating businesses was correct. Also, BID does not complete desk audits for all contracts. We found no evidence that BID had conducted a desk audit for one of the 26 (3.8%) applicable contract files we reviewed.[6] In addition, BID could not conduct desk audits for eight (30.8%) other files because the businesses had not filed the certifications, as required.

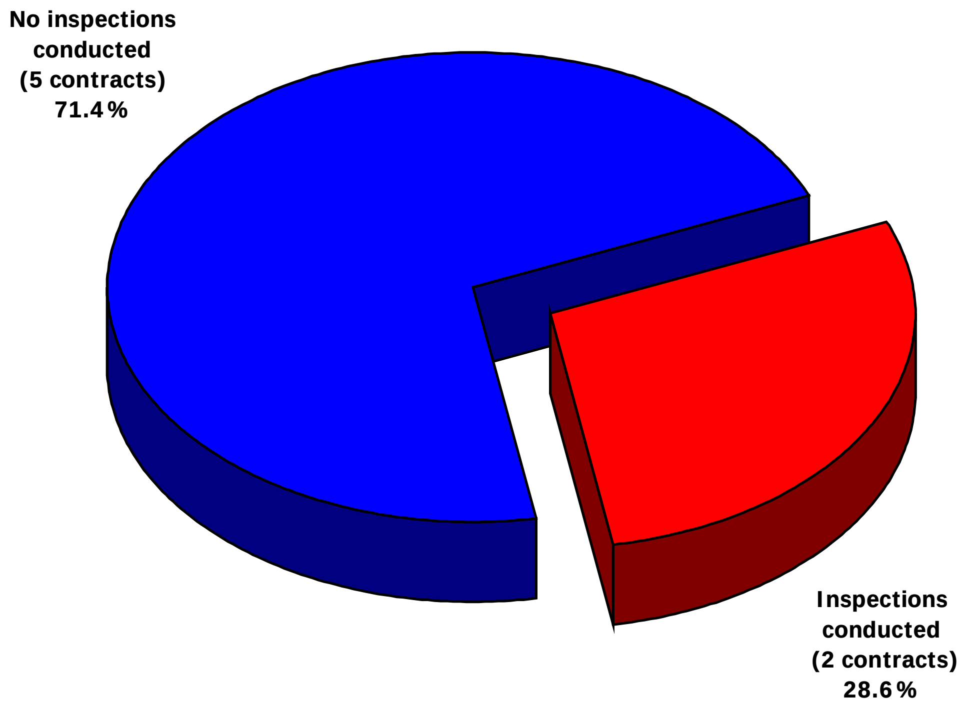
When we discussed this issue with a BID official, she said that BID relies on businesses to be honest when self-reporting this information. She also said that having access to records maintained by the Department of Labor would be helpful in verifying information reported by businesses. Independent verification would help ensure that abuse of the program does not occur.

*(See Recommendation 14 on page 16.)*

**Inspection Process Is Not Effective.** In addition, BID is required by Rule 951(E) to inspect the buildings and equipment for which businesses received sales tax rebates through the program. However, according to BID staff, they are behind on their inspections because they do not have enough time or personnel to conduct them. Our findings on inspections support BID's statement. Seven of the 30 contracts we reviewed were expired, meaning that BID should have conducted inspections of those businesses. However, we found that BID had not conducted inspections for five of these seven (71.4%) contracts. Exhibit 12 on the following page shows the results of this analysis.

[6] For the other contract files, the certifications were due after the audit period.

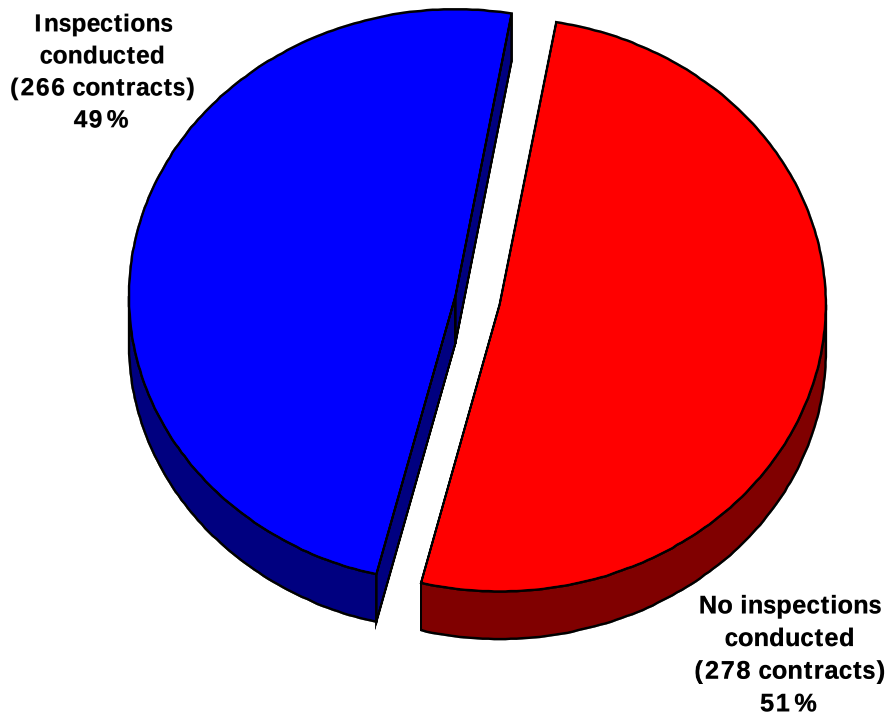
**Exhibit 12**
**Inspections for Expired Sample Contracts**
**Fiscal Years 1997 Through 2001**
**Enterprise Zone Program**




**Source:** Prepared by legislative auditor's staff using information from reviews of BID's contract files and other data obtained from BID.

We also analyzed all expired contracts included on BID's database for fiscal years 1997 through 2001. We found that a total of 544 contracts had expired, but that BID had conducted inspections for less than half (266 or 49%) of these contracts. Exhibit 13 shows the results of this analysis.

**Exhibit 13**
**Inspections for All Expired Contracts**
**Fiscal Years 1997 Through 2001**
**Enterprise Zone Program**




**Source:** Prepared by legislative auditor's staff using information from reviews of BID's contract files and other data obtained from BID.

In addition to the fact BID does not conduct inspections for all contracts as required, we question the focus of the inspections. According to information we obtained about the Department of Revenue's procedures concerning the Enterprise Zone Program, the Department of Revenue requires the businesses to submit invoices supporting the purchase of the buildings and equipment for which sales tax rebates are requested. Since the Department of Revenue appears to be verifying that the businesses' purchase of buildings and equipment are legitimate, BID's inspection of those buildings and equipment may be unnecessary. BID's inspections would be more effective if they focused on verifying employee data for the job tax credits the businesses receive.

*(See Recommendation 15 on page 16 and Matter for Legislative Consideration 4 on page 19.)*

## Deficiencies Exist in Enabling Legislation

We noted two issues of concern relating to the statutes that govern the Enterprise Zone Program. One statute contains outdated information regarding the applicable census data used in administering the program. In addition, no statute exists that prevents abuse of the program through non-retention of equipment purchased. Statutes containing outdated language create a risk that the program could be administered incorrectly. In addition, if critical control elements are missing from the laws, abuse of the program may occur.

R.S. 51:1784(C) requires DED to use 1990 census data or other approved data to determine if areas qualify for designation as enterprise zones. Based on this law, BID is using 1990 census data to make the determinations. However, the 2000 census data are now available. Thus, more current data are available to use in making the determinations. If the program administrators use outdated data, incorrect eligibility determinations could result.

In addition, state law does not require program participants to retain equipment purchased under the program that is subject to a local sales tax rebate. Therefore, a business could purchase equipment under the program, receive the sales tax rebates, and then sell or transfer the equipment to someone else. For example, an individual who owns multiple businesses could purchase equipment in the name of one of his/her businesses that qualifies for the program and then donate the equipment to another of his/her businesses that is not eligible for the program.

*(See Matters for Legislative Consideration 5 and 6 on page 20.)*

## Some Program Rules Are Outdated and Unnecessary

Two rules for the Enterprise Zone Program are outdated, and another is unnecessary. In addition, no program rule has been adopted to reflect a recent change in the statutes governing the program. Outdated and unnecessary rules can cause confusion over how the program is to be administered.

Rules 901(C)(3) and 939 contain outdated language. Rule 901(C)(3) refers to employers who hire Aid to Families with Dependent Children recipients. However, the Aid to Families with Dependent Children Program has been replaced by the Family Independence Temporary Assistance Program. Also, a BID official said that this provision is not used, regardless of the name of the assistance program. Rule 939 deals with multi-tenant operations. It contains special provisions for businesses that apply for the Enterprise Zone Program but that share facilities with other occupants/tenants. According to a BID official, Rule 939 is a special rule that was adopted for one particular case several years ago. This official said that they do not want to publicize the rule to other businesses because some developers would use it to build multi-tenant facilities and enjoy the tax benefits of the program without actually operating a business from the facility themselves.

In addition, part of Rule 919 (B) may be unnecessary. Rule 919 (B) says that businesses wishing to apply for the program must file their applications within three months after construction ends or operations begin, whichever is later. This language mirrors language in the rules for the Industrial Property Tax Exemption Program. However, according to BID officials, the date that operations began is not important in the Enterprise Zone Program because the program provides sales tax rebates for purchases associated with the construction phase of a business. The date operations begin has no impact on the construction period.

Finally, the program rules have not been updated to reflect a recent amendment to R.S. 51:1787. In 1999, the legislature amended R.S. 51:1787 to add subsection (H). The new subsection allows businesses located outside the boundaries of enterprise zones or economic development districts to participate in the Enterprise Zone Program.

*(See Recommendation 16 on page 17.)*

## Problems Common to Industrial Property Tax Exemption and Enterprise Zone Programs

This section contains findings that are common to both the Industrial Property Tax Exemption and Enterprise Zone Programs. Since these problems were found to be common to two programs, the other business tax incentive programs administered by BID may also need to be addressed, as well.

### Name Changes and Transfers of Ownership Rules Are Not Enforced

BID does not enforce Rule 17 of the Industrial Property Tax Exemption Program or Rule 951(G) of the Enterprise Zone Program. These rules require program participants to notify BID of any name changes or changes in ownership within three months. If these rules are not enforced, businesses could change their names or ownership and obtain tax breaks more than once without BID's knowledge.

In 10 of the 30 (33.3%) Industrial Property Tax Exemption Program contract files we reviewed, the businesses had a change of name or ownership. We found no evidence that BID had enforced the rule for any of these cases. In four of the 30 (13.3%) Enterprise Zone contract files we reviewed, the businesses had a change of name or ownership. In two of these cases (50%), we found no evidence that BID had enforced the rule. BID does not require businesses to report the dates of name changes or transfers, although some businesses may do so voluntarily. Therefore, it is not possible to determine whether all name changes and transfers are reported to BID within the specified time period.

*(See Recommendation 17 on page 17.)*

### Legislative Involvement in Awarding Incentives Is Limited

The legislature does not have an oversight role in the awarding of Industrial Property Tax Exemption and Enterprise Zone contracts. As noted on page 63, these two programs account for almost $2.1 billion in estimated tax relief for fiscal years 1997 through 2001, according to BID's data. On the other hand, the Legislative Budget Committee is required by law to approve incentives provided through the Industry Assistance Program, which accounts for only $1.5 million in estimated tax relief for this time period. In addition, the Joint Legislative Committee on the Budget must approve incentives provided by the Biomedical Research and Development Park and the University Research and Development Parks Programs, although these two programs are inactive. Thus, the legislature has oversight over only a very small portion of total tax relief provided to businesses in the state.

R.S. 47:4304 says that the governor and the Legislative Budget Committee determine whether to enter into Industry Assistance Program contracts. R.S. 46:813.1 says that the SBCI, with the approval of the governor and the Joint Legislative Committee on the Budget, may enter into Biomedical Research and Development Park contracts. R.S. 17:3389 says that that the SBCI, with the approval of the governor and the Joint Legislative Committee on the Budget, may enter into University Research and Development Park contracts. No such legislation exists for the Industrial Property Tax Exemption Program or the Enterprise Zone Program, the two largest tax incentive programs. If the legislature were involved in the process for the Industrial Property Tax Exemption and Enterprise Zone programs as it is for the smaller programs, it would be better informed about the effectiveness of those two programs.

*(See Matter for Legislative Consideration 7 on page 20.)*

## References to Rule 1 Should Be Removed From Statute and Administrative Code

The enabling legislation for the Enterprise Zone Program and the rules in the Administrative Code for the Industrial Property Tax Exemption Program contain references to Rule 1. Rule 1 of the program rules required program participants to give preference to Louisiana manufacturers, suppliers, contractors, and labor. Rule 1 was declared unconstitutional in 1997 because it violated the Commerce Clause of the U.S. Constitution. However, the corresponding statute and rules were not updated accordingly. Therefore, the statute and the rules contain outdated and misleading provisions.

R.S. 51:1787(B)(1) for the Enterprise Zone still says that businesses and contractors should give preference to Louisiana manufacturers, suppliers, contractors, and labor, unless not reasonably possible to do so. In addition, LAC Chapter 5, §501, which contains the rules governing the Industrial Property Tax Exemption Program, still states that businesses and contractors should give preference to Louisiana manufacturers, suppliers, contractors, and labor, unless not reasonably possible to do so. Since the language in these provisions is unconstitutional, they should be amended.

*(See Recommendation 18 on page 17 and Matter for Legislative Consideration 8 on page 20.)*

## Database Documentation Is Insufficient

BID has not documented how its business tax incentives database was created or how it is operated and maintained. In addition, BID has no standard procedures for approving or documenting changes made to the database. Documentation is critical because it defines the systems and procedures for performing data processing tasks. BID's lack of documentation makes it difficult to determine the origin and purpose of some fields and calculations in the database. In addition, a lack of continuity may exist if staffing changes occur in the future.

BID created its database in 1994 to maintain information about the various tax incentive programs it administers because the DED Information Services Division did not meet BID's needs. BID officials said that the database has proven very useful. However, when BID created the database, it did not prepare any systems documentation, such as user's manuals or operating instructions, to explain and describe how the system functions. BID officials said that they have not documented the database because it is a "work in progress."

BID officials demonstrated to us several controls in the database and several ways that the staff has increased its efficiency through computer usage. During the demonstration, we noted that some enhancements and automated checks were not working. According to BID, these problems exist because BID frequently modifies the database, which causes glitches in the database to occur. BID staff said that they continuously improve the database to address these glitches.

COBIT, Control Objectives for Information and Related Technology, is a committee that has developed generally accepted information technology control objectives. According to COBIT, "management should ensure that all requests for changes [and] system maintenance . . . are standardized and are subject to formal change management procedures. Changes should be categorized and prioritized and specific procedures should be in place to handle urgent matters. Change requestors should be kept informed about the status of their request." COBIT also states, "the change process should ensure that whenever system changes are implemented, the associated documentation and procedures are updated accordingly."

*(See Recommendation 19 on page 18.)*

## Database Contains Errors

We identified several inaccuracies in BID's database. These inaccuracies result from the lack of access, input, and output controls, as well as the computer glitches discussed in the previous section. BID uses the database to track the status of applicants, to estimate the dollar amount of tax relief awarded to businesses, and to provide information to the SBCI, and ultimately, the governor, for decision-making purposes. In addition, other governmental agencies and private individuals use information from the database to prepare various reports and studies. Since numerous entities and individuals rely on information from the database, it should be as accurate as possible.

The types of errors we identified in the database include the following:

- Inconsistent use of data fields
- Incomplete date fields
- Keystroke errors
- Incorrect dollar amounts
- Inaccurate status codes

One access control weakness we identified is that BID allows multiple users to update the database. The input control weaknesses we noted are a lack of edit checks, reasonableness checks, and comparison of data entered against source documents. The output control weaknesses we found are a lack of reviews for completeness and accuracy, as well as a lack of reconciliation of control totals.

According to BID, some database errors are the result of major database upgrades and changes. Also, BID officials said that some of the database errors resulted from turnover of clerical staff. They also said that in some cases, program administrators only have time to enter the information required by the SBCI for its meetings.

*(See Recommendation 20 on page 18.)*

## Some Incentive Programs Are Inactive

Several business tax incentive programs are not currently in use. While these programs are under the authority of BID, some of them have never been active. Others have been active in the past but are not currently in use. If tax incentive programs are inactive, they are of no benefit to the state because their purpose is to entice businesses to locate, grow, and thrive in Louisiana. Retaining them in state law could cause confusion as to what types of tax incentive programs Louisiana actually offers.

A listing of the inactive business tax incentive programs under the authority of BID is contained in Exhibit 14 on the following page. BID is responsible for administering five of these programs. However, for various reasons, they are not active. For two other programs, BID plays a minor role. All of these programs should either be modified to make them beneficial to businesses and the state or eliminated.

*(See Matter for Legislative Consideration 9 on page 20.)*

**Exhibit 14**
**Overview of Inactive Business Tax Incentive Programs**

| Name of Incentive Program | Constitutional and Statutory Citation(s) | Year Created | Description | Reasons BID Says These Programs Are Inactive |
|---|---|---|---|---|
| **Incentive Programs Administered by BID** | | | | |
| Almonaster Michoud Ad Valorem Tax Exemption | R.S. 33:4701 and R.S. 33:4708 | 1985 | Exempts ad valorem taxes for new industrial business within the New Orleans Business and Industrial District. | This program is no longer viable and no longer used. BID only provides information on this program. |
| Depressed Energy Intensive Industry | R.S. 45:1163.2 | 1984 | Establishes a rate structure for electric service companies to help them remain competitive with comparable industries located outside of the state. | Legislation has been repealed and for all practical purposes this incentive is sunset. |
| Louisiana Biomedical Research and Development Park; tax exemptions | R.S. 46:813.1 | 1991 | Exempts and/or rebates 30% of state and up to 100% of local taxes. Allows an additional five-year tax credit against state corporation franchise and income tax. | Enterprise Zone is a less complicated program that allows better benefits. |
| Mid City Research and Technology Zone; East Baton Rouge Parish | R.S. 33:3031 | 2000 | Exempts state taxes and allows sales/use tax rebates for research and technology companies locating in a specific zone. | Recently enacted program. Enterprise Zone allows better benefits. BID staff doubt that this program will be used. |
| University Research and Development Parks; tax exemptions | R.S. 17:3389 | 1991 | Exempts up to 30% of state taxes. Allows an additional five-year tax credit against state corporation franchise and income tax. Rebates up to 100% of sales/use tax. | Enterprise Zone is a less complicated program that allows better benefits. |
| **Incentive Programs in Which BID Has an Active Role But Does Not Fully Administer** | | | | |
| Film and Video Sales/Use Tax Rebate | R.S. 47:1125 through R.S. 47:1128 | 1990 | Provides a tax refund for production companies that intend to film in Louisiana. | BID provides information on this incentive to the public. BID also presents requests for this incentive to SBCI for approval. |
| Industrial Revenue/ General Obligation Bonds | R.S. 39:991 through R.S. 39:997 | 1964 | Allows a parish or municipality to issue bonds and use the proceeds toward industrial enterprises. | BID only completes a form letter for the secretary of DED to sign. |

**Source**: Prepared by legislative auditor's staff using information obtained from BID, the 1974 Louisiana Constitution, and the Louisiana Revised Statutes.

# State and Local Tax Relief Provided Through Incentive Programs

## How much state and local tax relief was provided during fiscal years 1997 through 2001 as a result of business tax incentives administered by the Business Incentives Division (BID)?

Using information provided by BID, which is the best available data, the estimated amount of tax relief provided to businesses for this time period is approximately $2.2 billion. Determining the actual amount of tax relief provided would require a great deal of coordination among the Departments of Economic Development, Revenue, and Labor, as well as local tax assessors and possibly other local officials. Currently, no such coordination exists. Also, no mandate exists to calculate the tax revenues and job creation that will be realized from increased business activity resulting from the tax incentives. The Governmental Accounting Standards Board (GASB) and the National Conference of State Legislatures recommend that economic development agencies monitor business incentive programs and measure the resulting costs and benefits. Since no cost benefit analyses are performed that would show the actual tax relief provided and resulting benefits gained, the effectiveness of the programs cannot be determined. Thus, the business tax incentive programs and the companies that receive tax relief lack fiscal accountability.

**Recommendation 21:** DED should develop means to determine the actual cost of tax relief provided to businesses through each incentive program if the legislature determines that DED should perform this function instead of the independent entity discussed in Matter for Legislative Consideration 12 on page 59. To determine the actual cost, the legislature may need to pass legislation allowing DED to have access to the records of the Departments of Revenue and Labor, as discussed in Matter for Legislative Consideration 11 on page 59. *(See pages 60 through 62.)*

> **Summary of Department of Economic Development Response:**
> **The department agrees with the recommendation**. BID staff will work with local assessors, the Louisiana Tax Commission, and the Departments of Revenue and Labor to gather information needed to determine the actual cost of tax relief provided to businesses through each incentive program. The department will also work with those agencies to propose changes to laws, if necessary, to allow access to confidential information. *(See Appendix C for full text of the department's response.)*

**Recommendation 22:** If DED (or another independent entity) does not develop means to determine the actual cost of tax relief provided to businesses through each incentive program, BID should improve its methodology for estimating these amounts.

The improved methodology should include procedures to require verification of numbers reported to BID by businesses. In addition, for the Industrial Property Tax Exemption and the Restoration Tax Abatement Programs, the methodology should use current millage rates and trend analysis of average millage rates when applicable. Also, the methodology for the Industrial Property Tax Exemption Program should include a consideration of depreciation and present worth of equipment purchases. *(See pages 63 through 66.)*

> **Summary of Department of Economic Development Response:**
> **The department agrees with the recommendation**. BID staff will implement the recommended changes to improve its methodology for estimating the cost of tax relief provided to businesses through each incentive program. *(See Appendix C for full text of the department's response.)*

**Recommendation 23:** DED (or an independent entity) should develop and implement procedures to compare the actual cost of each incentive program to the benefits derived from each. These comparative analyses should take into consideration what the state expects to receive in return for the tax relief it gives to businesses. *(See pages 66 through 67.)*

> **Summary of Department of Economic Development Response:**
> **The department agrees with the recommendation**. BID staff will develop or purchase and implement procedures to perform a cost benefit analysis for each incentive application received. These comparisons will be provided to the SBCI for review and consideration before granting tax relief. *(See Appendix C for full text of the department's response.)*

**Recommendation 24:** Once cost benefit analyses are implemented for each active incentive program that BID administers, DED officials should work with the Office of Planning and Budget and legislative staff to develop efficiency performance indicators for each of the six incentive programs administered by BID and to report outcome and efficiency indicators for each program externally. *(See pages 68 through 69.)*

> **Summary of Department of Economic Development Response:**
> **The department agrees with the recommendation**. BID staff will work with the Office of Planning and Budget and legislative staff to develop outcome and efficiency indicators for all active and the recently legislated incentive programs the department administers. Developing these indicators should also provide data necessary to meet the requirements of SB71 of the 2002 1st Extraordinary Legislative Session. *(See Appendix C for full text of the department's response.)*

**Recommendation 25:** DED should include "clawback" provisions in all applicable incentive program contracts to provide recourse to the state if businesses do not meet incentive program obligations. *(See page 69.)*

**Summary of Department of Economic Development Response: The department agrees with the recommendation.** BID staff will work with DED's legal staff and the SBCI to develop and include "clawback" provisions in all contracts. *(See Appendix C for full text of the department's response.)*

**Matter for Legislative Consideration 10:** The legislature may wish to consider reallocating the Department of Labor's current resources or granting the Department of Labor new resources to collect and verify the information needed by DED to verify employment data of businesses receiving tax incentives. Collecting and verifying this information is necessary for successful implementation of Matter for Legislative Consideration 11. *(See pages 60 through 62.)*

**Matter for Legislative Consideration 11:** The legislature may wish to consider amending R.S. 47:1508 and R.S. 23:1660 and/or creating new legislation that would allow DED (or another appointed entity, if applicable) to have access to confidential records at the Departments of Revenue and Labor, respectively, related to tax incentives that businesses receive from the state. Any new legislation may need to establish a public duty on the part of DED to obtain the necessary information as a part of its program administration responsibilities. *(See pages 61 through 62.)*

**Matter for Legislative Consideration 12:** The legislature may wish to consider adopting legislation that directs an independent agency such as the Division of Administration to collect verified data from the Departments of Economic Development, Revenue, and Labor relating to the active business tax incentive programs administered by BID and store the data in a centralized database. The independent agency should use this information to conduct a cost benefit analysis for each incentive program to determine what the state receives in return for the incentives it provides to businesses. *(See pages 66 through 67.)*

**Matter for Legislative Consideration 13:** The legislature may wish to consider adopting efficiency and outcome indicators as key performance indicators for each tax incentive program BID administers in order to ascertain the cost of operating each program and the net impact each program has on the state's economic well-being. *(See pages 68 through 69.)*

**Matter for Legislative Consideration 14**: The legislature may wish to consider adopting legislation giving the Department of Revenue clear authority to recapture tax benefits from companies that do not meet contractual clawback provisions. Doing so would give the Department of Revenue greater authority than currently exists because the authority would be exercised through the department's normal tax collection process rather than through contractual litigation. *(See page 69.)*

## Cost of Business Tax Incentives Is Unknown

BID does not determine the cost in terms of actual tax relief provided to businesses of the three largest business tax incentive programs it administers. Instead, BID broadly estimates the amounts of tax relief provided through these programs; however, the estimates are not reliable. For the other three active incentive programs, BID uses a better data collection process to determine the cost of the programs, but the amounts are not verified. Therefore, the cost of these incentive programs to the state and local governments is unknown.

### Actual Amount of Tax Relief Is Not Determined

The three largest business tax incentive programs in terms of number of contracts awarded are the Industrial Property Tax Exemption, Restoration Tax Abatement, and Enterprise Zone Programs. BID's estimates of tax relief provided to businesses through these programs are broad and are not reliable. Also, the Departments of Revenue and Labor do not have the authority to provide BID with the information they need to follow up and determine the actual values of the incentives at the end of the contract terms. Therefore, BID cannot ascertain the total amount of state and local tax relief granted as a result of these three programs.

Other governmental agencies involved in these programs also do not determine the amount of tax relief provided to businesses. For example, the Industrial Property Tax Exemption and Restoration Tax Abatement Programs affect local property taxes, but several local tax assessors told us that they do not calculate the amount of tax relief provided. For the Enterprise Zone Program, BID certifies the job tax credits awarded to businesses and communicates this information to the Department of Revenue. However, we cannot determine if the Department of Revenue keeps track of these job credits.

For the other three programs, (Industry Assistance, Quality Jobs, and Tax Equalization), BID records more accurate amounts for tax relief provided to businesses. For the Industry Assistance Program, BID negotiates the contract amounts with the businesses and then provides the Department of Revenue with copies of the negotiated contracts, which show the amounts of tax relief the businesses should receive. For the Quality Jobs Program, BID certifies for the Department of Revenue the job tax credits earned by each business. The Department of Revenue then sends BID a list of the tax credits used by each business and the cash payments made to each business in the form of tax rebates. For the Tax Equalization Program, BID requests some businesses to meet with the Department of Revenue to determine the appropriate way to apply tax credits, depending on the accounting structure of the businesses. The actual tax equalization amounts are determined when the businesses submit their state income tax returns to the Department of Revenue. The businesses are also required to send BID copies of the tax returns. Thus, the amounts BID records for tax relief for these three programs are more reliable than BID's estimates of tax relief for the other three programs. However, the Department of Revenue is ultimately responsible for the accuracy of the credits claimed by businesses.

**Confidential Information at Department of Revenue.** The Department of Revenue is statutorily charged with protecting the confidentiality of taxpayer records under R.S. 47:1508. According to Department of Revenue officials, this requirement prevents the department from sharing tax credit information with BID. As a result, BID cannot obtain accurate information about the actual cost of the various tax incentive programs it administers.

We attempted to review the records of businesses that have received tax credits, rebates, and refunds from the Department of Revenue so that we could calculate the amount of actual tax relief provided to the businesses. Department of Revenue officials said that they believed there was no clear guidance as to its authority to provide the information because the department was not the target of the audit. Our general counsel opined that we did have access to the records, and we shared this opinion with the department. However, the department chose to request an attorney general's opinion instead. The resulting Attorney General opinion No. 01-467, dated March 11, 2002, confirms that we do have access to this information. For further discussion of this issue, see Issue for Further Study No. 2 on pages 9 through 10 of this report.

**Lack of Communication Between Departments of Economic Development and Revenue.** The Department of Economic Development (DED) and the Department of Revenue have opposing missions regarding taxes. DED's mission is to encourage growth, stabilization, and diversification through programs and incentives, whereas the Department of Revenue's mission is to collect taxes to fund state operations. These opposing missions and conflicting views on confidentiality requirements create a communication gap between the two departments. If the two departments do not share information, the state will never know the actual amount of tax revenues it has given up in support of businesses. In addition, the state cannot determine the actual amount of taxes it will collect as a result of increased business activity attributable to the tax incentives.

**Confidential Information at Department of Labor.** BID also does not have the authority to access information from the Department of Labor's Unemployment Insurance database. The information maintained on the database would help BID track employment data for businesses that receive employment-related tax incentives. As with the Department of Revenue, the Department of Labor has concerns about the confidentiality of this information under R.S. 23:1660.

GASB suggests that economic development programs collect information on assisted firms by using firm-specific data on employment, location, and Standard Industrial Classification codes from state unemployment insurance programs. In addition, the U.S. Department of Labor states in its Unemployment Insurance Program Letter No. 34-97 that disclosure of unemployment insurance data to a public official is permissible and encouraged because such disclosure lends to more effective administration of numerous laws. According to our research, several states' economic development programs, such as Minnesota and Maryland, are allowed access to their states' Unemployment Insurance databases. However, in Louisiana, instead of obtaining employment information from the Department of Labor for programs such as the Enterprise Zone Program, BID collects it from the businesses. If BID could access information maintained by the Department of Labor, it would help BID determine the number of job credits that should be awarded to businesses. It would also help BID calculate the actual cost of tax relief provided and the resulting jobs created because of specific tax incentives.

However, as previously noted, BID does not verify the employment information reported by the businesses. In addition, information in the Department of Labor's database may not be reliable as evidenced by a management letter from the Financial and Compliance Division of the Office of the Legislative Auditor to the Department of Labor dated December 13, 2000. The letter questions the accuracy and completeness of the database. Thus, no assurance exists that the employment information collected by either BID or the Department of Labor is reliable.

In addition, according to Department of Labor officials, the Department of Labor does not track many of the specific data elements that BID would need to calculate the actual amount of tax relief provided to businesses. For instance, they said that wage record files do not track jobs created or hourly wages. Therefore, even if DED did have access to the Department of Labor's database, DED still may not have all information necessary to determine the number of job credits that should be awarded, to calculate the actual cost of tax relief provided or to determine the number of jobs created by businesses that receive incentives.

*(See Recommendation 21 on page 57 and Matters for Legislative Consideration 10 and 11 on page 59.)*

## BID's Estimates of Tax Relief Need Improvement

Since BID does not determine the actual amount of tax relief provided to businesses through the six active tax incentive programs it administers, BID estimates the amount of tax relief for each application it receives. As mentioned previously, BID's estimates are broad and may not be reliable. However, we used the estimates to quantify the amount of tax relief provided from fiscal years 1997 through 2001 because it was the best available data. Based on these estimates, the amount of tax relief provided was approximately $2.2 billion. Exhibit 15 shows the estimated amount of tax relief for each individual tax incentive program. Exhibit 16 on the following page shows the top contracts in terms of tax relief provided for each tax incentive program.

**Exhibit 15**
**Estimated State and Local Tax Relief Provided**
**Fiscal Years 1997 Through 2001**

| Program | Dollar Amount | Type of Tax |
|---|---|---|
| **Industrial Property Tax Exemption** | $1,767,833,130 | Local property tax |
| **Enterprise Zone** | $325,474,530 | State corporate income and franchise taxes; state and local sales tax |
| **Restoration Tax Abatement** | $39,286,483 | Local property tax |
| **Quality Jobs** | $2,105,153 | State corporate income and franchise taxes |
| **Tax Equalization** | $63,697,456 | Various state taxes |
| **Industry Assistance** | $1,500,000 | Various state taxes |
| **TOTAL ESTIMATED TAX RELIEF PROVIDED** | **$2,199,896,752** | |

**Source:** Prepared by legislative auditor's staff using information obtained from BID's database.

**Exhibit 16**
**Contracts With Largest Amounts of Estimated Tax Relief**
**Fiscal Years 1997 Through 2001**

**Industrial Property Tax Exemption Program**

| Company Name | Tax Relief |
|---|---|
| Conoco, Inc. | $46,636,263 |
| Motiva Enterprises, L.L.C. | $30,540,826 |
| International Paper Co. | $22,091,509 |
| Westlake Petrochemical Corp. | $20,685,678 |
| WPT Corp. | $18,426,540 |
| Chevron Chemical Company, L.L.C. | $18,231,441 |
| Pennzoil-Quaker State Co. | $17,584,461 |
| LA Pigment Co., LP. | $17,336,784 |
| Union Carbide Corp. | $15,595,607 |
| Nelson Industrial Steam | $14,041,051 |

**Enterprise Zone Program**

| Company Name | Tax Relief |
|---|---|
| Orion Refining Corp. | $28,430,668 |
| Conoco, Inc. | $16,837,097 |
| Union Carbide Corp. | $10,137,111 |
| Westlake Petrochemical Corp. | $9,842,815 |
| Georgia Gulf Corp. | $9,584,833 |
| BASF Corp. | $7,773,956 |
| International Paper Co. | $6,536,515 |
| Shell Chemical Co. | $6,315,205 |
| Westlake Polymers | $6,103,397 |
| Monsanto Co. | $5,522,203 |

**Restoration Tax Abatement Program**

| Company Name | Tax Relief |
|---|---|
| 800 Canal Street Limited Partnership | $2,856,366 |
| New Iberia High School Limited Partnership | $1,742,567 |
| Historic Restoration, Inc. | $1,558,884 |
| Travelers Insurance Co. | $1,279,936 |
| Patriot American Hospitality Partnership, LP | $1,240,892 |
| CS&M Associates DBA Sheraton New Orleans | $1,231,788 |
| Schwegmann Giant Super Markets | $1,103,849 |
| Baronne Development, LLC. | $1,007,882 |
| Refco Poydras Hotel Joint Venture | $958,298 |
| Emporia, LC | $912,539 |

**Quality Jobs Program**

| Company Name | Tax Relief |
|---|---|
| West Telemarketing Corporation | $786,516 |
| Galliano Marine Service, L.L.C. | $390,555 |
| West Telemarketing Corporation | $330,660 |
| Hamilton Relay, Inc. | $244,998 |
| Stewart Services, Inc. | $163,983 |
| Riverbarge Excursion Lines, Inc. | $153,477 |
| La Grain International, Inc. | $14,611 |
| Port Barre Apparel, Inc. | $12,539 |
| Shreveport Fabricators, L.L.C. | $7,814 |

**Tax Equalization Program**

| Company Name | Tax Relief |
|---|---|
| Westlake Petrochemical Corp. | $14,691,411 |
| LA Pigment Co., LP | $13,760,532 |
| Westlake Group - WPT Corp. & WPE Corp. | $12,429,319 |
| Stuller Settings - etal | $6,424,215 |
| Century Telephone Enterprises | $5,540,000 |
| Chase Manhattan Mortgage Corp (Troy & Nichols) | $4,239,005 |
| Mercantile Credit Corporation | $2,937,459 |
| Diversified Foods - etal | $1,528,491 |
| Georgia-Pacific Corporation | $915,238 |
| Ironclad, LP | $625,424 |

**Industry Assistance Program**

| Company Name | Tax Relief |
|---|---|
| Louisiana - Pacific Corporation | $1,500,000 |

**Source:** Prepared by legislative auditor's staff using information obtained from BID's database and interviews conducted at Department of Economic Development.

BID provides the members of the SBCI with its estimates to use when they make decisions on approving applications for tax incentives. Although the estimated tax relief amounts BID reports to the SBCI may not be reliable, the SBCI, and ultimately, the governor, approve the applications based on the estimates. In addition, other governmental agencies and private individuals use BID's estimates when preparing various reports and studies. For instance, the legislature uses reports and fiscal notes that contain the estimates. In addition, the estimates may have an indirect impact on state and local revenue forecasts. Also, many economic development studies and reports, such as studies by DED's Office of Communications, are affected by BID's estimates. Since numerous entities and parties use and report BID's estimates, the estimates should be as reliable as possible. However, BID includes certain factors in and excludes others from its estimates that may dilute their accuracy. These factors are discussed in the following sections.

**BID Relies on Numbers Reported by Businesses.** BID generally calculates its estimates using job creation and investment amounts reported by the businesses participating in the incentive programs. As previously mentioned, BID does little inspection or verification to ensure that these figures are accurate or reasonable. Also, when BID does conduct inspections, they may occur several years after the tax relief has been estimated and/or the contracts have been awarded. As a result, BID has no assurance that the figures businesses report are accurate. Its estimates, therefore, may be unrealistic.

**BID Uses Outdated Millage Rates.** For the Industrial Property Tax Exemption and the Restoration Tax Abatement Programs (the two programs that affect local property taxes), BID estimates each business's tax relief based on the previous year's millage rate instead of the current year's millage rate. The current year's millage rate usually becomes available in March or April. BID uses the previous year's millage rate in an effort to charge all businesses that apply for exemptions during the same calendar year the same fees. However, under this system, BID is using outdated millage rates for estimates made after March or April of any given year. By not using the current millage rate, BID could understate or overstate the amount of estimated tax relief. The magnitude of the error depends on fluctuations in the millage rates, which are based on property values, in each parish.

In addition, BID uses current average millage rates to estimate property taxes for 5 or 10 years into the future. BID does not take into consideration future changes in the millage rates or appraised values of the properties. Thus, BID's estimates are not adjusted for changes in rates and values over time.

**Valuation of Assets Over Time Is Not Considered.** For the Industrial Property Tax Exemption Program, BID uses the cost of equipment reported by businesses applying for exemptions to calculate its estimates of tax relief. BID does not take into account depreciation of the equipment. Since equipment today will not be worth the same amount 10 years from now when it is taxed, these figures are not realistic. As a result, BID may be overstating the amount of tax relief in its estimates.

BID officials said that a present worth analysis should be used to estimate the amount of tax relief in these cases. A present worth analysis could more closely estimate tax relief. However, they also said that this type of analysis might not be possible because of the many variables involved. A present value analysis must recognize that some types of equipment last longer than others and that different types of equipment are depreciated differently. A present worth analysis must also attempt to predict inflation rates over the life of each contract.

*(See Recommendation 22 on pages 57 through 58.)*

## Incentive Programs Lack Fiscal Accountability

According to economic development literature, governments should adopt performance evaluation methods to monitor the costs and benefits of each incentive. Performance evaluation methods help government agencies achieve fiscal accountability for the programs they administer. Since BID does not determine the actual cost of the incentive programs, and its estimates of the cost are not reliable, program impact cannot be measured. Thus, no fiscal accountability exists for the business tax incentives BID administers.

### No Cost Benefit Analyses Are Conducted

The first step in determining the net impact of incentive programs is to identify how much the programs actually cost state and local governments in terms of tax relief provided to businesses. The cost of the tax relief is one of the major elements of a meaningful cost benefit analysis. The next step is to determine what the state and local governments receive in terms of increased business activity in return for the tax incentives awarded. Since no mechanism is in place to determine program costs or returns, BID cannot prepare meaningful cost benefit analyses that would demonstrate the overall effectiveness of the various incentive programs.

DED's Office of Communications does perform an analysis in the form of an Annual Report on Business Incentives Activities. The analysis shows the capital investment and employment projections made by companies at the time that incentive contracts are awarded to them. However, no one is responsible for determining the actual cost of the incentives in terms of tax relief provided or the benefits state and local governments receive as a result of the incentives.

Also, as previously mentioned, BID attempts to estimate economic impact on the staff comments forms it provides to the SBCI. These estimates are based on company projections and capital investment information that businesses report to BID. However, the staff comments forms are incomplete, as previously discussed. In addition, based on our observations of the SBCI meetings, the board appears to award contracts regardless of the economic impact information on the forms.

Companies that receive incentives are required to submit annual reports to BID. These reports show valuable information that could be used to implement meaningful cost benefit analyses such as:

- Number of company employees
- Annual payroll earnings of the employees
- Additional employees that work full time on the site but are not employed by the contract holder
- Total taxes the company pays to the state and local governments per year

According to a BID official, BID neither enforces the filing of these reports nor uses them to determine program benefits. In addition, the SBCI generally does not review the reports, and very few BID officials review them. Also according to BID officials, over the years, DED has allowed companies to submit less thorough annual reports. Thus, a valuable tool for measuring program benefits is not used.

Although cost benefit analyses are not the only factor that should be considered when determining whether to award tax incentive contracts to businesses, they are an important one. Without them, the state has no way of knowing exactly what it will receive in return for the tax relief it provides through the incentives. Without cost benefit analyses, the state cannot know whether it is receiving adequate returns for the incentives it awards.

*(See Recommendation 23 on page 58 and Matter for Legislative Consideration 12 on page 59.)*

## Cost Benefit Analyses Would Result in More Meaningful Performance Data

If a cost benefit analysis of each tax incentive program were prepared, BID could develop more meaningful objectives and performance indicators for each program. The National Conference of State Legislatures Task Force on Economic Incentives suggests that agencies build more accountability into incentive programs from the outset and tie program benefits to performance. However, outcome and efficiency indicators are not reported externally for each of Louisiana's incentive programs. As a result, the current performance data reported in the Budget Request and other sources are not as meaningful or useful as they could be.

The 2002-2003 Budget Request lists one objective and four performance indicators for BID. The objective is not specific to any particular incentive program and the performance indicators do not measure the cost or impact of the individual programs. BID's objective is "Through the Business Incentive activity, to assist in the creation of 12,550 permanent jobs through the approval of 665 tax incentive projects by Fiscal Year 2003." The performance indicators are as follows:

- Number of projects approved
- Number of permanent jobs created
- Number of construction jobs created
- Amount of capital investment

These performance indicators are an improvement over those reported externally in past years. However, since BID does not verify employment data reported by businesses, the values of the second and third performance indicators may not be reliable. Also, GASB recommends that performance data be disaggregated so that the performance of each individual program can be determined. Overall averages can conceal information that is potentially useful to governmental officials, agencies, and the general public. DED does maintain outcome indicators internally for the six incentive programs BID administers. However, DED does not maintain efficiency indicators for each program, and neither outcome nor efficiency indicators are reported for each program to the legislature or other parties.

Reporting improved performance indicators externally would allow decision-makers to monitor the state's overall progress in the area of business development. Also, if objectives and outcome and efficiency indicators were reported externally for each incentive program, the legislature and other decision-makers could identify which programs are achieving their intended purposes and which ones are not. They could then determine which programs should be retained, altered, or abolished.

*(See Recommendation 24 on page 58 and Matter for Legislative Consideration 13 on page 59.)*

## Clawbacks Could Improve Businesses' Accountability

Not all contracts the state enters into with businesses for tax incentives contain clawbacks. Clawbacks are provisions that require businesses to give back all or a portion of tax incentives they have received if they do not meet investment and/or employment projections. Based on economic development literature we reviewed, the common trend in many states is to implement clawback provisions that encourage businesses to be more accountable. Without clawbacks, a valuable enforcement mechanism is lost.

According to Fluor Global Location Strategies, a site location consulting firm, clawback provisions were viewed as necessary evils in the past. However, they are now viewed as an equitable guarantee of mutual performance. DED has placed limited clawback provisions in some of its incentive contracts. However, Department of Revenue officials said they are uncertain if they have the authority to enforce the provisions. As a result, the state has little recourse if businesses do not comply with incentive contract terms.

*(See Recommendation 25 on page 58 and Matter for Legislative Consideration 14 on page 59.)*

# Factors Affecting Economic Development

## What factors are most important to a state's economic well-being, and how does Louisiana compare to other states?

In the literature and statistics we reviewed, Louisiana ranks among the bottom states in terms of economic development. Louisiana is joined by Arkansas, Mississippi, West Virginia, North Dakota, and South Dakota. The top ranking states are Colorado, Washington, Massachusetts, California, Connecticut, and Minnesota. The major factors contributing to these rankings relate to technology; research and development; and quality of life issues such as education, working poor, and employer health coverage. Louisiana ranks poorly in all these categories. In addition, site location consultants consider factors such as the public education system and skilled labor to be most important in determining where businesses should locate or expand. Louisiana ranks poorly in these factors, as well. Site location consultants also consider business incentives to be an important factor for site location decisions. In the past, the Department of Economic Development (DED) has not adequately targeted its economic development efforts toward these factors. However, DED has begun to re-target its efforts to focus on technology and research and development, providing a unique opportunity for improvement in the areas discussed in this section.

**Recommendation 26:** DED should continue to move forward with a well-rounded economic development approach. The approach should address the critical business and quality of life factors that are discussed in this section of the report. DED should work with other state agencies and the legislature to pursue strategies that will result in improvements in these factors. DED should couple it efforts in addressing these factors with an improved package of business tax incentives that address today's economy. Any changes DED makes to any tax incentive programs should be balanced against the current tax structure. *(See pages 71 through 83.)*

> **Summary of Department of Economic Development's Response:**
> **The department agrees with the recommendation**. The department will constantly review and refine its approach to economic development and the incentive programs available to its clients. Any changes made will be balanced against Louisiana's tax structure, and implementation will be based on maintaining a competitive posture with competing states. *(See Appendix C for full text of the department's response.)*

## Louisiana Ranks Poorly in Many Factors Important to Economic Development

To determine how Louisiana compares to the other 49 states in terms of factors important to economic development, we researched and compared data from three recent business climate studies. These studies are listed in Exhibit 17 below. The studies rank the 50 states based on various economic development factors.

The rankings for the states as they relate to these factors varied across the studies. However, we found that certain states tended to rank high and certain states tended to rank low across all three studies for certain factors. The top and bottom ranked states we identified are shown in Exhibit 17.

**Exhibit 17**
**Top and Bottom Ranked States in Terms of Economic Development**

| State | Number of Times State Cited in Studies |
|---|---|
| **Top Ranked States** | |
| Colorado | 5 |
| Massachusetts | 4 |
| Washington | 3 |
| California | 3 |
| Minnesota | 2 |
| Connecticut | 2 |
| **Bottom Ranked States** | |
| Arkansas | 5 |
| Mississippi | 4 |
| West Virginia | 4 |
| **Louisiana** | **3** |
| North Dakota | 2 |
| South Dakota | 2 |

**Note:** The Corporation for Enterprise Development study includes three types of rankings. The other two studies include only one type of ranking.

**Source**: Prepared by legislative auditor's staff based on a comparison of data included in the *Corporation for Enterprise Development, 2000 Development Report Card*; *the Milken Institute, New Economy Index 2001*; and the *Progressive Policy Institute, The State New Economy Index (1999).*

| State Ranking | Our Rating |
|---|---|
| 1-15 | High |
| 16-36 | Moderate |
| 37-50 | Low |

**Factors Contributing to State Rankings**. We analyzed all factors from each study that contributed to the state rankings shown in Exhibit 17. Based on the rankings for each factor, we rated the states as high, moderate, or low, as shown in the box to the right. We then defined factors as significant if at least four of the top states ranked high for those factors and at least four of the bottom states ranked low for those factors. We categorized the significant factors as shown in Exhibit 18 below. We also included Louisiana's rating for each significant factor in the exhibit.

**Exhibit 18**
**Factors Significant to Economic Development and Louisiana's Rating for Each Factor**

| Significant Factors | Louisiana's Ratings |
|---|---|
| **Technology** | |
| 1. Technology Companies | Moderate |
| 2. Commercial Internet Domains | Low |
| **Research and Development** | |
| 3. Private Research and Development | Low |
| 4. Small Business Innovation Research (SBIR) Grants | Low |
| 5. Industry Research and Development | Low |
| 6. Patents Issued | Low |
| **Quality of Life** | |
| 7. Basic Educational Skills Proficiency - Math | Low |
| 8. High School Attainment | Low |
| 9. College Education Attainment | Low |
| 10. Education-Percentage of Population Age 25+ with Advanced Degrees, 2000 | Moderate |
| 11. Ph.D. Scientists and Engineers in Work Force | Low |
| 12. Employer Health Coverage | Low |
| 13. Working Poor | High |
| 14. Poverty Rate | High |
| 15. Teenage Pregnancy | High |
| **Others Factors** | |
| 16. Voting Rate | High |
| 17. Urban Mass Transit Availability | Moderate |
| 18. Managerial Professional Jobs | Moderate |
| 19. Export Focus of Manufacturing | Moderate |
| 20. Venture Capital | Moderate |
| 21. Sectoral Diversity | Moderate |

**Source**: Prepared by legislative auditor's staff using a comparison of data in the *Corporation for Enterprise Development, 2000 Development Report Card;* the *Milken Institute, New Economy Index 2001*; and the *Progressive Policy Institute*, *The State New Economy Index (1999).*

As can be seen in Exhibit 18, Louisiana ranks poorly in 13 of the 21 factors (62%) that research studies show are important for economic development. Louisiana ranks moderate in seven factors (33%) and well in only one factor (5%)--voting rate. Louisiana's poor rankings relate to technology, research and development, and quality of life factors such as education. This is an important point because the largest tax incentive program DED administers exempts businesses from paying property taxes, which help fund the public education system.

According to the studies we reviewed, the factors in Exhibit 18 are critical to today's economy. Recent changes in the economy have given businesses more flexibility in deciding where to locate. Traditionally, factors affecting the cost of doing business, such as taxes, have been more important. In the new economy, a firm's competitive advantage is based as much on technology and knowledge as on geography and political boundaries. Quality of life factors have become very important in responding to the new economy.

DED's new economic development strategy, Vision 2020, was recently adopted to improve the state's image and business climate. Under Vision 2020, efforts are underway to diversify the economy and seek new alliances with business groups in nine key cluster areas. These cluster groups range from expanding established sectors such as energy and petrochemical manufacturing to developing new territory in biotechnology and entertainment. Vision 2020 offers a unique opportunity for DED to work for improvement in the business and quality of life factors where Louisiana ranks poorly.

## Business Site Location Consultants Consider Education-Related Factors Critical

According to our research, businesses rely more on the use of site location consultants when deciding where to locate or expand than they used to. These consultants provide information based on research about the various states, which allows businesses to make informed decisions on the best area for relocation or expansion. We compared factors from various site selection sources to determine which ones they consider to be important. We defined factors that were included in at least two of these sources as significant. We then rated the importance of each significant factor based on the number of sources in which each was cited. Some factors tied for the first and third place rankings.

In our research, we found that factors important to site location consultants fall into two categories: business factors and quality of life factors. The significant factors in each of these categories are listed in

Exhibit 19 on the following page. We also included Louisiana's ranking for each factor as compared to the other 49 states. As shown in the exhibit, Louisiana ranks poorly in many of the significant factors that site location consultants consider important.

**Exhibit 19**
**Significant Factors Important to Site Location Consultants and Louisiana's Rankings**

| Business Factors | Louisiana's Rankings | | Quality of Life Factors | Louisiana's Rankings | |
|---|---|---|---|---|---|
| 1. Skilled Labor | Relates to education level. See rating for public education in Quality of Life section. | | 1. Rating of Public Education | High school attainment (2000)<br>College attainment (2000) | 47<br>43 |
| 1. Transportation Infrastructure | Highway deficiency (2000)<br>Bridge deficiency (2000)<br>Urban mass transit (2000) | 43<br>39<br>26 | 1. Availability of Universities | Institutions of higher education (1999) | 16 |
| 2. Tax Exemptions/ Incentives | Not applicable* | | 1. Recreational/Cultural Opportunities | Per capita state spending on state art agencies (2001)<br>State parks, recreation areas, and natural areas (2000) | 22<br>35 |
| 3. Construction Costs | Not available | | 2. Crime Rate | Violent crime (2000)<br>Property crime (2000)<br>Total (2000) | 7<br>5<br>4 |
| 3. Labor Costs | Average weekly earnings of production workers (2000) | 6 | 3. Housing Availability | Homeowner vacancy rate (2000)<br>Rental vacancy rate (2000) | 22<br>10 |
| 3. Availability of Buildings/Land | Percent of nonfederal land that is developed (1997) | 25 | 3. Low Housing Costs | Housing costs (2000) | 1 |
| 3. Energy Availability and Cost | Energy cost (2000) | 19 | 3. Health Facilities | Community hospitals (2001) | 14 |
| 3. Proximity to Markets/Customers | Not available | | 3. Climate | Normal daily mean temperature (2000)<br>Percent of days that are sunny (2000) | 4<br>13 |

* The sources we reviewed do not provide state rankings for tax exemptions or other types of business incentives.

**Source:** Prepared by legislative auditor's staff from a comparison of factors that site location consultants named in interviews and in the following sources - *Area Development* magazine's "1999 Corporate Survey," "2000 Corporate Survey," and "2001 Corporate Survey"; *Site Selection* magazine March 2001; and other articles. Louisiana's rankings were obtained from the studies listed in Exhibit 17, Morgan Quitno's *State Rankings 2001, CQ's State Fact Finder 2002,* the Louisiana Commission on Law Enforcement, the Louisiana Department of Education, the Louisiana Department of Economic Development, and the Louisiana Department of Health and Hospitals.

**Business Factors.** Exhibit 19 shows that skilled labor tied with transportation infrastructure as the number one factor in the business factors category. Skilled labor is directly related to education, which is the number one factor in the quality of life factors category. However, Louisiana ranks near the bottom of the states in education. The fact that skilled labor and public education are seen as the most important factors by site location consultants in both categories indicates that these factors are equally important for economic development. A skilled workforce and public education are interrelated because without a good public education system, there is a limited base for a skilled workforce. Louisiana's low ranking in public education can give site location consultants a negative picture of Louisiana's ability to produce a skilled workforce.

Exhibit 19 also shows that incentives, especially tax exemptions, are the second most important business factor in site selection decisions. According to a Deloitte & Touche Fantus Corporate Real Estate Solutions 2001 presentation we reviewed titled "Location Strategy Trends: How Might They Impact the River Parishes?" incentives are important, but not critical, for site location decisions. In 2001, consultants with Location Advisory Services in New Jersey stated in an *Area Development* article that incentives remain an important site selection factor and that most corporations are aware of and now seek incentives. However, Location Advisory Services' experience shows that corporations usually seek incentives after contending finalist locations are selected. Thus, the incentives are viewed as a differentiator among places in which a project could operate successfully.

The Location Advisory Services' article also says that it appears that more companies are making incentives a first-cut screen in selecting location. This change is fostered by the increased publicity given to incentives in the press, competitive positioning by economic developers, and the singular emphasis placed on incentives as the major factor in site selection by some consulting firms that specialize in that aspect of the process. For example, the Wadley-Donovan Group said in a 1999 article that incentives are increasing in importance and play a more decisive role when choosing among several locations. Wadley-Donavan contends that tax abatements are the most sought-after incentive, followed by training and infrastructure grants.

In addition, the consultants, Grant Thornton LLP, say that businesses are trying to offset their investments by using cheaper labor and government incentives. PricewaterhouseCoopers states in a 1999 article that incentives help companies lower their initial start-up costs and reduce annual operating expenses. Also, in 1999, a firm called Fluor Consulting Global Location Strategies contended that incentives are highly valued and can improve the return on investment and market competitiveness. Although state and local incentives declined slightly in the rankings in *Area Development's* 2000 corporate survey and dropped even further in 2001, the survey indicates that site location consultants continue to prioritize these financial inducements.

Louisiana offers businesses many tax incentives, as shown in Exhibit 1 on page 2. In December 2001, Dr. James A. Richardson, a local economic consultant, completed a study of the tax incentives DED offers as compared to those offered by other southern states. In his report, Dr. Richardson concludes that Louisiana is forced to resort to tax incentives to equalize its tax burden comparative to other states rather than using the incentives to entice businesses to locate in Louisiana. He recommends that if the current tax structure is retained, Louisiana needs to tie incentive programs to the new economic development clusters that were established as part of DED's new 20-year strategic plan. He also includes in his report a list of state tax incentive programs that should be retained, changed, and added. Finally, Dr. Richardson recommends that if the state tax structure is altered, tax incentives must be altered as well because the two must be in harmony.

Metrovision, a New Orleans area economic development group, also contracted for a study of Louisiana's state and local incentives, which was completed in September 2001. The study is in two parts: "An Analysis of Economic Development Incentives in the Southeastern U.S." and "Comparing Louisiana's Incentive Programs to the 12 Southeastern States." In part two of the study, Metrovision concludes that Louisiana is competitive with its basic incentive programs. However, in order to compete for its cluster industries, the state should consider revising its tax credit, exemption, and payroll tax rebate programs to offer incentives that are attractive to the cluster industries.

In earlier sections of this audit report, we make specific recommendations related to needed improvements in DED's administration of tax incentive programs. These improvements are necessary to attain greater accountability. If implemented, the improvements will allow taxpayers to see evidence that the tax incentives given to businesses are positively affecting Louisiana's economy.

Five factors tied for third place in the ranking of significant business factors for site selection, as shown in Exhibit 19 on page 76. They are:

- Construction costs
- Labor costs
- Availability of buildings/land
- Energy availability and cost
- Proximity to markets/customers

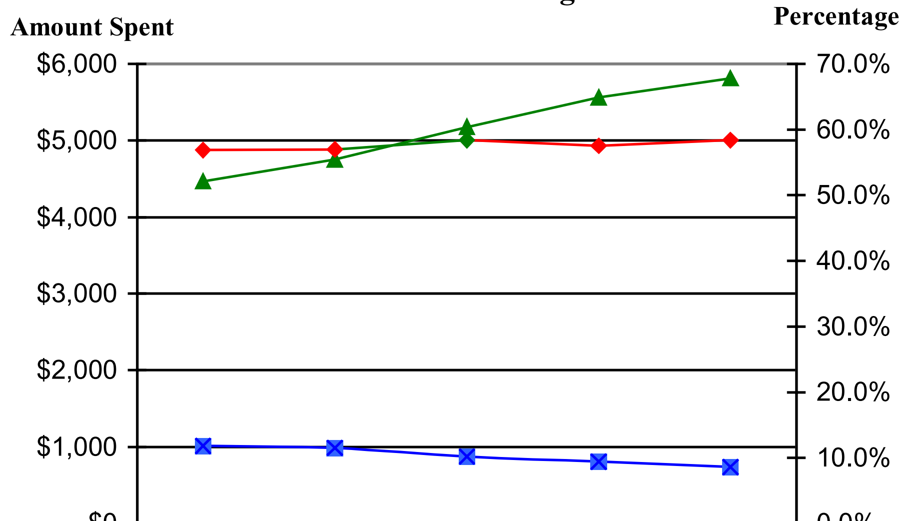
These factors relate to practical issues and concerns of building and establishing a facility in a new location. Overall, Louisiana ranks in the middle for these factors. Regarding energy availability and cost, *Area Development* magazine's "2001 Corporate Survey" indicates that because of the 2001energy crisis on the west coast and elsewhere, energy availability and cost have taken on heightened importance for site location consultants. In 2001, the site location consultant firm of DEALTEK, Ltd.'s, chief executive officer stated in an *Area Development* article that companies are more interested than before in finding and benefiting from reliable electricity infrastructure and reduced costs via electric deregulation. DED officials noted that since Louisiana has plentiful energy resources, this strength could be used as leverage in negotiating with companies interested in locating in Louisiana. Regarding proximity to markets and customers, information on DED's Web site shows that Louisiana is within 600 miles of major markets such as Houston, Dallas/Fort Worth, Atlanta, St. Louis, and Nashville.

**Quality of Life Factors.** One survey we reviewed ranks quality of life factors independent of business factors but reports that survey respondents say these factors are equally important. In addition, a Price Waterhouse Coopers article states that companies are placing more significance on quality of life factors because they realize that an attractive area in which to live and work can be a strategic advantage for attracting and retaining needed employees. However, as shown in Exhibit 19 on page 76, except for cultural and recreational opportunities, Louisiana ranks poorly in quality of life factors ranked first and second: education and crime rate. The state's poor rankings for these factors could preclude the state from attracting more progressive industries in the future. Louisiana ranks much better in the factors tied for third place: housing availability, low housing cost, health facilities, and climate.

According to the Deloitte & Touche Fantus presentation we reviewed, the importance of quality-of-life factors varies depending on the type of facility to be located or expanded. According to a Metrovision official, quality-of-life is of utmost importance to a corporate office/headquarters with high-paid personnel who want an executive lifestyle, including a low crime rate, cultural and recreational opportunities, a good local education system, and good neighborhoods. Conversely, quality-of-life issues become much less important for the location of manufacturing or distribution plants because their focus is on lowering the cost of operations, which includes labor costs. According to our research, Louisiana has historically drawn more manufacturing and distribution plants where the quality-of-life factors are less important. If Louisiana hopes to attract more high-paying jobs, improvement will have to be made in the quality-of-life factors.

We extended our review of some of the quality-of-life factors to determine if trends for Louisiana were improving. Exhibit 20 below shows the trend for several education measures from 1996 through 2000, the most recent period for which data are available. This chart shows that since 1996, as the amount spent per student has increased, the dropout rate has decreased. However, although the dropout rate has decreased, the number of at-risk youth is on the rise. Louisiana defines at-risk youth as students who qualify for free school lunches. The federal government publishes income eligibility guidelines for states to use in determining which students are eligible for the free lunch program. According to the state Department of Education's *Grade Level Retention in Public Schools 1997-98 to 2000-01*, poverty has a "great effect on grade retention." The report says that students on free lunch are twice as likely to be retained in their current grades as students receiving reduced price lunches or students not receiving any food services.

**Exhibit 20**
**Louisiana's Education Rates**
**Fiscal Years 1996 Through 2000**




| Fiscal Year | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Expenditures per Pupil | $4,468 | $4,751 | $5,178 | $5,562 | $5,814 |
| Percentage of "At-risk Youth" on Free and Reduced Lunch | 56.9% | 57.0% | 58.4% | 57.5% | 58.4% |
| Drop-out Rate | 11.8% | 11.5% | 10.2% | 9.4% | 8.6% |

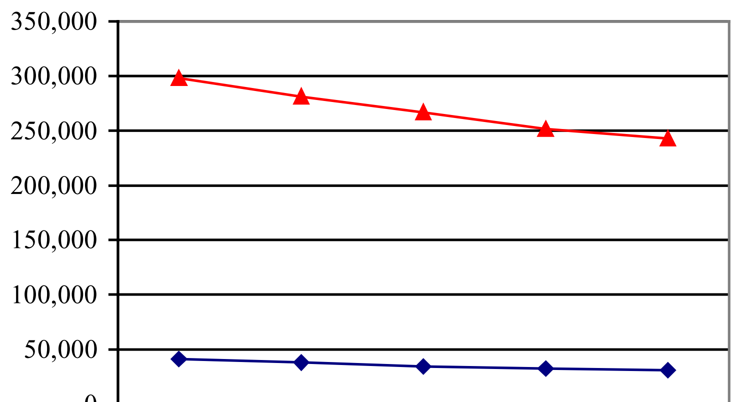
**Source**: Prepared by the legislative auditor's staff using information provided by the Louisiana Department of Education. These data have not been audited.

Crime measures for 1996 through 2000, the most recent period for which data are available, are shown in Exhibit 21 below. The violent crime rate has improved in Louisiana from a state ranking of number four in 1996 to a ranking of number seven in 2000. This trend indicates a decrease of approximately 25% in violent crimes by number of offenses, including murder, rape, robbery, and aggravated assault over the five-year period. Although violent crimes including murder have decreased significantly, Louisiana still ranked number one of all the states in the number of murders for each of those years.

Louisiana's property crime rate has moved from a number four ranking in 1996 to a number five ranking in 2000. FBI data indicates an 18% decrease in the number of offenses for property crimes, including burglary, larceny-theft, and motor vehicle theft from 1996 to 2000.

**Exhibit 21**
**Louisiana's Crime Rate Based on Number of Offenses**
**1996 Through 2000**

**Number of Offenses**



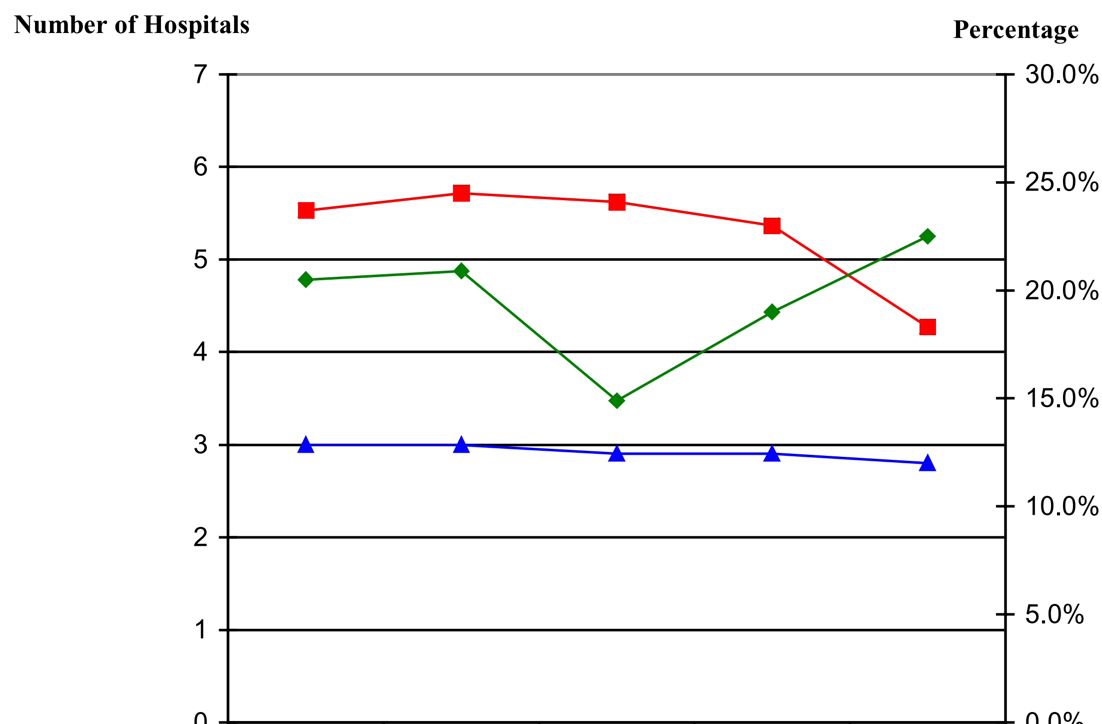

| Year | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Property Crime | 257,130 | 243,423 | 232,378 | 219,219 | 211,904 |
| Violent Crime | 40,426 | 37,248 | 34,057 | 32,033 | 30,440 |
| Number of Murders | 762 | 682 | 560 | 468 | 560 |

**Source**: Prepared by the legislative auditor's staff using information provided by the Louisiana Commission on Law Enforcement and Administration of Criminal Justice. These data have not been audited.

Overall, the total crime index indicates that Louisiana has maintained a fourth place ranking of all the states for the past four years (1996 through 2000). Considering the state's high ranking in crime as compared to other areas in the country, companies considering locating in Louisiana may have concerns about safety issues.

Research indicates that the quality of health care in a state is also important to site location consultants in making decisions about locating businesses in an area. Several health care measures for Louisiana for 1997 through 2001, the most recent period for which data are available, are shown in Exhibit 22 below.

**Exhibit 22**
**Louisiana's Health Care Rates**
**1997 Through 2001**




| Year | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| Number of Community Hospitals per 100,000 Population | 3 | 3 | 2.9 | 2.9 | 2.8 |
| Percent of Population Lacking Access to Primary Health Care | 23.7% | 24.5% | 24.1% | 23.0% | 18.3% |
| Percent of Population not Covered by Health Insurance | 20.5% | 20.9% | 14.9% | 19.0% | 22.5% |

**Source:** Prepared by the legislative auditor's staff using information provided by the Louisiana Department of Health and Hospitals. These data have not been audited.

According to research done by the Morgan Quinto Press in 2001, Louisiana ranked third in the percent of population not covered by health insurance. Approximately 22.5% of Louisiana's residents are not covered by health insurance as compared to the national average of 15.5%. In addition, Louisiana ranks well above the national average in the lack of access to primary care. In 2001, 18.3% of Louisiana residents did not have access to primary health care as compared to 9% for the rest of the nation. However, the research shows that more Louisiana residents have access to primary health care than they did in 1997. Also, Louisiana appears to have more than the average number of community hospitals. In 2001, Louisiana had 50% more hospitals than the national average. Louisiana ranks number 14 in the United States for the number of community hospitals per 100,000. Both of these trends could be beneficial for economic development efforts in the state.

**Impact of Terrorist Attacks.** The September 11, 2001, terrorist attacks have dramatically changed the priorities of site location consultants and companies looking to relocate, according to several articles in *Area Development*'s "2001 Corporate Survey." Deloitte & Touche Fantus of New York states that how and where companies relocate will become the focus of risk-management plans and site selection decisions, and that decentralization will become the new mantra. The firm contends that the economic development community will benefit from this push for decentralization of operations and diversification of risk. The result will be that operations and business units will be divided and moved around the country and the globe. The president of the site location consulting firm Moran, Stahl and Boyer of Georgia agrees with Deloitte & Touche Fantus, asserting that it may ultimately be more effective to deploy smaller operations into multiple locations.

Deloitte & Touche Fantus also predicts that increased significance will be placed on smaller communities, areas offering nurturing roots, and areas that are less likely targets for disruption. New jobs will be created in these remote, smaller communities, and companies will benefit from the lower operating costs that these areas afford. Overall, Deloitte & Touche Fantus contends that the events of September 11 are likely to reinvigorate economic development activity in the United States. Louisiana's economy could benefit from this trend of seeking smaller communities to relocate if economic development efforts are adequately re-targeted.

*(See Recommendation 26 on page 71.)*

# Appendix A

# Audit Scope and Methodology

# Appendix A: Audit Scope and Methodology

We conducted this performance audit under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. All performance audits are conducted in accordance with generally accepted government auditing standards as promulgated by the Comptroller General of the United States. Preliminary work on this audit began in May 2001. Because of other legislative demands, the audit was not completed until March 2002.

## Scope

This audit focused on tax incentives administered by the Business Incentives Division (BID), which is located within the Resource Services Section of the Office of Business Development of the Department of Economic Development (DED). We concentrated our work on the Industrial Property Tax Exemption Program and the Enterprise Zone Program. The audit covers fiscal years 1997 through 2001. The objectives of the audit were to answer the following questions:

- Were tax incentive contracts awarded and administered in conformity with the state constitution, state laws, and established rules?
- How much state and local tax relief was provided as a result of business tax incentive programs administered by the Business Incentives Division
- What factors are most important to a state's economic well-being, and how does Louisiana compare to other states?

## Methodology

**To gain an understanding of the laws and rules that govern the business incentive programs, the procedures used by BID to administer the programs, and the current issues related to business tax incentives, we completed the following procedures:**

- We reviewed the Louisiana State Constitution, Louisiana Revised Statutes, administrative rules, attorney general opinions, and court cases as they related to DED, the State Board of Commerce and Industry, and the individual business tax incentive programs.
- We reviewed the Executive Budgets for fiscal years 2000-2001 and 2001-2002; the supporting schedules dealing with BID from the fiscal year 2000-2001 budget request; and the sections dealing with BID from the fiscal year 2001-2002 Budget Request packet, which included the operational plan.

- We interviewed DED and BID officials, as well as several members of the State Board of Commerce and Industry, and gathered pertinent background information and information about standard procedures.

- We observed several of the State Board of Commerce and Industry's board and committee meetings. We also observed the workshop that BID conducts for businesses applying for tax incentives.

- We reviewed outside literature such as newspaper and Internet articles, audit reports, and studies as they related to economic development, tax incentives, and the State Board of Commerce and Industry.

**To determine if tax incentive contracts were awarded and administered in conformity with the state constitution, state laws, and established rules, we performed the following procedures:**

- For the six active incentive programs administered by BID, we compiled all provisions from the constitution, state laws, rules, and policies and procedures dealing with the purposes of the programs, qualification requirements for applicants, on-going requirements for contractees, and other administrative requirements for BID. We compared these sources for consistency and interviewed agency personnel for follow-up and clarification. We reviewed the results of this work along with statistical data on contracts in effect from fiscal years 1997 through 2001 and then selected the Industrial Property Tax Exemption Program and the Enterprise Zone Program for detailed audit work.

- Using Audit Command Language (ACL), a specialized audit software program, we randomly selected a sample of 30 contracts from the Industrial Property Tax Exemption Program and 30 contracts from the Enterprise Zone Program for detailed review and analysis.

- We developed data collection instruments to systematically review the 60 randomly selected contract files maintained by BID. When we found insufficient information or other discrepancies in the files, we obtained further information through interviews with division officials and reviews of supplemental documentation. We used statistical techniques, where appropriate, when reporting the results of our work so that we could extrapolate the sample results to the entire population of 8,535 Industrial Property Tax Exemption contracts and 2,170 Enterprise Zone contracts. The extrapolations provide estimates of what we would have found if we had reviewed all contracts. The estimates are presented in the audit report in the form of ranges of numbers. The method used to construct the ranges ensures that there is a 95% probability that the actual results are within the ranges.

- During our review of the sample contract files, we also interviewed five members of the State Board of Commerce and Industry, including the Governor's Office representative on the board. In addition, we interviewed the Senior Attorney for the House of Representatives' Fiscal Division. We conducted these interviews to obtain a better understanding of the process for approving the contracts and to clarify points of the constitution, laws, and rules. In addition, we obtained legal clarification on various points of law from the Legislative Auditor's General Counsel.

**To determine how much state and local tax relief was provided as a result of the business tax incentive programs administered by BID, we performed the following procedures:**

- We accounted for all active business tax incentive programs administered by BID, as well as those that are inactive and those for which BID has an active role but does not fully administer.

- We obtained an understanding of BID's database, which contains various data about each incentive contract and tracks each contract over time, by interviewing the creator and the users of the database, making observations of how the database works, and completing an internal controls questionnaire for information systems. We also obtained an electronic copy of the database as of approximately June 30, 2001. We traced source documents to the database to determine its overall reliability. We also obtained a list of reports generated from the database, a list of the parties that receive the reports, and an understanding of how the reports are used. Using ACL, we extracted from the database contracts that were active during our audit period for further analysis and review.

- We interviewed officials of the Department of Revenue to determine what business incentives data it maintains for the Enterprise Zone Program and how these data could be obtained for the other active incentive programs administered by BID. We also discussed the department's interaction with BID regarding incentive contracts.

- We interviewed by phone officials of the Department of Labor to determine possible means of verifying information BID receives from businesses participating in the Enterprise Zone Program on jobs created and hours worked by employees.

- We interviewed four assessors by phone to learn how they account for Industrial Property Tax Exemptions. We also visited two other assessors. During these visits, we interviewed the assessors and examined relevant documentation.

- We attempted to use BID's database to compute the actual amount of tax relief provided to businesses for the audit period for each incentive program. However, as discussed in the audit report, it was not possible to determine the actual amount of tax relief, so we used BID's estimates of tax relief instead.

**To determine what factors are most important to a state's economic well-being, and how Louisiana compares to other states, we conducted the following procedures:**

- To determine how the states rank in terms of factors important to economic development, we researched and compared rankings from the following three recent business climate studies: the Corporation for Enterprise Development's "2000 Development Report Card," the Milken Institute's "New Economy Index 2001," and the Progressive Policy Institute's "The State New Economy Index 1999."

- To determine what factors are significant to site location consultants, we interviewed various consultants and members of the DED Communications and Research Section (previously called the Office of Policy and Research) and Cluster Services Section (previously called the Marketing Division). We compared the factors named in these interviews and in *Area Development* magazine's "1999 Corporate Survey," "2000 Corporate Survey," and "2001 Corporate Survey"; *Site Selection* magazine March 2001; and other articles and identified the ones that were common across the interviews and studies. We obtained Louisiana's rankings for these commonly-cited factors from the business climate studies listed in the previous bulleted section, Morgan Quitno's "State Rankings 2001," Congressional Quarterly's "State Fact Finder 2002," and from data provided by the Louisiana Commission on Law Enforcement and the Louisiana Departments of Education, Economic Development, and Health and Hospitals.

- To determine the trends for some of the significant quality of life factors cited by site location consultants, we gathered and analyzed applicable data for a five-year period.

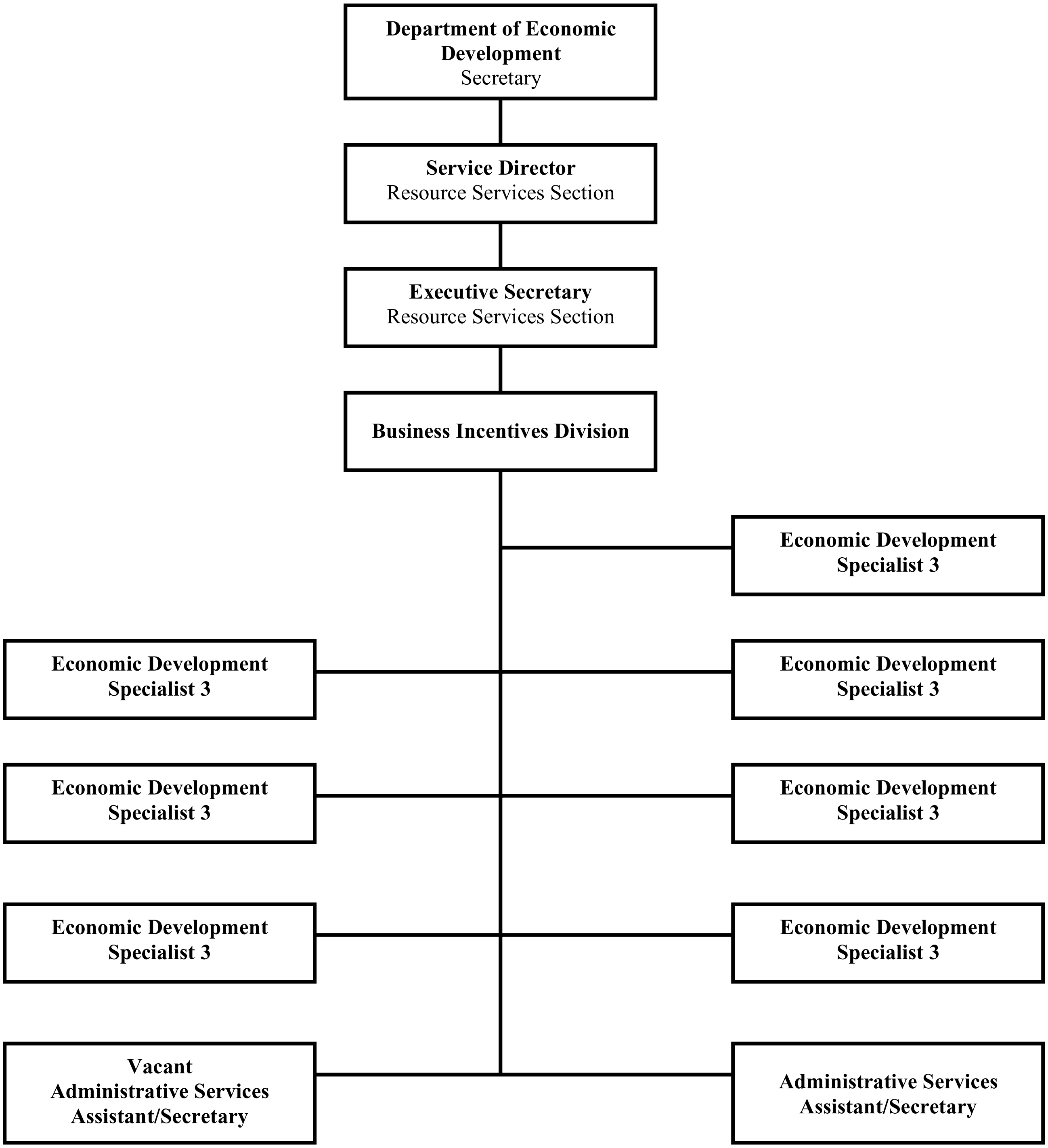
## Other Work Performed

We performed various other procedures that we considered necessary to address the audit objectives. These procedures included data collection, interviews, and analyses. From these procedures and the work previously described, we identified ways BID can improve administratively and how DED should focus its economic development efforts.

# Appendix B

# Organizational Chart of Business Incentives Division

# Appendix B: Organizational Chart of Business Incentives Division




**Source:** Prepared by legislative auditor's staff from information obtained from DED.

# Appendix C

# Department of Economic Development's Response

State of Louisiana

DEPARTMENT OF ECONOMIC DEVELOPMENT

RECEIVED
LEGISLATIVE AUDITOR

02 APR 29 PM 1:09

**M.J. "Mike" Foster, Jr.**
Governor

**Don J. Hutchinson**
Secretary

April 29, 2002

Dr. Daniel G. Kyle, Ph.D., CPA, CFE
Legislative Auditor
P.O. Box 94397
Baton Rouge, Louisiana 70804-94397

Dr. Kyle:

First, let me thank you for the professionalism exhibited by your staff during the recent programmatic audit of two of the state's incentive programs, the Industrial Tax Exemption Program and the Enterprise Zone Program.

One of the guiding principals during the reorganization of the Louisiana Department of Economic Development is that the Department must be accountable to the public and lawmakers. To that end, we are openly embracing the results and recommendations made in your audit report. My staff will work with the State Board of Commerce and Industry, other state agencies and the Legislature to develop and implement the necessary rules, procedures and controls to ensure a sense of confidence in our ability to administer all of the incentive programs administered by this agency.

As we reviewed the audit results and prepared the following responses, we recognized the value of having an independent set of eyes to review our systems. This review provides us a beginning point for programmatic change and will help us move forward to meet the goals and principles already adopted by the Department of Economic Development. In some instances additional financial, technology, and external expertise will be pursued to address concerns raised by your office.

As you will see by the attached, we responded to each recommendation individually. Some of our changes can be done internally by management, some will be done by State Board of Commerce and Industry rule change and some will require future legislative action. Both Department of Economic Development executive management and staff are available to further discuss the recommendations and responses that are attached.

Should you have any questions feel free to contact us at 225-342-5388.

Sincerely,

Don J. Hutchinson

Don J. Hutchinson
Secretary

# Attachment

## Department of Economic Development
## Responses
## to
## Performance Audit
## of
## Office of Business Development
## Resource Services
## Business Incentives Division

**Recommendation #1 - Department Partially Agrees**

In 1936, the Louisiana Constitution provided an exemption from ad valorem taxes for manufacturing establishments and since this time each grantor of these exemptions has struggled with the definition of qualifying operations. As noted in your audit report Article 7, Section 21(F) contains the broad language "... the State Board of Commerce and Industry or its successor, with the approval of the governor, may enter into contracts for the exemption from ad valorem taxes of a new manufacturing establishment or an addition to an existing manufacturing establishment, on such terms and conditions as the board, with the approval of the governor, deems in the best interest of the state (emphasis added)". To date, the best definition on record is that contained in the 1974 Louisiana Constitution which states that manufacturers are those who engage in the business of working raw materials into wares suitable for use or which give new shapes, qualities, or combinations of matter which already has gone through some artificial process.

The Department will work with the Rules Committee of the Louisiana Board of Commerce & Industry to define, through objective methods and criteria, those companies that meet the above stated definition and should be considered as meeting the first step in the application process.

The Department agrees that a definition of "additions" and guidelines for determining the types of items that are acceptable as plant additions should be developed. The Business Incentives Division staff will initiate contact with appropriate agencies and/or bodies, such as the Louisiana Tax Commission, the Department of Revenue and the Society of Louisiana CPAs, to develop rules to govern assets that will be considered as "additions". These rules will be submitted to the Rules Committee of the Louisiana Board of Commerce and Industry for review and recommendation to the full Board. These rules will be developed to apply to both plant additions and miscellaneous capital additions.

The Department agrees to work with the Rules Committee of the Louisiana Board of Commerce and Industry to develop criteria that may be used to determine whether applications for tax exemptions are in the best interest of the state. Criteria shall include the following:

1. Cost benefit analysis,
2. Certification of the applicant's compliance with environmental regulations,
3. Impact the applicant's business on other businesses in the area,

4. Number of jobs created, retained and/or reduced by the applicant,
5. Health insurance plans offered to applicant's employees,
6. Certification of applicant's compliance with OSHA regulations,
7. Support of the local government, and
8. Certification that receipt of the exemption is a deciding factor in the company's decision to invest in capital assets within Louisiana.

**Recommendation #2 – Department Agrees**

The Business Incentives Division staff will develop rules for approval by the State Board of Commerce and Industry to implement a review system that will include a check list for the review and analysis of items that appear to be replacement equipment. When rules are approved, staff will require certification by the applicant that questionable items are in fact not replacements. In those instances where it is determined that items are replacement, the amount of the application will be reduced by the original cost of the items being replaced.

**Recommendation #3 – Department Agrees**

The Business Incentives Division staff, in conjunction with the State Board of Commerce and Industry, will develop a system to perform the analysis of determining if providing an Industrial Tax Exemption contract to the applicant is in the best interest of the state and copies of the analysis will be provided in the information packet it delivers to the State Board of Commerce and Industry members.

**Recommendation #4 – Department Agrees**

The Business Incentives Division staff will develop rules for ratification by State Board of Commerce and Industry to determine that all applicants for Industrial Tax Exemption contracts are truly manufacturers, that only appropriate expenditures for additions are granted exemption, and that the granting of the exemption is in the best interest of the state.

**Recommendation #5 – Department Agrees**

The Business Incentives Division staff and the State Board of Commerce and Industry will encourage more local government input regarding applications for the Industrial Tax Exemption Program by continuing to mail announcements and agendas for State Board of Commerce and Industry meetings to all local officials, by posting the annual meeting schedule on our website, and by requesting letters of objection from local officials for all applications in their parishes.

**Recommendation #6 – Department Agrees**

The Business Incentives Division staff will notify the State Board of Commerce and Industry of all missed deadlines by applicants and participants of the Industrial Tax Exemption Program. This will be included as an agenda item for discussion at each meeting of the State Board of Commerce and Industry.

**Recommendation #7 – Department Agrees**

The Business Incentives Division staff, with the State Board of Commerce and Industry, will work to implement adequate controls to verify and support the actual costs of assets for which exemption is requested. The best recommendation put forth by the Legislative Auditor's staff is to require companies to maintain supporting invoices on hand at their facility for audit by Business Incentives Division staff and to coordinate with local assessors for confirmation of legitimate expenses.

**Recommendation #8 – Department Agrees**

The Business Incentives Division staff will include copies of the Breakdown of Purchases form for each Industrial Tax Exemption Program application delivered to the State Board of Commerce and Industry members prior to each meeting. The Business Incentives Division staff will encourage use of the information on these forms to help determine whether to award exemption contracts.

**Recommendation #9 – Department Agrees**

The Business Incentives Division will adopt formal procedures for scheduling and documenting Industrial Tax Exemption Program inspections and will report the results of the inspections to State Board of Commerce and Industry. Business Incentives Division staff will set schedules that will allow for the completion of all inspections in a timely and orderly manner, this may require dedicated staff to perform these inspections on a weekly basis and will include extending an invitation to the local assessor to accompany staff on all inspections. Results of these inspections will be provided to the State Board of Commerce and Industry on a monthly basis. Additionally, Business Incentives Division databases will be updated regularly to reflect completion of inspections.

**Recommendation #10 – Department Agrees**

The Department utilizes revenue generated by filing fees to cover expenses incurred in administering the various tax incentive programs. A review of the fees currently assessed as well as the expenses incurred in administering the programs ( both current and future) will be undertaken and shared with the members of the State Board of Commerce and Industry. Based upon the review, appropriate action will be taken to provide the necessary resources to administer the tax incentive programs in an efficient and effective manner. In some instances, additional state general fund or other sources of dollars may be required.

**Recommendation #11 – Department Partially Agrees**

The Business Incentives Division Staff will develop procedures for reviewing each Industrial Tax Exemption Program contract that comes up for its five year renewal. The review process will be based on the contract's own merits to determine whether the contract should be recommended to the State Board of Commerce and Industry for renewal. Additionally, documented reasons for each recommendation shall be included as part of the review package delivered to the members of the State Board of Commerce and Industry.

The Business Incentives Division Staff will develop rules limiting the life of the contracts for miscellaneous contracts to a five year period. These rules will be submitted to the State Board of Commerce and Industry for consideration.

**Recommendation #12 – Department Agrees**

The Business Incentives Division staff will notify the State Board of Commerce and Industry of all missed deadlines by applicants and participants of the Enterprise Zone Program. This will be included as an agenda item for discussion at each meeting of the State Board of Commerce and Industry.

**Recommendation #13 – Department Agrees**

The Business Incentives Division staff will update employment certification forms to include a spreadsheet for completion that will include the length of time the employee has been a resident, each employee's work status (full-time or part-time), and the number of hours the employees works each week during the year.

**Recommendation #14 – Department Agrees**

The Business Incentives Division staff will coordinate with the Department of Labor and Department of Revenue to develop a system for verification of employees for which credits are claimed.

**Recommendation #15 – Department Agrees**

The Business Incentives Division staff will revise its inspection procedures to include a more thorough review of a company's employee records to verify accuracy of credits claimed. This will incorporate random reconciliation of information received from Department of Labor.

**Recommendation #16 – Department Agrees**

The Business Incentives Division staff will review Rule 901(C)(3), Rule 939, and Rule 919 for applicability and appropriateness and will recommend appropriate changes to the Rules Committee of the State Board of Commerce and Industry. Additionally, Business Incentives Division staff will recommend appropriate changes to the Rules Committee of the State Board of Commerce and Industry to incorporate the 1999 amendment made to R.S. 51:1787. This amendment allows businesses located outside the boundaries of enterprise zones or economic development districts to participate in the Enterprise Zone Program.

**Recommendation #17 – Department Agrees**

The Business Incentives Division staff will enforce Rule 17 of the Industrial Tax Exemption Program and Rule 951(G) of the Enterprise Zone Program which require business to notify Business Incentives Division of name changes and changes in ownership on a timely basis and impose appropriate penalties for noncompliance. These penalties will be developed as rules and submitted to the Rules Committee of the State Board of Commerce and Industry for ratification.

**Recommendation #18 – Department Agrees**

The Business Incentives Division staff will make appropriate recommendations to the Rules Committee of the State Board of Commerce and Industry to repeal all provisions of the rules that require compliance with Rule 1 for both the Industrial Tax Exemption Program and the Enterprise Zone Program.

**Recommendation #19 – Department Agrees**

One of the goals developed during the reorganization of the Department is to become an e-ready agency and to provide our customers and clients electronic access to our programs via the web. This electronic access will better serve our customers and allow accumulation of more data. However, since the information technology resources of Department of Economic Development are limited, the Department will have to contract the assistance necessary to implement the recommended changes. This will include the review and documentation of the Business Incentives Division processes, information technology requirements definition, and development of an integrated and comprehensive database along with the required procedures outlining requirements for approval of programming changes.

**Recommendation #20 – Department Agrees**

The Business Incentives Division staff will work with our Information Technology professionals and contract resources to ensure that during the redevelopment of our databases safeguards are put into place to require user login by password for tracking of exactly who made changes to the database information. Additionally, we will require the contractor(s) to incorporate edit checks, reasonableness checks and required field protocols into their coding of the input and output pages. Also, Department of Economic Development staff will develop input manuals for the training of our clerical staff to ensure adequate continuity of procedures and processes.

**Recommendation #21 – Department Agrees**

The Business Incentives Division staff will work with local assessors, the Louisiana Tax Commission, Department of Labor and Department of Revenue to gather available and appropriate information to determine the actual cost of tax relief provided to businesses through each incentive program administered by the Department of Economic Development. If it is determined that specific legislation is required to allow our sister agencies to provide what is considered confidential information, then the Department will work with those agencies to propose specific changes to the laws of Louisiana that will allow this sharing.

**Recommendation #22 – Department Agrees**

The Business Incentives Division staff will work to improve its methodology for estimating the cost of tax relief provided to businesses through each incentive program. These methods may include some of the aforementioned items such as reconciliation to local assessor records and Department of Labor or Department of Revenue information. Additionally, the Department will work with our research professionals to develop the recommended trend analysis model for calculating more accurate millage projections for use in determining the amount of incentive provided to a company. Finally, the Business Incentives Division staff will work with the Louisiana Tax Commission to develop methods of using their depreciation tables and/or discount tables to determine the estimated tax relief provided and the impact of the Industrial Tax Exemption Program on future parish revenues.

**Recommendation #23 – Department Agrees**

The Business Incentives Division staff will develop, or purchase, and implement procedures to perform a cost benefit analysis for each incentive application received. These comparisons will be provided to members of the State Board of Commerce and Industry for review and consideration in making their determination of granting tax relief.

**Recommendation #24 – Department Agrees**

Following development of the cost benefit analyses, Business Incentives Division staff will work with the Office of Planning and Budget and legislative staff to develop both outcome and efficiency performance indicators for all of the currently active, and the recently legislated, incentive programs administered by the Department. This should address the concerns of this report and also provide data for meeting the requirements of SB71 of the 2002 1$^{st}$ Extraordinary Legislative Session.

**Recommendation #25 – Department Agrees**

The Business Incentives Division staff will work with our legal staff and the Board of Commerce and Industry to develop and include "clawback" provisions in all of our incentive program contracts. This language will provide recourse to the State if businesses do not meet the obligations of the respective program in which they are participants.

**Recommendation #26 – Department Agrees**

As you are aware, the Vision 2020 Louisiana's Master Plan for Economic Development has been adopted and is being used as a driver of public policy and budgetary initiatives. This represents the first time the entirety of state government has a plan for its future. Subsequent to the development of this plan and using the goals laid out in the plan, the Department of Economic Development worked with a governor appointed task force, with broad representation, to reorganize the Department of Economic Development. Following the recommendations of the taskforce the Department of Economic Development has worked with the Governor's Office and the Legislature to implement recommendations for the reorganization of the Department.

We are the leading state in the union to fully embrace cluster based economic development as our approach to growing and diversifying our economy. This approach is intended to provide and create a business environment that enhances and encourages entrepreneurship, capital investment, job retention, attraction & creation, and university partnerships that nurture commercialization opportunities.

The Department of Economic Development has recently worked with the Legislature and our sister agencies to develop new incentive programs that will assist our state in growing and attracting much of the new economy business opportunities. These incentives include credits designed to encourage Biotech Research & Development, technology development and/or technology commercialization. Additional incentives to encourage our film industry were also passed. And finally, our Quality Jobs Program has been redesign to encourage higher paying jobs, with health care requirements, in manufacturing and the identified cluster areas of our economy.

As we move toward the year 2020, we will constantly review and refine our approach to economic development and the incentive programs that are available to our clients. When changes are necessary they will always be balanced against Louisiana's tax structure and implementation will be based on maintaining a competitive posture with our competing states.

# Appendix D

# Comments on State Board of Commerce and Industry's Response

# Appendix D: Comments on State Board of Commerce and Industry's Response

Since BID serves as the SBCI's staff, the board did not prepare a separate response. The board chairman stated that he generally concurred with DED's response.