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Office of the Auditor General

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Thomas W. Hayes
Auditor General

May 4, 1987

P-442

Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

Chapter 83, Statutes of 1985, requires the Office of the Auditor General to report to the Legislature by June 30, 1987, on the effects of the Enterprise Zone Act (EZA) and the Employment and Economic Incentive Act (EEIA). The report should cover the effects of the EZA and EEIA for the first two years of their operation; however, since the Department of Commerce (department) did not begin implementing the programs associated with the legislation until October 1986, it is too early for us to evaluate the effects of the EZA and EEIA. Therefore, while this letter complies with the statutory requirement that we report by June 30, 1987, we will wait to evaluate the effects of the EZA and EEIA until the programs have been operating long enough to allow us to review a sufficient amount of data.

While gathering information to determine whether we could evaluate the effects of the EZA and EEIA, we did find that the department lacks a plan to comply with the evaluative requirements of the EZA and EEIA. As a result, the costs and benefits of these programs cannot be measured. The department also is not monitoring the EEIA program. As a result, the department may be allowing areas, and businesses within those areas, to receive program benefits to which they are not entitled.

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Background

Chapters 44 and 45, Statutes of 1984, established the EZA and EEIA in March 1984 to stimulate business and industrial growth in certain economically depressed areas in the State. To attract business and industry investment in the depressed areas, the state and local governments offer various incentives. For example, under the EZA, the State offers tax credits to businesses that hire certain individuals who are unemployed or who participate in qualified job training programs. To qualify for the tax credits offered by the State under the EEIA program, a business must first be certified by the department. There is no such requirement for a business to qualify under the EZA program. In addition, under both programs, the State will give priority to businesses in program areas for state loans and for bidding on state contracts.

The EZA and EEIA authorized the department to select ten economically depressed areas to participate in the EZA program and nine areas to participate in the EEIA program. Areas interested in participating competed for selection through an application process that began in January 1985. In October 1986, the department selected the first nine areas for the EZA program and the first three areas for the EEIA program. The department selected the final EZA program area in December 1986 and, according to the department's manager of the EZA and EEIA programs, plans to select the final six EEIA program areas by the end of calendar year 1988.

Within the department, the Office of Business Development is responsible for the EZA and EEIA programs. According to the director of this office, since the legislation was enacted, the department has focused its efforts on providing assistance to applicant areas, selecting the areas for participation, and implementing the department's regulations governing the establishment of the programs. The director further stated that the department has developed a reporting system by which the local governments in the program areas annually provide information that the department will use in its evaluation of the EZA and EEIA programs.

Scope and Methodology

To determine whether we could evaluate the effects of the EZA and EEIA and to determine whether the department had a plan for complying with the evaluative requirements of the EZA and EEIA, we reviewed the department's records documenting the progress of the implementation of the EZA and EEIA programs. In addition, we examined the department's

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methodology for evaluating the effects of the programs. Finally, we interviewed officials from the department, the Franchise Tax Board, and the Employment Development Department. To determine the department's role in monitoring the EEIA, we reviewed state laws and interviewed department officials.

The Department Has Not
Evaluated the EZA and EEIA
and Has Not Monitored the EEIA

The California Government Code contains various requirements directing the department to evaluate the effects of the EZA and EEIA programs. In addition, to carry out the EEIA, the department needs to monitor the compliance of participants in the EEIA program with program requirements. However, because the department did not select areas to participate in the programs until October 1986, it may be too early for the department to comply with the evaluative requirements at this time. Nevertheless, it is not too early for the department to have developed and begun implementing a plan to accomplish the evaluation since the Government Code requirements have been law since March 1984. Such a plan should identify what tasks need to be done, what resources are required, and when the resources will be needed. Further, the plan should divide each task into several steps with deadlines to accomplish the tasks efficiently and systematically. The department, however, has not developed such a plan.

The Government Code, Sections 7078 and 7086, requires the department to submit to the Legislature, no later than March 20, 1987, reports that evaluate the effects of the EZA and EEIA programs. However, in the three years since the Legislature enacted the EZA and EEIA, the department has not determined all of the information it needs to evaluate these effects. For example, the department has not determined what information it will use to evaluate the impact of the EZA and EEIA programs on state and local revenues. In addition, the department has not determined how it will evaluate the information it obtains. For example, the department's consultant for evaluating the programs stated that the department has not decided whether to compare the information it obtains on program areas with information on areas not participating in the programs.

Further, the department has not established the sources of the information it plans to obtain but is currently negotiating with the Franchise Tax Board and the Employment Development Department. Finally, the department has not established the date by which it intends to meet its evaluative requirements.

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The department also has not considered all of the possible effects of the EZA and EEIA programs. For example, the department has not considered the effects of the programs on property tax revenues in the areas participating in the programs. Further, the department has not considered all of the effects resulting from the State giving priority for state loans and contracts to qualified businesses within program areas.

The Government Code, Section 7086, also requires that an area participating in the EEIA program begin implementing its program plan within six months of being selected by the department; otherwise, the area cannot continue to participate in the program. To implement this code section, the department needs to monitor the progress of the program in the selected areas. As of April 15, 1987, the three areas currently participating in the EEIA program have participated for six months. However, the department has not yet taken action to ensure that the areas begin implementing the program plan. Further, the department has not identified the steps needed to revoke an area's selection if the area has not begun implementing the program plan.

Finally, the Government Code, Section 7082, requires the department to periodically audit businesses that the department certifies as eligible to receive EEIA incentives to ensure that the businesses comply with program requirements. This code section further requires the department to revoke the certification of those businesses that are not in compliance. Businesses already certified by the department are currently eligible to receive EEIA program incentives. As of March 23, 1987, the department had taken no action to ensure that businesses receiving EEIA program incentives were complying with eligibility requirements. Further, the department had not identified the steps necessary to revoke a business' certification if the business failed to comply with the program requirements. However, the department has developed guidelines that it intends to use to monitor businesses for compliance with EEIA program requirements.

The department has neither developed a plan for complying with the evaluative requirements of the EZA and EEIA nor monitored the EEIA because it has not placed sufficient emphasis on meeting these responsibilities. The department's manager of the EZA and EEIA programs said that the department has placed most of its emphasis on the application process that leads to the selection of those areas that participate in the programs and on providing technical assistance to the local governments and businesses implementing the programs. The program manager further stated that he has not had enough staff and other resources to evaluate the EZA and EEIA programs and to monitor

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the EEIA. In 1984, the department initially filled 2.7 program positions with state personnel. In addition, the department contracted with a law firm in July 1984, a consultant in October 1985, another consultant in July 1986, a computer programmer in August 1986, and a volunteer worker in September 1986.

By delaying the evaluation of the effects of the programs, the State could be foregoing revenue through tax credits without knowing whether these programs benefit economically depressed areas. In addition, by not monitoring their compliance with the EEIA program requirements, the department may be allowing areas, and businesses within those areas, to receive program benefits to which they are not entitled.

The director of the department's Office of Business Development acknowledges that the department needs a plan for complying with the evaluative requirements of the programs. The director further stated that the department needs to monitor the EEIA. He said the department has begun developing a monitoring plan that includes the guidelines that the department intends to use to monitor businesses.

Conclusion

Although we could not evaluate the effects of the EZA and EEIA, we determined that the department lacks a plan to comply with the evaluative requirements of the EZA and EEIA. As a result, the costs and benefits of these programs cannot be measured. The department also is not monitoring the EEIA. As a result, the department may be allowing areas, and businesses within those areas, to receive program benefits to which they are not entitled.

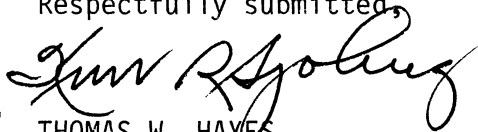
Recommendations

The department should establish and implement a plan for evaluating the EZA and EEIA. The plan should include steps to determine what information the department needs to evaluate the effects of the programs, how it will evaluate the information, and where it will obtain the information. The plan should also include steps to determine what resources it needs to do the work and the dates by which the department will accomplish each of these steps. In addition, the department should begin monitoring the EEIA.

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We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this letter.

Respectfully submitted,



for THOMAS W. HAYES
Auditor General

Attachment: Business, Transportation and Housing Agency's response to the Auditor General's report

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BUSINESS, TRANSPORTATION AND HOUSING AGENCY

May 1, 1987

Mr. Thomas W. Hayes
Auditor General
Office of the Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Hayes:

Thank you for the opportunity to review and comment on the draft letter concerning the Department of Commerce's evaluation of the Enterprise Zone Act and the Department's evaluation and monitoring of the Employment and Economic Incentive Act.

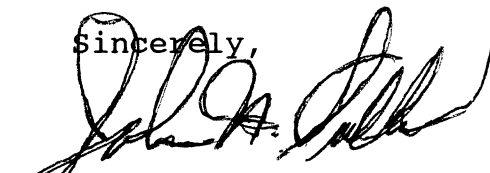
The Department of Commerce and I accept the recommendations advanced in the recommendations section of the letter and intend to act upon them with haste. I would, however, like to comment upon one minor point.

While we acknowledge that no formal evaluation plan has yet been prepared, the department has devoted considerable resources to this effort including the preparation of numerous elements that ultimately will comprise the formal plan. For example, the department has taken steps to ensure that the local areas are implementing their program plan. These include a wide variety of technical assistance and weekly consultation with program area staff. The ultimate strategic evaluation plan will include the department and local area elements that have been developed, as well as those recommended

I have directed the Department of Commerce to complete this plan by August 15, 1987. A copy of that plan will be delivered to your office by that date.

Again, thank you for the opportunity to review and comment on your office's letter submitted to the members of the Joint Legislative Audit committee.

Sincerely,


for JOHN K. GEOGHEGAN
Secretary