Travis County Rebates and Abatements Audit #15-05

October 29, 2015

TRAVIS COUNTY
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From: Nicki Riley, CPA
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Date: October 29, 2015

RE: Examination of Travis County Property Tax Rebates and Abatements

Scheduled as part of our statutory requirements, specifically those in Texas Local Government Code Sections §112.006, §115.001, §115.002, §115.003 and §115.0035, the Risk Evaluation and Consulting (REC) Division of the Travis County Auditor's Office has completed an examination of the property tax rebates and abatements in place with Travis County during the 2014 tax year. We conducted our examination in accordance with the applicable statutes governing the County Auditor's Office and those relating to County financial and accounting protocols. As a result of our examination, we are providing this report on our findings and recommendations.

BACKGROUND

Property tax rebates and abatements are agreements where local governments agree to either discount, refund, or completely eliminate property taxes for some or all of an entity's tax parcels in order to encourage a number of desired outcomes. These outcomes include increasing economic diversity, attracting new businesses, stimulating economic growth, and assisting in workforce development. This often involves increasing investment and jobs in economically stressed areas.

In a property tax rebate, the full amount of property taxes due is collected from the party to the rebate. The County then verifies that the party is in compliance prior to a contractually-governed percentage of the tax payment being "rebated" (refunded) to the party. For tax abatements, the party's actual tax bill is reduced by a set percentage set forth in the contract. If the party is not in compliance, the County must inform the Appraisal District in order to update the entity's appraisal information.

Contract compliance for rebates and abatements has been performed by the Travis County Planning and Budget Office (PBO). PBO is responsible for reporting to the Commissioners' Court and the Auditor's Office any issues of noncompliance. The Travis County Attorney advises the Court and PBO on legal and contractual matters related to rebates and abatements.

Travis County has two active abatements (with Hewlett Packard and Home Depot) and three active rebates (with Samsung, The Domain, and FRV Solar). Currently, Travis County is not pursuing new abatement agreements, relying instead on rebates. For the 2014 tax year, these five entities received just over $10M from the County in tax benefits due to these agreements, detailed below:

2014 Tax Year	Abatement/Rebate Benefit Claimed
Home Depot USA, Inc.	$ 220,603.00
Hewlett Packard, Inc.*	380,416.77
Samsung Electronics Co., Ltd.	8,842,784.00
The Domain	567,189.00
FRV AE Solar, LLC	259,415.11
Total	$ 10,270,407.88

***Note:** The Hewlett Packard abatement amount is for tax year 2013. Hewlett Packard has failed to timely remit their Agreement Benefits Notice to Travis County; therefore, tax year 2014 information was not available at the time of the audit.

Travis County has also entered into rebate agreements with Apple, Inc., Charles Schwab, HID Global, and RRE Austin Solar, LLC which should be in place in the next few years.

SCOPE OF EXAMINATION

The primary objective of this examination was to review the rebate and abatement compliance process, the associated policies and procedures, and the associated internal controls.

EXAMINATION METHODOLOGY

Our work was based primarily on reviews of the relevant contracts and supporting documentation, as well as detailed data verification and interviews with PBO and third party personnel. The use of these techniques would not necessarily disclose all material weaknesses or compliance issues for the rebates and abatements being reviewed. In regards to the written and verbal representations made by PBO personnel, unless otherwise noted in this report, office management maintains that the assertions we relied upon in the examination were correct to the best of their knowledge.

SUMMARY OF FINDINGS & RECOMMENDATIONS

Our review disclosed significant findings in regards to compliance for Samsung, Home Depot, FRV Solar, and Hewlett Packard. These findings stemmed from more general concerns about policies and procedures and the control environment related to rebate and abatement compliance. Overall, we have a number of concerns about Travis County's ability to properly verify compliance with rebate and abatement contracts.

Based on our findings, we recommend a reevaluation and retooling of the County's compliance process. First, we recommend that the County examine the costs and benefits of employing an independent third party to perform some or all of the compliance process. If the County finds this alternative unworkable, internal policies and procedures should be formalized and improved to meet best practices, and concerns about the independence of the compliance function should be addressed. We also recommend that PBO follow up on findings specific to individual rebates and abatements, resolving those issues as appropriate.

See the Executive Summary on page 8 for a summary of major findings and our overall recommendations, followed by responses from PBO management on page 37. Details of our reviews of and findings for abatements can be found on pages 10 through 21, while our review of rebates can be found in detail on pages 22 through 36. Process flowchart documentation for the rebate and abatement processes can be found beginning on page 42.

OPINION ON REBATE AND ABATEMENT COMPLIANCE AND RELATED INTERNAL CONTROLS

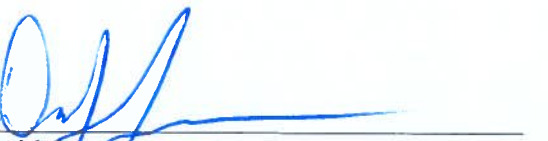
Based upon our examination, we noted significant internal control and procedural weaknesses that negatively impact the County's ability to adequately regulate compliance with property tax rebates and abatements. Because of these findings, we give the internal controls for this area a rating of "Requires Significant Improvement". See Attachment A on page 41 for a description of each of the ratings we use to describe the effectiveness of the internal controls environment for the functional area under review.

CLOSING

This report is intended solely for the information and use of PBO and the Commissioners' Court. We greatly appreciate the cooperation and assistance received from PBO management and staff during this examination. Please contact us if you have any questions or concerns regarding this report.

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Specific Findings

Home Depot – This entity did not employ sufficient full-time employees to receive the full abatement offered under the contract from 2008 through 2014. Because of their partial compliance, Home Depot's abatement should have been pro-rated for each of these years; however, Home Depot received their full tax abatements in all seven years. These excess abatements totaled $260,862.

Hewlett Packard – In the areas of employment and investment, HP was technically non-compliant with its abatement contract from 2009 through 2011; however, HP received their full abatement in those years. This noncompliance was remedied with a retroactive contract amendment in 2012. Per the applicable agenda documents, it does not appear that the Commissioners' Court was officially notified of this situation during HP's years of noncompliance.

Samsung – Since the 2009 tax year, the testing protocols utilized to verify Samsung's hiring/employment requirements at its Fab 2 facility have been less than what is considered best practice to sufficiently determine Samsung's compliance with the applicable terms of its rebate contract. This is not meant to imply that Samsung was not in compliance with their contractual terms, only that the testing was not sufficient to verify compliance.

FRV Solar – FRV did not provide sufficient information to verify the creation of 175 to 200 temporary construction jobs during the construction of the facility required by the rebate contract. Also, the three to five permanent jobs that are required by the contract have not currently been verified by Travis County. In addition, the local/state/national purchase requirements in the rebate contract do not appear to have been met - Trina Solar, a Chinese manufacturer, was paid approximately $69 million for solar panels and related products and services installed at the facility.

Process Findings:

We were concerned with a number of aspects of the compliance process. In particular, compliance testing protocols were not sufficient to reasonably verify that the private entities were in full compliance with the terms of their agreements. In addition, the compliance function has not received sufficient support, especially in the areas of training, legal assistance, and the utilization of specialized third parties.

The placement of the compliance function within a department directly administered by the Commissioners' Court may limit the function's independence. It is important that the compliance process itself be as free as possible from the influence of public policy concerns.

Generally, we have concerns with the level of management review and the timeliness of the County's compliance reviews. We also feel that a rebate and abatement-specific conflict of interest policy for County officials is warranted. In addition, the County is not issuing Certificates of Occupancy to its rebate and abatement partners as is contractually required.

Overall Recommendations:

We recommend a full review of the rebate and abatement compliance function. Given the complexity and specialized nature of this function, employing independent third parties to perform significant portions of Travis County's compliance duties might significantly improve overall efficiency and effectiveness.

We also recommend that the appropriate parties resolve the specific findings of this audit where appropriate. Recoupment of the $260,862 in invalid abatements with Home Depot should be a priority in this process.

ABATEMENT AGREEMENTS

HOME DEPOT TAX ABATEMENT

Company Overview

The Home Depot USA, Inc. and its subsidiaries (Home Depot) operate full-service, warehouse-style stores averaging approximately 104,000 square feet. The stores stock approximately 35,000 different kinds of building materials, home improvement supplies, and lawn and garden products. Home Depot also offers over 700,000 products through its websites, including Home Depot, Home Decorators Collection, and Blinds.com. Home Depot is publicly traded on the New York Stock Exchange.

In September 2004, Home Depot began forming an Economic Development Agreement with Travis County to construct a Data Center facility to be located on 8.162 acres of land at 1300 Park Center Drive, Austin, Texas 78753, which would handle transactions and business records from throughout the country. Activities at the facility primarily focus on research and development relating to new trade-secret technology and applications essential to Home Depot.

Contractual Requirements of Home Depot

Home Depot is required to meet property, investment, jobs, construction, environmental attention, and minority participation goals as defined in section 5.1.1 of the Economic Development Contract with Travis County. The following paragraphs contain a description of Home Depot's required performance goals.

Investments

Per Section 5.1.1 (c) "Value Investment", Home Depot is contractually required to invest $400 million over the ten-year period, consisting of the purchase of the former Exodus Communications facility, real property improvements, and the transfer of computer equipment and peripherals from Georgia, which were valued at acquisition cost. Another significant component will be the annual purchase of computer equipment and peripherals of at least $15 million for the first ten years, beginning no later than January 1, 2006.

Home Depot is required to invest in real property improvements, facilities and structures, business personal property, and non-capital expenditures in accordance with the following schedule:

For the first five years:		Second five years:	
Year 1:	$140,000,000.00	Year 6:	$15,000,000.00
Year 2:	$15,000,000.00	Year 7:	$15,000,000.00
Year 3:	$15,000,000.00	Year 8:	$15,000,000.00
Year 4:	$15,000,000.00	Year 9:	$15,000,000.00
Year 5:	$15,000,000.00	Year 10:	$140,000,000.00
Total	**$200,000,000.00**	**Total**	**$200,000,000.00**

Although Travis County has not audited the investments, Padgett has issued a report on the City's behalf, and no significant exceptions were noted. The total investment reported to the City in 2008 was approximately $480 million. Although the amounts reported to the City were higher than the amounts reported to Travis County, they both far exceed the required amounts of the contract. In tax year 2013, Home Depot reported a balance of $863 million.

Jobs

Home Depot must create and maintain 500 permanent full-time positions by July 1, 2008, as stated in Section 5.1.1 (b) "Jobs", as follows:

300, but no fewer than 200 jobs by July 1, 2006;
400, but no fewer than 300 jobs by July 1, 2007;
500, but no fewer than 400 jobs by July 1, 2008.

If Home Depot maintains at least 400 but less than 500 jobs during any year that benefits are claimed, then, as a penalty, the abatement will be decreased in accordance with Section 5.1.1 (b) (ii) "Pro-Rata Benefits", as follows; The number of actual jobs "numerator" will be divided by the required number of jobs "denominator" being 500, multiplied by the annual abatement amount. If Home Depot maintains any less than 400 jobs (80%) of the required number of jobs, it will be considered out of compliance with the agreement.

Home Depot must also maintain an average salary for all permanent employees with benefits of approximately $58,608.00 per year.

Construction

Travis County and the City of Austin were to obtain a Certificate of Occupancy from Home Depot no later than January 1, 2008, to ensure that Home Depot was in compliance with all City and County codes and ordinances in accordance with Section 5.1.1 (d) (ii). The Certificate of Occupancy is significant because it marks the completion date and the beginning of the ten-year abatement term. No benefits can be earned prior to the completion date.

Environmental Attention

Home Depot must also ensure that environmental issues are considered during and after construction. For instance, the project must not be located over an environmentally sensitive aquifer or contributing zone. In addition, the project must be completed and maintained in a way that preserves and respects the natural environment by maintaining green space, and it must not violate any federal, state, or local legislation or regulations.

Minority Participation

Historically underutilized businesses (HUBs) are a diversity program used to increase the amount of goods and services utilized by businesses that are at least 51% owned by minorities. Home Depot was required to use good faith efforts to use HUBs.

Compliance Requirements of the County

The Planning and Budget Office (PBO) is charged with compliance, inspection, and notification of any issues pertaining to the Determination of Benefits that Home Depot provides on an annual basis, per Section 4.2 Determination of Agreement Benefits "Annual Report" of the agreement. Based on our review of the contract, terms, reports submitted, and interviews with Travis County

personnel, the following methods and procedures used by PBO to verify compliance and enforce non-compliance with contractual requirements were identified.

Inspection and Monitoring Process
The County has the right to inspect pertinent records of Home Depot and verify contractual compliance, per Section 4.2.1 (b) (iii), "Right of Inspection". Generally, site inspections and reviews should be conducted timely, in accordance with Section 4.2.3 "Agreement Benefits Notice" which states that the:

> *"County will advise the Company of such material issues that are identified through the verification process within thirty (30) days of receipt of the Agreement Benefits Notice (annual report) and other reporting information to allow the Company to correct/complete such Agreement Benefits Notice."*

If the site inspection is not conducted within 30 days after the annual report is received, the County may have a difficult time correcting or detecting mistakes made by Home Depot.

The County began performing on-site payroll reviews in 2011. Prior to 2011, compliance issues were handled through phone calls and emails, and no substantive verifications were performed. The last review was performed by Travis County personnel during May of 2015.

Annual certification process
Home Depot must provide an annual report to the Travis County Appraisal District (TCAD), the Tax-Assessor Collector, and PBO detailing their tax benefits no later than April 30th, per Section 4.2.1 (a) "Notice". The report details the contractual objectives required against the actual results.

Home Depot has timely sent the annual report by April 30th detailing the total amount invested, total number of full-time employees, average salaries of full-time employees, and the tax benefit claimed.

<u>Full-Time Employee Verification</u>
Home Depot's Payroll Department sends redacted payroll reports that exclude names and social security numbers, per Section 5.7.2, (e) "Employment Records and Investment Certification". The report supports the calculation for full-time employees created and maintained at the new facility and the average salary for all positions.

Annually, County personnel request the payroll information from the Director of Human Resources, Michelle Shillinglaw; the Excel report is exported from the accounting system. County personnel reviews the numbers totaled in Excel but does not test the file. Since tax year 2010, 5 to 12 employees have been selected and traced to a paycheck stub for verification purposes. Finally, County personnel verify the total number of employees reported in Excel to the annual report.

<u>Benefit and Length of Employment Verification</u>
Home Depot must employ full-time positions receiving full-time benefits. The positions must also be filled no less than ten out of twelve months of the year for which the abatement is

claimed, per Section 5.1.1 (b) (i), a "Full-Time Employee". Currently, no verification process exists to confirm this requirement.

Compliance Verification

After County personnel complete the final review of the payroll information and annual report, an email is sent to PBO management and the Auditor's Office to certify that Home Depot has fulfilled its annual obligations.

Tax Abatement History

Home Depot first became eligible to claim a tax benefit in tax year 2005, but had not met the minimum standards required to qualify until 2007. The abatement term is January 1, 2006 through December 31, 2015. The original contract with Travis County has never been amended and required the creation of 400, but no fewer than 300 jobs and an investment of approximately $400 million beginning July 1, 2006.

Under their contract with the City of Austin, Padgett, Strateman, & Co. LLP, ("Padgett") performed "Agreed Upon Procedures" from 2006 through 2007 on behalf of the City of Austin. Padgett conducted an examination to verify that only specific items were mathematically correct and did not express an opinion of compliance. Specifically, they tested the investments required and found only minimal exceptions. In 2008, Padgett was unable to obtain supporting documentation for new employees and no further benefits were claimed from the City.

Tax Benefits

The total amount of tax abatement credits claimed by Home Depot from 2006 through 2014 totaled $1,973,140.55. This benefit was claimed based on Section 4.0 "Agreement Benefits", which allows for a fifty percent relief in Ad Valorem Taxes on real property and improvements, and one hundred percent relief on eligible equipment, provided that Home Depot honor its contractual obligations on an annual basis. The parties both agree on an effective year value of $12 million dollars of real property and improvements. Therefore, that amount is reduced from the tax calculation on an ongoing basis.

TCAD enters the tax benefits claimed by Home Depot in the tax database as shown in Attachment B. County personnel review the tax abatements and property tax receipts to ensure that Home Depot has paid the correct portion of current year taxes.

Finding #1: Pro-Rate Benefits – Employment (Serious)

Job Requirements – Home Depot did not employ the maximum number of full-time employees (500) required to maintain the full tax abatements from 2008 through 2014. This resulted in a recalculation and recapture of each year's tax abatement totaling approximately $260,862 in accordance with Section 5.1.1 (b) (ii), "Pro-Rata Benefits" (See Chart History.). In addition to the recapture, Travis County personnel have not verified whether all full-time positions receive full-time benefits or if they are employed ten out of twelve months of the year as required in Section 5.1.1 (b)(i). The chart on the following page details these items:

Home Depot Tax Abatement Recapture

Reporting Year/Tax Year	FTE Count Required	FTE Count Actual	Pro rate %	Abatement Given	Exempt Amount (Adjusted Pro-Rata)	Correct Taxable Amount	Tax Rate	Actual Taxes Paid	Correct Tax	Recapture Amount
2005	No Benefits claimed									
2006	200-300	420	0%	$36,864,707	$ 36,864,707	$ 11,896,610	0.44990%	No Recapture		
2007	300-400	511	0%	$42,184,209	$ 42,184,209	$ 14,496,049	0.42160%	No Recapture		
2008	400-500	449	89.80%	$45,983,242	$ 41,292,951	$ 21,954,356	0.41220%	71,162	$ 90,496	$ 19,334
2009	400-500	436	87.20%	$47,987,867	$ 41,845,420	$ 23,284,644	0.42150%	72,254	$ 98,145	$ 25,891
2010	400-500	417	83.40%	$49,749,022	$ 41,490,684	$ 25,397,276	0.46580%	79,833	$ 118,301	$ 38,468
2011	400-500	417	83.40%	$47,664,404	$ 39,752,113	$ 25,050,482	0.48550%	83,206	$ 121,620	$ 38,414
2012	400-500	401	80.20%	$52,495,257	$ 42,101,196	$ 27,820,870	0.50010%	87,152	$ 139,132	$ 51,980
2013	400-500	409	81.80%	$56,611,835	$ 46,308,481	$ 26,902,137	0.49460%	82,098	$ 133,058	$ 50,960
2014	400-500	419	83.80%	$48,451,045	$ 40,601,976	$ 24,217,509	0.45630%	74,689	$ 110,504	$ 35,815
							Total	**$ 550,394**	**$ 811,256**	**$ 260,862**

Note: This recapture is based on the FTE Actual Count being less than the maximum, per Section 5.1 (b) ii, which states that "The product of a fraction having a numerator being the actual number of jobs for that year and a denominator being 500, times the Annual Amount Abated." The information above was obtained and prepared by the PBO compliance analyst.

Finding #2: Best Practices (Serious)

a. **Compliance** – Overall, compliance testing is insufficient to properly ensure that the terms of the contract are being met. Each relevant contractual requirement of the private entity should be reviewed for compliance in sufficient detail to give PBO a reasonable level of comfort that these requirements are being met.

b. **Review** – County personnel do not mathematically recalculate the abatement or perform substantive testwork on the payroll files or investments to ensure they are accurate.

c. **Conflict of Interest** – Travis County currently has no policies and procedures in place to confirm if County officials have a conflict of interest with Home Depot. No information is collected or gathered annually to determine independence. We recommend establishing a formal policy by which conflicts of interest between the County and parties to rebate and abatement agreements can be avoided. This policy should identify what situations constitute inappropriate conflicts and the potential ramifications of these inappropriate relationships. Relevant County officials should document their understanding of their responsibilities under this policy.

Finding #3: Other Issues (Less Serious)

a. **Construction, Environmental Attention and Minority Participation** – County personnel did not issue a Certificate of Occupancy, monitor environmental issues, or audit the minority participation program as required in Section 5.1.1 (d)-(f). In addition, Travis County relied upon the City of Austin's compliance team throughout the construction phase. However, after the City of Austin terminated their agreement with Home Depot in 2008, no further work was performed by the City.

b. **Timeliness** - Home Depot sends the annual report to Travis County in March each year. However, County personnel do not always perform a review of the annual report within 30 days, as required in Section 4.2.3 "Material Issues in Agreement Benefits Notice", which states that "County will advise the company of such material issues that are identified in the verification process within thirty (30) days of receipt of the Agreement Benefits Notice".

c. **The City of Austin Audit** - In 2008, Padgett performed an independent review of Home Depot and was unable to verify supporting documentation (pay-check stubs) for the full-time positions employed at Home Depot. Also, in 2008 Padgett counted 419 employees compared with 440 employees reported to the City, a 21 employee difference, or 4.8%.

Significance

The tax abatement subject to recapture from 2008 through 2014 totaled $260,862 in funds that may be recouped from Home Depot.

Recommendations

Based on the noted significance, we recommend that Travis County implement best practices to ensure that Home Depot is in full compliance with past and current contractual obligations by verifying all support and reports in detail. They should calculate and verify the mathematical accuracy of each report in accordance with each section of the agreement and notify Home Depot of any errors in a timely manner. In addition, PBO should pursue the collection of the $260,862.

HEWLETT PACKARD TAX ABATEMENT

Company Overview

Hewlett Packard, Inc. (HP) is a global provider of software and technology solutions and services to consumers, businesses, and government entities.

HP's operations are organized into seven segments for financial reporting purposes: Personal Systems, Printing, Enterprise Group, Enterprise Services, Software, HP Financial Services, and Corporate Investments. HP employs approximately 302,000 employees world-wide, was founded in 1939 and is headquartered in Palo Alto, California.

During 2007 and 2008, HP focused its growth on developing a data center in North Austin and entered into an Economic Development Agreement with Travis County for tax abatement purposes. HP and the County formed an agreement subject to the Texas Local Government Code, Chapter 381.004 and Texas Tax Code, Chapter 312.

Contractual Requirements of HP

Both sites are required to meet property, investment, jobs, construction, environmental attention, and minority participation goals as defined in section 5.1.1 of the Economic Development Contract with Travis County. The following paragraphs contain a description of HP requirements per the agreement.

Investments

Per Sections 5.1.1 (c) "Value Investment", each site was contractually required to invest $250 million in real property improvements, facilities and structures, business personal property and non-capital expenditures in accordance with the following schedule:

Year 1	66,000,000
Year 2	153,000,000
Year 3	23,000,000
Year 4	8,000,000
Total	250,000,000

As previously mentioned, when both contracts were amended January 24, 2012, the Commissioners' Court allowed both sites to average the value of both investments together to determine the total basis required to determine compliance.

Properties

The Project shall include the development, completion, and maintenance of the Hewlett Packard Data Center at the following locations:

1. Ed Bluestein Site
   Address: 3301 Ed Bluestein Boulevard, Austin, TX 78721
   Real Property Tax Account #02-0726-0301-0000
   Personal Property Tax Account #97-4781-8000-0000

2. Tandem Site
   Address: 14219 Tandem Boulevard, Austin, TX 78753
   Real Property Tax Account #02-6711-1002-0000
   Personal Property Tax Account #97-5007-9000-0000

Jobs
Per Section 5.1.1 (b)(i) "Total Number of Jobs", each site was contractually required to create the following number of full-time employees in order to receive full benefits in accordance with the following schedule:

Date	No. of Jobs
By 10/1/08	40, but no fewer than 32
By 10/1/09	70, but no fewer than 56
By 10/1/10	110, but no fewer than 88
By 10/1/11	140, but no fewer than 112

The new amendment allowed the average number of jobs from the two sites to determine compliance with the agreement terms. For example, since each agreement requires a total of no fewer than 112 employees, HP may take the total of the FTE's from the Ed Bluestein site and the total of FTE's from the Tandem site, add those together, and take the average to determine compliance as to both agreements. As long as the average of the totals from the two sites equal 112 or more for the applicable year, HP will be in compliance.

Average Salary
Both sites must also maintain an average salary for all permanent employees with benefits of approximately $60,000.00 per year, per Section 5.1.1 (b) (v).

Construction
Travis County and the City of Austin were to obtain a Certificate of Occupancy from both sites no later than October 31, 2007 to ensure that HP was in compliance with all City and County codes and ordinances in accordance with Section 5.1.1 (d) (ii). The Certificate of Occupancy is significant because it marks the completion date and the beginning of the ten-year abatement term. No benefits can be earned prior to the completion date.

Environmental Attention
HP must also ensure that environmental issues are considered during and after construction. For instance, the project must not be located over an environmentally sensitive aquifer or contributing zone. In addition, the project must be completed and maintained in a way that preserves and respects the natural environment by maintaining green space, and they must not violate any federal, state, or local legislation or regulations.

Minority Participation
HP was required to use good faith efforts to use historically underutilized businesses (HUBs).

Compliance Requirements of the County
PBO is charged with compliance, inspection, and notification of any issues pertaining to the Determination of Benefits that HP provides on an annual basis, per Section 4.2 Determination of

Agreement Benefits "Annual Report" of the agreement. Based on our review of the contract, terms, reports submitted, and interviews with County personnel, the following methods and procedures used by PBO to verify compliance and enforce non-compliance with contractual requirements were identified.

Inspection and Monitoring Process

The County has the right to inspect pertinent records of HP and verify contractual compliance, per Section 4.2 (b) (iii) "Right of Inspection". Generally, site inspections and reviews should be conducted timely, in accordance with Section 4.2.3 "Agreement Benefits Notice" which states that the *"County will advise the company of such material issues that are identified through the verification process within thirty (30) days of receipt of the Agreement Benefits Notice (annual report) and other reporting information to allow the company to correct/complete such Agreement Benefits Notice."*

If the site inspection is not conducted within 30 days after the annual report is received, the County may have a difficult time correcting or detecting mistakes made by HP. HP has been slow to produce backup information, hindering PBO's efforts to complete these processes.

Annual certification process

HP is required to provide an annual report to TCAD, the Tax-Assessor Collector, and PBO detailing their tax benefits no later than April 30th, per Section 4.2.1 (a) "Notice". The report details the contractual objectives required against the actual results.

Full-Time Employee Verification

HP's payroll department sends Texas Workforce Commission (TWC) payroll reports to PBO personnel via email on an annual basis. The Payroll reports include totals and include average payroll calculations. The amounts are not audited or recalculated; they are reviewed and compared against the annual report. This process began in tax year 2010.

Benefit and Length of Employment Verification

HP must employ full-time positions receiving full-time benefits. The positions must be filled no less than ten out of twelve months of the year for which the abatement is claimed, per Section 5.1.1 (b) (i) "Total Number of Jobs".

Compliance Verification

After County personnel complete the final review of the payroll information and annual report, an email is sent to PBO Management, the Auditor's Office, and the County Attorney to certify that HP has fulfilled its annual obligations.

Amendments

There are two original contracts for HP signed in 2006, one for each of the properties related to the abatement (Tandem and Ed Bluestein). Both properties were originally required to have equal investment and employment goals; however, the original contracts were amended twice. The first amendment, made in 2008, was made to correct clerical errors in the original contracts.

The second amendment, made in 2012, combined the investment and employment goals for both sites to ensure compliance with the abatement agreement. This amendment supersedes any prior agreement, making the amendment retroactive (per Commissioners' Court direction).

Tax Abatement History
The abatement term is January 1, 2008 through December 31, 2017. HP first became eligible to claim a tax benefit in tax year 2008. The City of Austin had an abatement agreement with HP from 2006 to 2008.

Padgett, Strateman & Co. LLP ("Padgett") performed "Agreed upon Procedures" from 2006 through 2007 while under contract with the City of Austin. Their examinations were only performed to verify that specific items were mathematically correct and did not express an opinion on compliance.

HP had difficulties in meeting its abatement requirements from 2009 to 2011. During that period, the abatement contract contained separate investment and employment requirements for the two HP locations. Due to economic factors, HP was unable to meet its investment and hiring goals at the Ed Bluestein location. In 2012, HP and the County retroactively amended the abatement contract, allowing HP to meet its contract terms by combining employment and investment totals for both locations.

HP did not provide their 2013 annual report until September 9, 2014 (due April 30, 2014) and failed to provide the requested supporting payroll records until March 16, 2015. According to PBO, HP is undertaking an internal restructuring process and has not been timely in its responses recently.

Tax Benefits
The tax benefits are claimed in accordance with Section 4.1 "Agreement Benefits", which allows for a sixty percent relief in Ad Valorem Taxes on real property and sixty percent relief on eligible property, provided that HP honors its contractual obligations annually.

TCAD enters the tax benefits claimed by HP in the tax database as shown in Attachment B. County personnel review the tax abatements and property tax receipts to ensure that HP has paid the correct portion of current year taxes.

Finding #1: Best Practices (Serious)

a. **Compliance** – Overall, compliance testing is insufficient to properly ensure that the terms of the contract are being met. Each relevant contractual requirement of the private entity should be reviewed for compliance in sufficient detail to give Travis County a reasonable level of comfort that these requirements are being met.

   Based on the information highlighted in the chart on the following page, we noted that both HP sites were non-compliant from 2009 to 2011. We were unable to verify that this non-compliance was communicated to the Court during this period.

Hewlett Packard Abatement Analysis

Tandem Site

Tax Year	Abatement Period	Total Investment Amount Required	Investment Amount Actual	FTE Count Required	FTE Count Actual	Abatement Claimed
2008	1 out of 10	66,000,000.00	146,796,127.00	40	39	
2009	2 out of 10	153,000,000.00	23,442,158.00	70	260	$ 205,288.00
2010	3 out of 10	23,000,000.00	541,902.00	110	454	$ 170,712.73
2011	4 out of 10	8,000,000.00	47,924,890.00	140	795	$ 134,242.20

Ed Bluestein Site

Tax Year	Abatement Period	Total Investment Amount Required	Investment Amount Actual	FTE Count Required	FTE Count Actual	Abatement Claimed
2008	1 out of 10	66,000,000.00	264,757,008.00	40	40	
2009	2 out of 10	153,000,000.00	6,907,532.00	70	48	$ 265,216.51
2010	3 out of 10	23,000,000.00	168,805.00	110	45	$ 233,085.06
2011	4 out of 10	8,000,000.00	52,908,043.00	140	37	$ 171,579.98

Combined Properties

Tax Year	Abatement Period	Total Investment Amount Required	Investment Amount Actual	FTE Count Required	FTE Count Actual	Abatement Claimed
2012	5 out of 10	500,000,000.00	543,446,465.00	280	1,193	$ 299,675.23

b. **Review** – The County began performing payroll reviews in tax year 2010. Prior to 2009, Travis County management handled compliance issues through phone calls and emails; no verifications were performed. County personnel do not currently recalculate the abatement or perform any substantive testwork on the payroll files or investments to ensure they are accurate. In addition, no management review is made to ensure HP is compliant, and no on-site visits are performed.

c. **Conflict of Interest** – Travis County currently has no policies and procedures in place to confirm if County officials have a conflict of interest with parties to rebates and abatement contracts. No information is collected or gathered annually to determine independence. We recommend establishing a formal policy by which conflicts of interest between the County and parties to rebate and abatement agreements can be avoided. This policy should identify what situations constitute inappropriate conflicts and the potential ramifications of these inappropriate relationships. Relevant County officials should document their understanding of their responsibilities under this policy.

Finding #2: Other Significant Issues (Less Serious)

a. **Timeliness** – Travis County personnel have not performed a timely review of the annual reports for tax years 2008 through 2013, as required in Section 4.2.3 "Material Issues in Agreement Benefits Notice", which states that "County will advise the company of such

material issues that are identified in the verification process within thirty (30) days of receipt of the Agreement Benefits Notice". In addition, HP failed to send the 2013 annual report and payroll reports to Travis County on a timely basis, in violation of Section 4.2.1.(a) "Notice".

b. **Construction, Environmental Attention and Minority Participation** – County personnel did not issue a Certificate of Occupancy, monitor environmental issues, or audit the minority participation program as required in Section 5.1.1 (d)-(f); the City of Austin's compliance team was relied on throughout the construction phase. However, after the City of Austin terminated their agreement with HP after the 2010 tax year, no further work was performed by the City.

Significance
The items above are significant for the following reasons:

1. Non-compliance issues should be reported to the Commissioners' Court in a timely manner to ensure that any potential matters can be resolved at the Courts discretion.

2. It is important that all annual reports are accurately and timely reviewed in detail to ensure that errors do not go undetected.

Recommendations
Based on the noted significance, we recommend that the County implement best practices to ensure that HP is in full compliance with past and current contractual obligations by verifying all support and reports in detail. They should calculate and verify the mathematical accuracy of each report in accordance with each section of the agreement and notify HP of any errors in a timely manner.

REBATE AGREEMENTS

SAMSUNG TAX REBATE

Company Overview
Samsung Electronics Co. Ltd. and its subsidiaries (Samsung) are primarily engaged in the production of consumer electronic products. Samsung distributes its products within domestic and international markets. Samsung was founded in 1938 and is based in Suwon, South Korea.

Samsung operates three business divisions. The Consumer Electronics Division manufactures color televisions, monitors, printers, air conditioners, refrigerators, laundry machines and other products. The Information Technology & Mobile Communications Division produces computers, handheld phones, network systems, digital cameras, and other products. The Device Solutions Division produces semiconductor and display business parts, dynamic random access memories, flashes, thin film transistor-liquid crystal displays and other products.

Samsung formed an agreement with the City of Austin and Travis County in 2006 to construct a new semiconductor wafer manufacturing factory to be located at 12100 Samsung Boulevard, Austin, Texas 78753. The agreement is subject to the Texas Local Government Code, Chapter 381.004 and Chapter 312, Texas Tax Code.

Contractual Requirements of Samsung
Samsung is required to meet property, investment, jobs, construction, environmental attention, and minority participation goals as defined in Section 5.1.1 of the Economic Development Contract with Travis County. The following paragraphs contain a description of Samsung's requirements per the agreement.

Investments
Samsung initially was unable to achieve the required investment goals in Section 5.1.1 (c) (ii) "Investment", which states that the "Company shall invest 3.5 billion dollars in real property improvements, facilities and structures, business personal property and non-capital expenditures at the Project no later than December 31, 2009". It was our understanding that the term "non-capital expenditures" was initially used by the County to account for payroll costs and the creation of jobs, but was later expanded by Samsung to include "cost of goods sold" to meet the required investment goal in 2009.

Jobs
Section 5.1.1 (b)(i) of the contract with Samsung states the following:

> *"The Company agrees to create the following number of new full time equivalent jobs (said full time jobs to include both Company employees and contract employees), in addition to the jobs existing on the Property as of October 1, 2005, by the respective dates set forth in the following table:*

Cumulative total new full time jobs to be created	Date by which jobs are to be created
500	12/31/2008
700	12/31/2009

The Parties agree that the total number of jobs (both employee and contract) existing on the Property as of the October 1, 2005 is 994."

Based on this, it is our understanding that the 994 existing jobs are included in the agreement to ensure that Samsung adds 700 new employees to their existing employee base versus simply transferring employees to the new semiconductor plant.

Construction
In attachment B of the agreement, "Description of Property and Project", is a listing which includes the property and an inventory of items which were scheduled to be constructed on the site for appraisal purposes.

Travis County and the City of Austin were to obtain a Certificate of Occupancy from Samsung no later than December 31, 2009, to ensure that Samsung was in compliance with all City and County codes and ordinances in accordance with Section 5.1.1(d)(ii). The Certificate of Occupancy is significant because it marks the completion date and the beginning of the twenty-year abatement term. No benefits can be earned prior to the completion date.

Environmental Attention
Samsung must also ensure that environmental issues are considered during and after construction. For instance, the project must not be located over an environmentally sensitive aquifer or contributing zone. In addition, the project must be completed and maintained in a way that preserves and respects the natural environment by maintaining green space, and must not violate any federal, state, or local legislation or regulations.

Minority Participation
Samsung was required to use good faith efforts to use historically underutilized businesses (HUBs).

Community Improvement
Samsung is to actively participate in the community and contribute to the development and improvement of Travis County in areas beyond those directly related to business and the economy. In the contract, Section 5.1.2 (c) "Community Improvement" states that Samsung will make a commercially reasonable effort to continue such participation related to local education, job training, and job mobility through activities such as financial contributions to local schools and volunteer work within the community.

As a part of these activities, Samsung provides direct financial contributions to Manor ISD on an annual basis by donating to students and their families for holiday wish lists. In 2015, Samsung stated that its employees donated more than 17,000 items, which included pencils, erasers, backpacks, paint, glue sticks, binders, composition books, and notebook paper.

Compliance Requirements of the County
PBO is charged with compliance, inspection, and notification of any issues pertaining to the Determination of Benefits that Samsung provides on an annual basis, per the Section 4.2 Determination of Agreement Benefits "Annual Report" section of the agreement. Based on our review of the contract, terms, reports submitted, and interviews with County personnel, the following methods and procedures used to verify compliance and enforce non-compliance with contractual requirements were identified.

Inspection and Monitoring Process
The County has the right to inspect pertinent records of Samsung and verify contractual compliance, per Section 4.2(c)(ii), "Right of Inspection". Generally, site inspections and reviews should be conducted timely, in accordance with Section 4.2.3 "Agreement Benefits Notice" which states that the *"County will advise the Company of such material issues that are identified through the verification process within thirty (30) days of receipt of the Agreement Benefits Notice (annual report) and other reporting information to allow the Company to correct/complete such Agreement Benefits Notice."* If the site inspection is not conducted within 30 days after the annual report is receipted, the County may have a difficult time correcting or detecting mistakes made by Samsung.

Annual certification process
Samsung must provide an annual report to TCAD, the Tax-Assessor Collector, and PBO detailing their tax benefits no later than January 31st, per Section 4.2.1 (a) "Notice". The report details the contractual objectives required against the actual results.

Full-Time Employee Verification
County personnel annually visit Samsung to review employment headcounts which appear to consist of all Samsung personnel posted locally, not just those at the Fab 2 plant. The employment headcounts are reviewed through payroll reports by positions and titles with redacted names and social security numbers. In 2009, 2011, and 2014, the reports were spot-checked and verified to paystubs.

Benefit and Length of Employment Verification
Samsung must employ full-time positions receiving full-time benefits. The positions must be filled no less than ten out of twelve months of the year for which the abatement is claimed, per Section 5.1.1 (b)(i) "Full-Time Employee".

Compliance Verification
After County personnel complete the final review of the payroll information and annual report, an email is sent to PBO Management and the Auditor's Office to certify that Samsung has fulfilled its annual obligations.

Tax Rebate History
Samsung first became eligible to claim a tax benefit in tax year 2008. The rebate term is January 1, 2008 through December 31, 2027. The tax incentive package agreed upon with Travis County provides an 80 percent ad valorem tax rebate, provided Samsung invests $3.5 billion locally, employs 700 new full time employees with an average salary of more than $54,000, and

complies with the remaining construction terms of the contract. Also, the taxable value of the property of the entire project was required to increase at least $500 million.

Prior Year Audits
Padgett, Stratemann, & Co. LLP ("Padgett") performed "Agreed upon Procedures" on behalf of the City of Austin from 2008 through 2014. The examinations were only performed to verify that specific items were mathematically correct and did not express an opinion on compliance.

Tax Benefits
The total amount of tax rebates claimed by Samsung from tax year 2008 through 2013 totaled $36,180,521.72. The tax benefits are claimed in accordance with Section 4.1 "Agreement Benefits", which allows for an eighty percent relief in Ad Valorem Taxes on the incremental value per year, provided that Samsung honors its contractual obligations annually.

After County personnel review the annual report from Samsung, a payment request is sent to the Auditor's Office as shown in Attachment B. These personnel also review the property tax receipts to ensure that Samsung has paid the correct portion of current year taxes.

Finding #1: Job Creation Requirements (Most Serious)

Compliance – We recommend that County personnel follow objective views of company policies, design or update internal policies to mitigate the risks of non-compliance, and lead internal audits of procedures. We were unable to verify the presence of these methods based on the observations and findings noted in the following four sections:

1. **Contract issues**
   Our office found it very difficult to audit this contract. It is vague in many areas, but particularly so in regards to employment requirements. Because of this, Samsung's hiring requirements are subject to multiple interpretations, causing confusion for the parties attempting to verify compliance in this area.

2. **Verification of New Employees (2008-2009)**
   As explained on page 25 of the contract under "Jobs", Samsung agreed to create new full-time equivalent jobs in excess of the existing 994 on the Property as of October 1, 2005; 500 by December 31, 2008; and 700 by December 31, 2009. It appears that County personnel understood this to mean that Samsung only needed to report 700 full-time jobs at the new factory. A proper compliance audit was never performed to ensure that Samsung did not transfer existing employees from its existing manufacturing plant or another facility to the new plant.

   In April of 2015, we discussed this issue with Samsung in an attempt to obtain sufficient information to verify that the requisite new jobs had been created by December 31, 2009. During this meeting, Samsung personnel stated that they would not provide this information. They stated that they had already provided all necessary information to County personnel in prior periods, and that they had been deemed to be in compliance by the County.

3. Required Number of Jobs (2010 to Present)

As the contract is written, after December 31, 2009, the 700 full-time employees at the Fab 2 plant can be reported without regard to hiring date. Therefore, Samsung is no longer required to focus on new hires; however, they must continue to maintain 700 employees at the plant. Specifically, Section 5.1.1(b)(i) of the contract requires that only the following jobs can be counted for reporting purposes: "*jobs directly related to the Project and working from the Property as soon as space is completed, but no later than December 31, 2009*."

In contrast, the payroll information verified by County personnel appears to include all Samsung employees employed locally, including the older 200 millimeter (mm) operational semi-conductor facility and all general administration buildings, in addition to the Fab 2 plant.

4. Complicating Factor – Changes to the Fab 1 and Fab 2 plants

Starting in 2012, Samsung made significant changes to both their older plant (Fab 1) and the newer plant (Fab 2), the latter of which is covered by this rebate agreement. Specifically, Samsung invested $4 billion (30% of the entire Samsung Austin investment) to retrofit the two facilities. It appears that Fab 1 is no longer producing 200 mm wafers and that much of the Fab 1 facility is now contributing to the production of 28 nm (nanometer) SOC systems. These items enhance and improve the capabilities of the standard 300 mm wafers.

Given the above changes made to the Fab 1 facility, we recommend that Travis County personnel work with Samsung to determine how the Fab 1 facility now functions in relation to Fab 2 and to determine if the two entities can be considered separate in relationship to our rebate contract. Depending on the results of this review, the County and Samsung should update the terms of the contract as is deemed appropriate.

Finding #2: Best Practices (Serious)

a. **Review** – The County began performing payroll reviews in tax year 2010. Prior to 2009, compliance was handled through phone calls and emails; no actual verifications were performed. Currently, County personnel do not perform any substantive testwork on the payroll files or investments to ensure they are accurate. In addition, no management review is made to ensure Samsung is compliant.

b. **Conflicts of Interest** – Travis County currently has no policies and procedures in place to confirm if County officials have a conflict of interest with parties to rebates and abatement contracts. No information is collected or gathered annually to determine independence. We recommend establishing a formal policy by which conflicts of interest between the County and parties to rebate and abatement agreements can be avoided. This policy should identify what situations constitute inappropriate conflicts and the potential ramifications of these inappropriate relationships. Relevant County officials should document their understanding of their responsibilities under this policy.

Finding #3: Other Significant Issues (Less Serious)

a. **Timeliness** – We were not able to confirm the timely review of the annual reports for all tax years as required in Section 4.2.3 "Material Issues in Agreement Benefits Notice", which states that "County will advise Company of such material issues that are identified in the verification process within thirty (30) days of receipt of the Agreement Benefits Notice".

b. **Construction, Environmental Attention, Minority Participation, Community Participation** – Travis County personnel do not issue a Certificate of Occupancy, monitor environmental issues, or audit the minority participation program as required in Section 5.1.1 (d)-(f). Travis County did rely on the City of Austin's compliance team throughout the construction phase.

c. **Contribution to Schools** – County personnel should obtain documented evidence of the existence of Samsung's contractually required annual financial contributions to Manor ISD.

Significance
The items above are significant for the following reasons:

1. Since the 2009 tax year, the testing protocols utilized to verify Samsung's hiring/employment requirements at its Fab 2 facility have been less than what is considered best practice to sufficiently determine Samsung's compliance with the applicable terms of its rebate contract.

2. Current-period payroll testing does not properly verify compliance with the contract requirement that 700 jobs be maintained at the Fab 2 location.

Recommendation
Based on the noted significance, we recommend that Travis County improve the monitoring and inspecting of payroll records and work closely with third party auditors to ensure the accuracy of tax rebate payments in the future. An annual third party audit of Fab 2 employment compliance levels would also be helpful to the compliance process.

DOMAIN TAX REBATE

Company Overview

The Domain is a high-density business, retail, and residential center operated by Simon Property Group and Endeavor Real Estate Group, (The Domain). It is located in the high-tech corridor of northwest Austin, Texas. In 2003, they entered into a collaborative partnership with investors to develop The Domain. In 2004, construction began on the initial 57 acres of the project.

The 303 acre property was purchased from IBM and Multech by the Endeavor Real Estate Group in 1999, with the financial assistance of the Blackstone Group and JER Partners. The first phase of the project opened on March 9, 2007 and includes 700,000 square feet of restaurants, office space, upscale retail stores, apartments, and a hotel.

Contractual Requirements of The Domain

The Domain is required to meet property, investment, jobs, construction, environmental attention, and minority participation goals as defined in Section 5.1.1 of the Economic Development Contract with Travis County. The following paragraphs contain a description of The Domain's requirements per the agreement.

Investments & Value

The County relied on TCAD's valuations and other information provided by The Domain to review completion of phase one construction, which was to exceed $100 million. The Domain was not initially in compliance with their investment requirement. They became compliant once the Commissioners' Court added additional verbiage to Chapter 28 allowing the investment contributions of other parties investing in the property to be counted toward the investment requirement in the contract.

Jobs

In Section 5.1.1 (c), as amended, it states "No later than December 31, 2011 (or the final phase of the Project, if the Project is completed in phases), a minimum of 1,100 permanent full-time equivalent jobs will be filled within the Project". In order to review employment compliance, the County entered into an interlocal agreement with the City in order for the County to utilize the City's third party audit of employment at the Domain.

Construction

Travis County was to obtain a Certificate of Occupancy from The Domain no later than four years from the date of the commencement of construction to ensure that The Domain was in compliance with all County codes and ordinances in accordance with Section 5.1.1 (e) (ii). The Certificate of Occupancy is significant because it marks the completion date and the beginning of the rebate abatement term. No benefits can be earned prior to the completion date of March 9, 2007.

Phasing

In Section 5.1.1 (e) (iii), it states, "If Company desires to complete the Project in phases, a phasing plan shall be submitted in writing to County for approval prior to the implementation of

such plan". However, the beginning of the 20-year rebate period will begin after the first phase is completed.

Environmental Attention
The Domain must also ensure that environmental issues are considered during and after construction. For instance, the project must be completed and maintained in a way that preserves and respects the natural environment by maintaining green space, and must not violate any federal, state, or local legislation or regulations.

Minority Participation
The Domain was required to use good faith efforts to use historically underutilized businesses (HUBs).

Affordable Housing
After the completion of phase one of construction, The Domain is required to complete and maintain at least 300 residential units with at least 10% meeting the requirements for affordable housing. This component is audited annually by the Travis County Housing Corporation and has had no exceptions to date.

Compliance Requirements of the County
The Planning and Budget Office is charged with compliance, inspection and notification of any issues pertaining to the Annual Report that The Domain provides on an annual basis. Based on our review of the contract, terms, reports submitted by The Domain and interviews with County personnel, the following methods and procedures are used to verify compliance and enforce non-compliance with contractual requirements were identified.

Inspection and Auditing
The County has the right to inspect pertinent records of The Domain and verify contractual compliance, per Section 5.2.2 "County Monitoring". Site inspections and reviews should be conducted within 30 days, upon receipt of the annual report as stated in Section 7.2.2 "Reimbursement Amount."

Currently, the City's auditor performs on-site visits at The Domain. Travis County personnel perform compliance reviews through an email exchange with headquarters in Indianapolis.

Annual certification process
The Company must provide an annual report to the County of the tax benefits due annually, per Section 5.2.1 "Annual Report", within a reasonable time after the end of each calendar year. However, The Domain does not consistently remit this report in a reasonable time period, typically filing it between April 30th and June 2nd of the following year. Furthermore, the County is unable to notify The Domain of any material issues within 30 days upon receipt of the report in accordance with Section 7.2.2 "Reimbursement Amount", because PBO must first verify the payroll audit performed by "Padgett", which can take a number of months to complete.

<u>Full-Time Employee Verification</u>
As stated above, as a result of the County's interlocal agreement with the City, we have relied upon audits performed by Padgett for verifications of full-time employees. Copies of the audits

are maintained in the City of Austin's compliance website. There have been no exceptions to date on these audits.

Compliance Verification

After County personnel complete the final review of the payroll information and the annual report, an email is sent to PBO Management and the Auditor's Office to certify that The Domain has fulfilled its annual obligations.

Amendments

The original contract was amended July 21, 2010, primarily to clarify Section 5.1.1 (c) "Jobs" to change the opening phrase of the first sentences from: "No later than 12 months after the Completion Date of the Project" to "No later than December 31, 2011". This allowed The Domain an additional year to meet the initial job creation requirement of 1,100 full-time jobs.

Tax Rebate History

The Domain first became eligible to claim a tax benefit in tax year 2008. The rebate term is January 1, 2008 through December 31, 2027. The tax incentive package formed with Travis County provides a 50 percent ad valorem tax rebate, provided The Domain invests $100 million, employs 1,100 new full-time employees and complies with the remaining construction terms of the contract. Also, the net present value of the total rebate cannot exceed $5 million when discounted at an annual rate of 7.5%.

Prior Year Audits

Padgett, Strateman, & Co. LLP ("Padgett") performed "Agreed upon Procedures" on behalf of the City of Austin from 2008 through 2014. The examinations were only performed to verify that specific items were mathematically correct and did not express an opinion on compliance.

Tax Benefits

The total amount of tax rebates claimed by The Domain from 2008 through 2013 totaled $3,383,193.86 (undiscounted).

The tax benefits are claimed in accordance with Section 7.2.2 "Reimbursement Amount", which allows for a fifty percent reimbursement of the ad valorem taxes paid on the Effective Date Value of the property, provided that The Domain honors its contractual obligations annually.

After County personnel review the annual report from The Domain, a payment request is sent to the Auditor's Office as shown in Attachment B. County personnel also review the property tax receipts to ensure that The Domain has paid the correct portion of current year taxes.

Finding #1: Best Practices (Serious)

a. **Compliance** – Overall, compliance testing is insufficient to properly ensure that the terms of the contract are being met. Each relevant contractual requirement of the private entity should be reviewed for compliance in sufficient detail to give Travis County personnel a reasonable level of comfort that these requirements are being met.

b. **Review** – The County began performing compliance reviews in tax year 2010. Prior to 2010, compliance issues were handled through phone calls and emails; no actual verifications were performed. County personnel do not perform any substantive testwork on the payroll files or investments to ensure they are accurate. For payroll, the County relies on the work of Padgett, the entity that performs payroll testing on behalf of the City. In addition, no management review is made to verify that The Domain is compliant.

c. **Conflict of Interest** – Travis County currently has no policies and procedures in place to confirm if County officials have a conflict of interest with parties to rebates and abatement contracts. No information is collected or gathered annually to determine independence. We recommend establishing a formal policy by which conflicts of interest between the County and parties to rebate and abatement agreements can be avoided. This policy should identify what situations constitute inappropriate conflicts and the potential ramifications of these inappropriate relationships. Relevant County officials should document their understanding of their responsibilities under this policy.

Finding #2: Other Significant Issues (Less Serious)

a. **Construction, Environmental Attention, and Minority Participation** – County personnel do not issue a Certificate of Occupancy, monitor environmental issues or audit the minority participation program as required in Section 5.1.1-5.1.2, the City of Austin's compliance team was relied on throughout the construction phases.

b. **Timeliness –** For all tax years under review, Travis County personnel did not perform reviews of the annual information in a timely manner as required in Section 7.2.2 "Reimbursement Amount". This section states that "County will advise The Domain of such material issues that are identified in the verification process within thirty (30) days of receipt of the Revenue Notice". The failure of The Domain to timely remit their annual report to the County contributed to this lack of timeliness.

c. **Monitoring of Chapter 28 Compliance** – Travis County Personnel have failed to monitor and evaluate the developer's associated entities (i.e.: other investors) to determine if these parties are in compliance with Travis County Code, Chapter 28 – Travis County Economic Development Program Policy, Section 28.002 (g). The section states the following:

> *"In the case of a project that includes a leasehold interest in real estate that has been approved by the Commissioners Court pursuant to this policy, the Company may retain eligibility for incentives as long as the County is provided a copy of the lease agreement that indicates the obligation of the company to pay all ad valorem taxes (either directly or indirectly) and the company agrees to provide the County with a copy of the cancelled check indicating payment of those ad valorem taxes each year in which incentives are requested."*

Significance

Although there have not been any significant performance issues with The Domain in the past, without timely reviews, the County may lose its ability to correct any issues going forward.

Recommendation

We recommend that Travis County personnel improve the timeliness of monitoring and inspecting of payroll records and work closely with third party auditors to ensure the accuracy of tax rebate payments in the future. They should also verify the compliance of the developer's associated entities with Chapter 28, Section 28.002 (g).

FRV SOLAR TAX REBATE

Company Overview

FRV Solar (FRV) is a subsidiary of FRV AE Solar. The 35 megawatt solar farm is located in Webberville, Texas. It is made up of 127,728 solar panels purchased from Trina Solar, mounted on single axis trackers, installed on 380 acres.

FRV formed an agreement with Travis County in April 2011 to construct the new solar farm. The agreement is subject to the Texas Local Government Code, Chapter 381.004 and the Texas Tax Code, Chapter 312.

Ribbon cutting by Austin's mayor, Lee Leffingwell, was held January 6, 2012, while operations began on December 20, 2011. The project was constructed by RES Americas, who will operate the plant for five years. SunEdison sold the plant to MetLife and Longsol Holdings in 2012, but will operate the plant for 20 years upon the expiration of the responsibilities of RES Americas. Austin Energy is purchasing the power generated under a 25 year Power Purchase Agreement.

Contractual Requirements of FRV

FRV is required to meet property, power generation, investment, jobs, construction, environmental attention, community development, local labor and materials, and minority participation goals as defined in Section 5.1.1 of the Economic Development Contract with Travis County. Below is a description of some of FRV's primary requirements:

Jobs

Full-time employees

FRV is required to create between three to five new jobs at the facility and the headquarters locations.

Construction Jobs

FRV was required to create between 175 and 200 construction jobs during the construction phase of the facility.

Construction

FRV was required to obtain a Certificate of Occupancy from Travis County no later than December 31, 2012, to ensure that FRV was in compliance with all County codes and ordinances in accordance with Section 5.1.1 (d) (ii). The Certificate of Occupancy is significant because it marks the completion date and the beginning of the twenty-year abatement term. No benefits can be earned prior to the completion date.

Local Labor and Materials

FRV Solar was required to make a reasonable effort to purchase all materials locally, or in the United States, per Section 5.1.1 (e). Based on the audit performed by Reznick Group, P.C., on December 20, 2011, FRV had spent approximately $69 million or 49% of their initial investment on solar panels and related costs purchased from Trina Solar, a Chinese manufacturer. County personnel consulted the County Attorney and determined that FRV made a commercially

reasonable effort to achieve this objective; however, sufficient documentation is not available to support this claim.

Environmental Attention
FRV must also ensure that environmental issues are considered during and after construction. For instance, the project must not be located over an environmentally sensitive aquifer or contributing zone. In addition, the project must be completed and maintained in a way that preserves and respects the natural environment by maintaining green space and must not violate any federal, state, or local legislation or regulations.

Minority Participation
FRV was required to use good faith efforts to use historically underutilized businesses (HUBs).

Compliance Requirements of the County
PBO is charged with compliance, inspection, and notification of any issues pertaining to the Determination of Benefits that FRV provides on an annual basis per Section 4.2 "Determination and Payment of Agreement Funds". The following methods and procedures are used by PBO to verify compliance and enforce non-compliance with contractual requirements were identified.

Inspection and Monitoring Process
The County has the right to inspect pertinent records of FRV and verify contractual compliance per Section 4.2.2 (c) (ii), "Inspection". Generally, site inspections and reviews should be conducted timely, in accordance with Section 4.2.3 "Material Issues in Annual Reporting Form" which states that the "County will advise FRV of such material issues that are identified through the verification process within thirty (30) days of receipt of the Annual Reporting Form and other reporting information to allow FRV to correct/complete such Annual Reporting Form." If the site inspection is not conducted within 30 days after the annual report is received, the County may have a difficult time correcting or detecting mistakes made by FRV.

Annual certification process
FRV must provide an annual report to TCAD, the Tax-Assessor Collector and PBO detailing their tax benefits no later than March 31st, per Section 4.2.2 (a) "Annual Reporting Form". The report details the contractual objectives required against the actual results.

<u>Full-time Employee Verification</u>
County personnel have received an affidavit as verification of the required three to five full-time employees.

<u>Construction Jobs Verification</u>
Travis County personnel received confirmation of 211,000 hours as support for the required 175 to 200 construction jobs. County personnel consulted the County Attorney and determined that FRV made a commercially reasonable effort to report the jobs.

<u>Benefit and Length of Employment Verification</u>
"The Company must employ full-time positions receiving full-time benefits, and filled no less than ten out of twelve months of the year for which the Annual Reporting Form is made" per Section 5.1.1 (b)(i), "Definition". Currently, no verification process exists to confirm this requirement.

Compliance Verification

After County personnel complete the final review of the annual report, an email is sent to PBO Management and the Auditor's Office to certify that FRV has fulfilled its annual obligations.

Amendments

The original contract was amended in 2011 and 2014 as a result of a change in ownership. There was no change with the existing company as per the agreements with Travis County, and there were no effects on the day-to-day functioning of the facility.

Tax Rebate History

FRV first became eligible to claim a tax benefit in tax year 2012. The rebate term is January 1, 2012 through December 31, 2032. The tax incentive package formed with Travis County provides an 80 percent ad valorem tax rebate, provided FRV creates 175 to 200 construction jobs, employs three to five full-time positions, and complies with the remaining terms of the contract. Also, FRV must invest not less than $100 million in improvements, facilities and structures, and business personal property.

Prior Year Audits

County personnel reviewed audits performed by Reznick Group, P.C. as of December 20, 2011. These audits were performed to verify that FRV's books were fairly stated in all material respects for federal income tax purposes. The audits confirmed that the property increased, on a cost basis (for federal tax purposes), by $138 million.

Tax Benefits

The total amount of tax rebates claimed by FRV is $244,692.06. The tax benefits are claimed in accordance with Section 4.1 "Agreement Funds", which allows for 80% relief in ad valorem taxes on the eligible property, provided that FRV honors its contractual obligations annually.

After County personnel review the annual report from FRV, a payment request is sent to the Auditor's Office as shown in Attachment B. County personnel also review the property tax receipts to ensure that FRV has paid the correct portion of current year taxes.

Finding #1: Best Practices (Serious)

a. **Compliance** – Overall, compliance testing is insufficient to properly ensure that the terms of the contract are being met. Each of FRV's relevant contractual requirements should be reviewed for compliance in sufficient detail to give Travis County a reasonable level of comfort that these requirements are being met.

b. **Review** – County personnel currently do not perform any substantive testwork on the payroll files or investments to ensure they are accurate. In addition, no management review is made to ensure FRV is compliant. No on-site inspections of the solar farm have occurred. On-site inspections are particularly important during the construction process to help verify sourcing of labor and materials, the number of construction jobs created, and consideration of environmental issues.

c. **Conflict of Interest** – Travis County currently has no policies and procedures in place to confirm if County officials have a conflict of interest with parties to rebates and abatement contracts. No information is collected or gathered annually to determine independence. We recommend establishing a formal policy by which conflicts of interest between the County and parties to rebate and abatement agreements can be avoided. This policy should identify what situations constitute inappropriate conflicts and the potential ramifications of these inappropriate relationships. Relevant County officials should document their understanding of their responsibilities under this policy.

Finding #2: Other Significant Issues (Less Serious)

a. **Construction, Environmental Attention, Minority Participation, Community Participation** – County personnel did not issue a Certificate of Occupancy, monitor environmental issues or audit the minority participation program as required in Section 5.1.1 (d)-(f). Travis County relied on the City of Austin's compliance team throughout the construction phase.

b. **Timeliness** – We were unable to confirm the timely review of the annual reports for tax year 2012 as required in Section 4.2.3 "Material Issues in Annual Reporting Form", which states that "County will advise the company of such material issues that are identified in the verification process within thirty (30) days of receipt of the Annual Reporting Form". County personnel have stated that the delay was caused by the purchase and sale of the parent company.

Significance
The items above are significant for the following reasons:

1. County personnel did not properly verify the hiring of three to five permanent employees or the creation of 175 to 200 construction jobs. These personnel also did not obtain supporting documentation of FRV's efforts to use local materials or employ full-time employees. Without this verification, it is not possible to determine if FRV is in compliance with their contract terms.

2. Without proper documentation and on-site verification of the proper construction of the solar farm, it is not possible to confirm that FRV is in compliance with its contractual obligations.

Recommendation
Based on the noted significance, we recommend that Travis County improve the monitoring and inspecting of payroll records and work closely with third party auditors to ensure the accuracy of tax rebate payments in the future.

MANAGEMENT RESPONSE

The Planning and Budget Office (PBO) would like to thank the County Auditor's Office for the recommendations provided for improving the compliance process for economic development agreements. In this management response, PBO will provide a brief background of the economic development program and lay out a plan and time table for improvements that will be made to address the process findings of this audit. In addition, PBO will address several specific, time-sensitive findings and our plan and time table for addressing those.

Background

On April 11, 1995, after soliciting the input of an array of interested parties including the Greater Austin Chamber of Commerce and Austin Interfaith, Commissioners Court adopted a "Resolution of County Election to Become Eligible to Participate in Tax Abatement and to Adopt Guidelines and Criteria for Tax Abatements". The Guidelines and Criteria for Tax Abatements, also approved on April 11, 1995, designated PBO or its designee as the administrator of the tax abatement agreements (§25.010 Administration).

On August 30, 2005, Commissioners Court adopted guidelines and criteria for tax rebate and tax abatement and other incentives. PBO was identified in those guidelines as the department administering the agreements. At that time, Commissioners Court began entering into tax rebate agreements. Another revision to the policy was undertaken beginning in 2011, after the existing policy expired on September 11, 2011. A revised policy was approved on November 27, 2012 while ongoing public input was sought. The latest revisions to the policy were approved on January 14, 2014.

The compliance process began with the Executive Manager of PBO handling most direct communications with the participating companies. Later, when the first rebate contracts came up for payment, the Budget Director and Budget Analyst assigned to economic development agreement compliance as a special project became involved. It was at this time that the process became more time consuming and, at the same time, continued to grow with the approval of additional agreements. Through the years, PBO and the involved companies worked together to gather information to determine compliance on these very complex contracts. Each contract has different time lines and requirements. When issues were found, as was the case with the HP agreement, PBO has discussed with and sought direction from the Commissioners Court. These issues have resulted in several amendments to the original agreements.

As the contracts have grown in complexity, PBO has partnered with the City of Austin as much as possible. The City of Austin's Chapter 380 contract compliance is handled within the 56 FTE economic development office and includes financial resources for third party auditors. The contract requirements for the Apple and HID agreements (not part of this audit) are similar for both jurisdictions allowing for concurrent compliance meetings. Therefore, the compliance procedures for these two companies are expected to be much more rigorous than in previous agreements approved in the infancy of this program. In addition, current payroll testing and investment verification are more in line with the recommendations of the Auditor's Office noted in this audit.

Documentation

While PBO is committed to improving and standardizing the compliance procedures for the department moving forward, it should be noted that most of the supporting documentation on payroll, HUB vendors and capital investment remains at the company location. PBO has the right to inspect and review any documentation in order to satisfy compliance on these contracts; however, due to open records rules, companies often opt to disallow documents leaving their office locations. This means that only notes of the meetings are retained by PBO. During the course of this internal audit, PBO provided the Auditor's Office with all documentation that was available. However, source documents were often not available and only the notes taken during the compliance meetings in the companies' offices are available.

This is the first time that the Auditor's Office has audited economic development agreements. The scope of this audit went back almost ten years to the start of the Home Deport abatement agreement. While files from previous managers were made available to staff, some documentation was not found for Auditor review. PBO will review best practices with regards to proper compliance documentation for future compliance efforts and implement them as soon as possible.

Response to Process Findings

PBO will develop a written compliance procedures manual that incorporates best practices. The manual will address the following:

- identify compliance testing criteria and standards
- set out the timelines for accomplishing the various steps of the compliance process
- set a specific format for identifying every item that must be tested for compliance for each agreement
- establish the documentation standards that will be required for each agreement
- stipulate how each file (electronic and hard copy) will be kept and where
- establish standard correspondence and reporting formats and methods
- identify the internal review process
- establish the process and timelines for notifying Commissioners Court of issues that may arise in the compliance process
- establish the process for closing out an agreement, including an end-of-contract true-up, if allowed

The timeline for development and completion of this manual is as follows:

Sep-Oct	Research best practices, obtain copies of other procedures manuals
Nov-Jan	Draft procedures manual and route for comment and input
March 2016	Implement new procedures

The compliance procedures manual will be updated as needed and will be comprehensively reviewed and revised, if necessary, biannually, after the end of each Texas Legislative Session, to ensure that any changes to state statute are appropriately captured not only in the County's economic development policy, but in the compliance procedures manual.

Select management and staff will seek out and attend appropriate training to ensure that staff is knowledgeable of economic development issues and is fully trained on contract compliance best practices. In addition, as PBO begins developing the compliance procedures manual, PBO will determine whether there are certain phases that are best accomplished by a third party audit firm. PBO will make its recommendation to Commissioners Court on this issue and seek Court approval and appropriate funding for such contractual assistance.

Independence from Commissioners Court

PBO believes that making the compliance process independent from Commissioners Court is unworkable because Commissioners Court is responsible for ensuring compliance with the economic development agreements. However, PBO will work to make the compliance process stronger and more transparent by establishing written compliance procedures based on best practices, researching the use of a third party audit firm to do the most complex and time-consuming compliance tasks. Finally, PBO will work with the County Attorney's Office to draft a conflict of interest policy specific to the economic development program. PBO will use the same timeline for development of this policy as the development of the procedures manual. The goal will be to have the Commissioners Court approve the policy in March 2016 at the latest.

Certificates of Occupancy

One process issue cited in the County Auditor's report that may prove problematic to implement is the issuance of a Certificate of Occupancy by Travis County, as required in the contracts. PBO spoke with TNR's Director of Development Services and Long Range Planning. She stated that within city limits, the city has jurisdiction over the issuance of Certificates of Occupancy. In the unincorporated area of the County, there is no authority for the County to issue Certificates of Occupancy. PBO will work with the County Attorney's Office to determine whether there is any other provision in the contracts (such as a general provision that may state that state law supersedes any specific contract provision) that can address this issue. Otherwise, some or all of the contracts may need to be amended for projects in the unincorporated area of the County.

Definition of Full Time Jobs

Another factor complicating the compliance process with regard to the verification of jobs created is the annual requirement that the jobs be filled 10 out of 12 months. PBO will explore ways in which this can be verified appropriately, especially in light of the fact that several new agreements will move to the compliance phase in the coming years.

Response to Specific Findings

Home Depot – On August 4, 2015, PBO briefed Commissioners Court on the compliance issue with Home Depot. PBO received direction from Court and with the help of the County Attorney's Office, has worked with Home Depot's legal counsel to recoup $260,862 in abated taxes. As of the writing of this response, Home Depot has remitted a check to Travis County for the full amount owed to the County of $260,862.

Hewlett Packard – PBO asked the Commissioners Court Clerk to search the meeting archives to determine whether there was any official notification to Commissioners Court during the period from 2008-2011. With the exception of a presentation from the Capital Area Council of Governments on the impact of economic development agreements on the county budget on June 3, 2008, there were no other items on the Court's agenda relating to this agreement. PBO notes anecdotally that it is likely that during the subject timeframe PBO management would have briefed the PBO subcommittee about this issue. However, this briefing would not have been to the full Court and in the future, such information will be posted for executive session discussions with the entirety of the Commissioners Court. It is PBO's intent that the development and use of a compliance procedures manual will keep this situation from occurring again.

Samsung – As part of its new compliance procedures, PBO will improve its compliance testing and documentation to ensure that compliance can be easily verified in the future. As part of this audit, the Auditor's Office recommends "that Travis County personnel work with Samsung to determine how the Fab 1 facility now functions in relation to Fab 2 and to determine if the two entities can be considered separate in relationship to our rebate contract."

PBO reviewed the agreement with the County Attorney's Office and believes that a renegotiation of the agreement is not supported by the rationale presented in the audit report.

The Agreement defines the Project as including the development of a semiconductor wafer fabrication facility to produce semiconductor wafers approximately 300 millimeters in diameter and the retooling and upgrading of the existing wafer fabrication facility located on the land, clearly indicating that the Project would include changes to the existing facility.

The changes to the Fab 1 and Fab 2 plants are not complicating factors. They are part of the bargained for development offered and accepted in the agreement. Both the changes to Fab 1 and the construction of the new plant area for Fab 2 were specifically included in the definition of the Project. In 4.1.3, the Agreement continues in this manner by stating that the incentives provided under this Agreement are granted for both new facilities and structures and for the modernization of existing facilities and structures.

PBO continues to work with the County Attorney's Office on contract interpretation when questions arise during the compliance process.

FRV Solar – PBO worked with the County Attorney's Office on the employee count verification and obtained an affidavit from FRV Solar verifying the appropriate number of employees. The County Attorney's Office advised PBO that this affidavit was sufficient documentation. For future verification of construction jobs, PBO will include specific criteria that must be met in the compliance procedures manual. For future agreements and the ongoing compliance process for existing agreements, PBO will improve its documentation of any interpretation of broad contractual statements such as "commercially reasonable effort."

ATTACHMENT A – INTERNAL CONTROLS RATING KEY

A good internal control system reduces the risk of errors, defalcations, and misappropriations of funds. Weak internal control systems provide an environment in which errors, defalcations, and misappropriations of funds can go undetected. The following details the various grades we assign to internal control systems:

RATING	RATING DESCRIPTION
Good	Well-established internal controls with few, if any, minor weaknesses noted
Adequate	The overall solid system of internal controls is sufficient to outweigh noted weaknesses
Requires Improvement	Internal control weaknesses exist that moderately impact the overall system of internal controls
Requires Significant Improvement	Significant internal control weaknesses exist that negatively impact the overall system of internal controls
Inadequate	The existing system of internal controls is materially ineffective

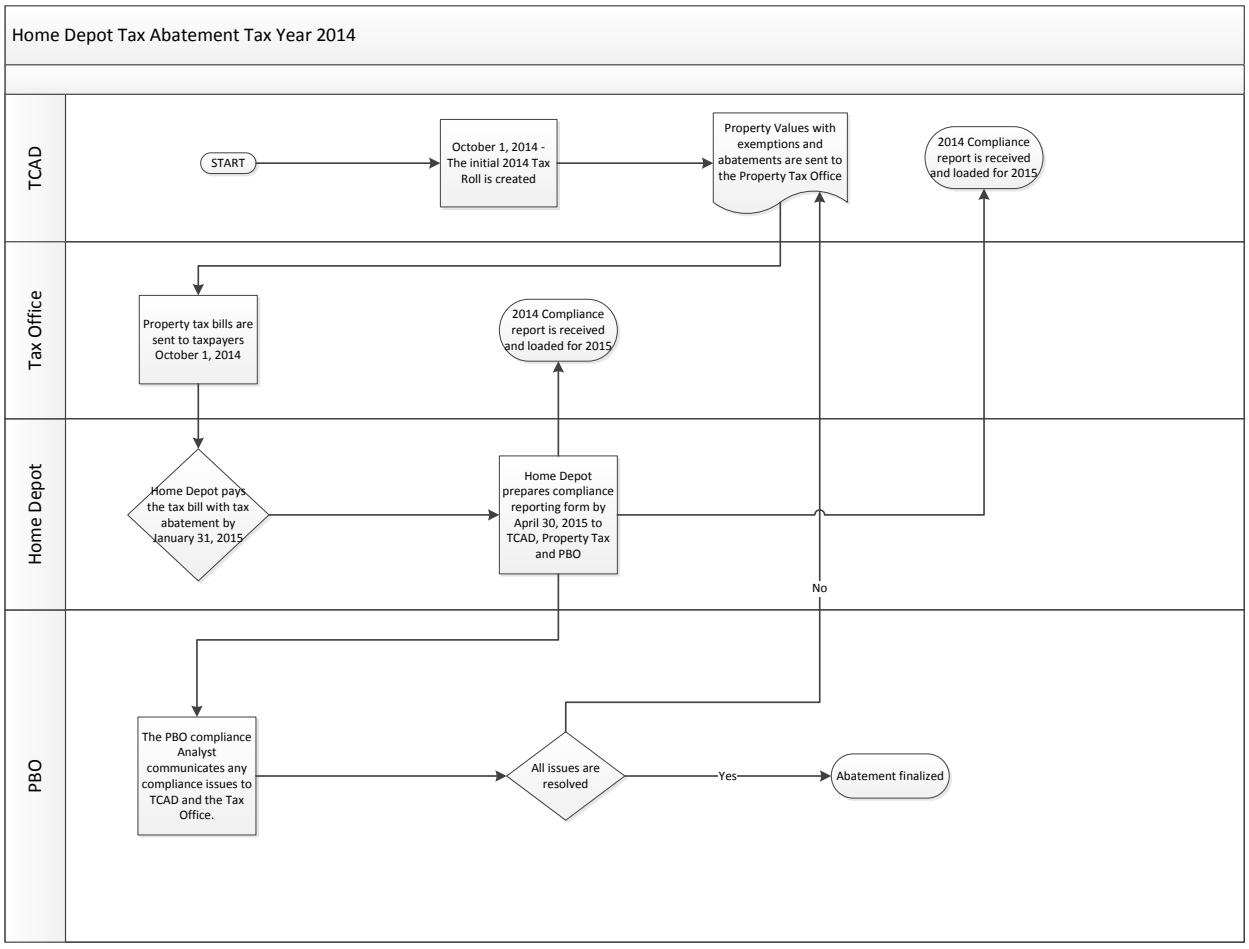
ATTACHMENT B – PROCESS FLOWCHARTS

Abatements

In accordance with Texas Tax Code, Chapter 312, a tax abatement is a local agreement between a taxpayer and a taxing unit that exempts all or part of the increase in the value of the real property and/or tangible personal property from taxation.

Tax abatements are an economic development tool available to cities, counties, and special districts to attract new industries and encourage the retention and development of existing businesses through property tax exemptions or reductions.

The process map below shows the decisions and parties involved in a Travis County tax abatement, using Home Depot as an example:



Rebates

In a property tax rebate, the full amount of property taxes due is collected from the party due the rebate. The County then verifies that the party is in compliance prior to a contractually-governed percentage of the tax payment being "rebated" (refunded) to the party.

Local Government Code, Chapters 380 and 381 allow counties the authority to provide a grant or a loan of County funds or services in order to promote economic development. This grant may take the form of a sales or property tax rebate.

The process map below shows the decisions and parties involved in a Travis County tax rebate, using Samsung as an example:

