Report of the Vermont State Auditor

August 23, 2010

VERMONT EMPLOYMENT GROWTH INCENTIVE

PERFORMANCE AUDIT OF CLAIMS REVIEW PROCESS

Thomas M. Salmon, CPA
Vermont State Auditor
Rpt. No. 10-4

Mission Statement

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THOMAS M. SALMON, CPA
STATE AUDITOR

STATE OF VERMONT
OFFICE OF THE STATE AUDITOR

August 23, 2010

The Honorable Shap Smith
Speaker of the House of Representatives

The Honorable Peter Shumlin
President Pro Tempore of the Senate

The Honorable James Douglas
Governor

Dear Colleagues,

State legislators today are faced with tough choices and less discretion in investing limited public funds. According to the National Conference of State Legislatures most remain committed to investing in economic development with states investing more than $2 billion in economic development programs, excluding tax incentives, in FY 2009. *Site Selection* magazine reported in November 2008 that 45 states, including Vermont, offered tax incentives for job creation alone.

This report evaluates the activity of one of Vermont's economic development programs, the Vermont Employment Growth Incentive program (VEGI), as required by statute. Since the inception of the program in 2007 through March 25, 2010, 46 companies were considered for incentives, of which four companies were denied and 16 initially approved, but subsequently had their authorizations rescinded.

To date, the volume of claims processed by the program administrators has been low. Only 10 companies were eligible to file claims for growth activity occurring in calendar year 2008, the activity year under audit. Of those 10 companies, only three were able to demonstrate that they had met their growth targets. The total amount of incentive payments made for 2008 growth activity was $53,814.

The first audit of the program conducted by our office in 2008 focused on evaluating the controls and management of the application process in the VEGI program. This audit focused on the claims process which is predominantly administered by the Department of Taxes (DOT).

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Our audit objective was to determine the extent to which the Department of Taxes has controls and processes in place to ensure that the claims, payments and recoveries are accurate, complete and timely. We found that those controls and processing could be enhanced and have made recommendations that, if implemented, could assist the Department of Taxes in its fiduciary role as it relates to the distribution of State resources.

I would like to thank the management and staff of the Department of Taxes and the Vermont Economic Progress Council for their cooperation and professionalism. If you would like to discuss any of the issues raised by this audit, I can be reached at (802) 828-2281 or at auditor@state.vt.us.

Sincerely,

Thomas M. Salmon CPA

Thomas M. Salmon, CPA
State Auditor

cc: Neale F. Lunderville, Secretary, Agency of Administration
James Reardon, Commissioner, Department of Finance and Management
Ellen Tofferi, Acting Commissioner, Vermont Department of Taxes
Karen Marshall, Chairperson, Vermont Economic Progress Council
Fred Kenney, Executive Director, Vermont Economic Progress Council

Contents

Report

Tables

Abbreviations

EATI	Economic Advancement Tax Incentives
GAGAS	Generally Accepted Government Auditing Standards
SAO	State Auditor's Office
DOT	Vermont Department of Taxes
VEGI	Vermont Employment Growth Incentive
VEPC	Vermont Economic Progress Council

Introduction

State legislators today are faced with tough choices and less discretion in investing limited public funds. According to the National Conference of State Legislatures most remain committed to investing in economic development with states investing more than $2 billion in economic development programs, excluding tax incentives, in FY 2009. *Site Selection*[1] magazine reported in November 2008 that 45 states, including Vermont, offered tax incentives for job creation alone.

Some of Vermont's economic development incentive programs were designed as an opportunity for the State to recruit businesses into the State or to assist those currently in the State to grow or expand beyond the growth that would occur absent the incentives. One of these programs, the Vermont Employment Growth Incentive program (VEGI) provides companies the opportunity to earn cash incentive payments if annual growth targets are met. Targets are established by a company at the time of application based on its anticipated growth. To be eligible for an incentive, a company must maintain or increase base payroll, meet the payroll target and attain either of the targets set for job growth or capital investments.

Since the inception of the program in 2007 through March 25, 2010, 46 companies have been considered for incentives of which four have had awards denied, and 16 awards have been rescinded or revoked[2]. Twenty-six[3] applicants remain in the program with authorized incentives totaling $25,782,290.

The total authorized incentive may be earned by a company over an award period of five years or less. Cash payments to companies meeting and

[1] *State Incentive Programs*, Site Selection Magazine, November 2008. Available at www.siteselection.com/issues/2008/nov/state-incentives/state-incentives.pdf. Accessed 4/26/10.

[2] Revoked is a term used by the Vermont Economic Progress Council to denote an applicant that has received an incentive payment that is subject to recapture.

[3] Applicants to the program file a claim in the first quarter of the year following the year growth activity commenced. The 26 applicants still in the program as of the audit fieldwork (May 2010) include six with growth activity beginning in year 2008 and the remainder with activity beginning in 2009 or projected to begin in 2010. Ten companies filed claims for activity year 2008; four subsequently had their award authorizations rescinded or revoked.

maintaining targets established for each of the five years are made in installments.[4] (See Appendix I for an illustration of a sample payment schedule.)

The program is jointly administered by the Vermont Economic Progress Council (VEPC) and the Department of Taxes (DOT). VEPC serves as an approval and authorization body for applicants to the program and the amount of incentive applicants may earn. DOT is statutorily responsible for evaluating the veracity of the growth activity listed on companies' annual claims for incentives as well as making cash payments to those whose claims have been validated. Further, DOT is responsible for recapturing incentive payments made to companies that have reduced their workforce to 90 percent or less of the jobs in place at the time of application.

The Office of the State Auditor (SAO) is required to conduct a biennial audit of the VEGI program.[5] The first audit of the program conducted by SAO was in 2008 for the program's first full year of activity – calendar year 2007. At the time of that audit, statute required SAO to include in the audit a comparative examination of the replaced Economic Advanced Tax Incentive (EATI)[6] program to the VEGI program, the VEGI program with respect to performance measurements, program expenditure controls, the adequacy and availability of program information, and recommendations for improved accountability and fiscal controls. Subsequently, the statute was amended to remove the specific requirements of the audit[7].

The scope of the first audit included comparing the two programs and evaluating the controls and management of the VEGI program. Our audit

[4] The first-year incentive payment may only be disbursed to the extent the full amount of qualifying payroll was actually paid in that year. Qualifying payroll generally refers to annualized Vermont gross wages and salaries paid for new, full-time Vermont jobs held by non-owners that meet a wage threshold of no less than 160 percent of Vermont minimum wage at the time of application.

[5] Pursuant to 32 VSA §163(10).

[6] The EATI program, which offered tax credits to qualifying businesses for economic growth, was replaced by the VEGI program as of January 1, 2007, due to significant shortcomings in the EATI program.

[7] 2007 Act 121 Sec. 23. See 32 VSA §163(10).

focus was on the application process.[8] Performance measures were evaluated during a subsequent audit.[9]

The timing of the first audit precluded analysis of the procedures used by the DOT in its consideration of claims for payments. Since DOT has been processing claims and we had not yet evaluated their process for doing so, we elected to focus our audit in this area.

The objective of our audit was to determine the extent to which the DOT has controls and processes in place to ensure that the claims, payments and recoveries are accurate, complete and timely. To perform this assessment, we evaluated the claims filed by February 28, 2009, for the growth activity which occurred during the calendar year 2008. (See the Scope and Methodology in Appendix II.)

[8] *Vermont Employment Growth Incentive: Compliance Audit Pursuant to 32 VSA §163(12)(B).* Report No. 08-08. June 12, 2008.

[9] *Department of Economic Development and Vermont Economic Progress Council; Enhancements to Performance Measurement Systems Could Be Made.* Report No. 09-05. September 14, 2009.

Highlights: Report of the Vermont State Auditor

Vermont Employment Growth Incentive: Performance Audit of Claims Review Process

(August 2010, Rpt. No. 10-4)

Why We Did This Audit

32 VSA §163(10) requires the Office of the State Auditor to biennially conduct an audit of the VEGI program. Our audit objective was to determine the extent to which the Department of Taxes has controls and processes in place to ensure that the claims, payments and recoveries are accurate, complete and timely.

What We Recommend

We recommend that the Department of Taxes:

1. Develop written procedures and controls over the activities required in the event recapture of a prior payment is required.

2. Develop written standards for the level of data validation that should be performed over information submitted by claimants in order to support approval or denial of a claim.

3. Implement additional controls surrounding management review to ensure systematic review of the tax examiner's work. These should include documenting when supervisory review is required and developing mechanisms to evidence supervisory review.

Findings

We found the Department of Taxes had established some internal controls for the VEGI program to ensure that claims and payments were accurate, complete and timely; however, the claims process could benefit from additional written procedures and documented supervisory review.

While DOT had comprehensively documented most procedures, certain aspects of claims processing were (1) not addressed or (2) were documented but lacked specific criteria to guide the tax examiner's review of claims and did not indicate the extent of supervisory review required nor the mechanisms to evidence that supervisory review had occurred.

1) Specifically, DOT had not documented procedures for addressing payment recapture. Although our testing of the sole claims payment subject to recapture found no error, the risk remains that without specific guidance, payments subject to recapture may be inaccurately calculated or wrongly pursued particularly if the volume of recapture activity increases.

2) While DOT had procedures that required validation of claimants' reported data, there appeared to be a lack of criteria for determining the extent of validation required to corroborate claims. For example, the tax examiner was inconsistent in selecting payroll information to verify during the evaluation of data, validating only 7.2 percent of employee wages on one claim and 66.7 percent on another. It was difficult to determine how the first example was deemed sufficient to validate the claim data. Without verification of a sufficient amount of data, DOT might incorrectly approve and pay a claim.

   In addition, the requirement for supervisory review over significant judgments made by the tax examiner was not addressed in DOT's procedures and was not evidenced in the documentation retained by DOT for each incentive claim we reviewed. Although the Internal Audit Section chief assured us that management review of claims processing occurred, we were unable to verify the nature and scope of management's review. According to the director of Taxpayer Services, a checklist is being developed that will be used for incidences of supervisory review.

Background

In 2006, Act No. 184 created the Vermont Employment Growth Incentive program (32 VSA §5930b) as a replacement to the EATI program, which offered tax credits that may or may not be used by the claimant depending upon its own level of tax liability. Act No. 184 noted that shortcomings in the EATI program had been identified in the areas of performance measurements and controls, program expenditure controls, State fiscal losses, and adequacy and availability of program information. The VEGI program was created in an effort to simplify the incentive program and address the concerns noted above.

VEGI's purpose is the creation of new, qualifying payroll and jobs, and the generation of new qualifying capital investments by awarding cash incentives to program applicants approved by VEPC and who meet their projected growth in those areas.

The VEGI statutes, including 32 VSA §5930a and §5930b, jointly task VEPC and the Department of Taxes with responsibilities for managing the program as well as annually filing a joint report to the legislature.

Vermont Economic Progress Council

The Vermont Economic Progress Council (VEPC) is a council of nine Vermonters, appointed by the Governor, plus two legislative representatives (as of April 1, 2009) who vote to approve or deny incentive applications. In addition there are two non-voting regional representatives from each of 11 economic development regions[10] of the State. The Council must ascertain, "to the best of its judgment, that ***but for*** the economic incentive to be offered the proposed economic development would not occur or would occur in a significantly different and significantly less desirable manner."

Once approved, applicants receive cash payments if they successfully meet annual payroll and either jobs or capital investment targets set at the time of application. VEPC's executive director and executive assistant provide support to companies in the application process.

[10] Vermont's 14 counties are represented by 11 economic development regions.

Department of Taxes

Companies authorized to receive an incentive have until the last day of February to file their incentive claims based on the growth activity of the previous calendar year. For instance, for growth activity that occurred in calendar year 2008, companies must have filed claims for authorized awards by February 28, 2009.

Under 32 VSA §5930b, the Department of Taxes is tasked with verifying base payroll data at the time of application; validating information when an award is claimed; and making the requisite payments to claimants who have met their annual targets. Depending upon the number of employees and the complexity of the data supporting the claims, a claim could take days or months to process, according to DOT's Internal Audit Section chief.

A web-based software, IntelliGrants™ by Agate Software, Inc., is used as a tool to administer the VEGI program. The online VEGI application and claims system allows applicants to manage and monitor their own application and claim activity. The IntelliGrants™ system has been used to process applications and claims since January 2009.

In order to earn an incentive, all companies in the program must file an annual claim. This is the case whether or not a company feels that targets have been met. This is so that DOT can determine:

1. If the base-year payroll and jobs have been maintained.

2. The level of shortfall if the base-year jobs have not been maintained. (A 90percent or greater drop below base-year jobs will trigger recapture.)

3. Whether the payroll growth target and either the jobs target or the capital investment target has been met for the current year.

4. Whether targets have been met for previous years and if not, whether the filed claim is still within the grace period allowed by statute, (i.e., Targets for years one, two or three may be met within the following two succeeding calendar-year reporting periods; targets for year four may be met within an additional one-year reporting period).

Ten companies filed claims as of February 28, 2009.[11] Six had activity related to their approved projects' incremental growth[12] beginning in 2007 and continuing through 2008; the remaining four companies had incremental growth activity beginning in 2008.

Once a claim is filed, DOT reviews the information provided by the claimant for timeliness of filing, completeness and consistency with other tax filings (such as payroll withholding reconciliations), and for accuracy of reported information. DOT will approve, deny, or delay a claim based on various factors, as follows:

- Approved – A company's claim is approved if it has met its annual payroll target, either its annual job or capital investment target, and has maintained the base payroll determined when its application was submitted. An approved company will receive a payment of one-fifth of their annual incentive award each year for five years as long as the targets are maintained. (Appendix I provides an example of an approved claim and schedule of installment payments.)

- Delayed – A claim may be delayed under the following conditions:

    - Companies not meeting their payroll targets and either their jobs and capital investment targets in any of the first three years may not claim incentives in that year, but are allowed two succeeding calendar years to meet targets for each of those years and one additional calendar year to meet fourth-year targets.

- Denial – Claims are statutorily required to be filed annually by the last day of February for the prior calendar-year period. An annual claim should be denied when:

    - A company fails to file a claim or files an incomplete claim by the last day of February.

[11] One of the 10 companies filing claims at the end of February 2009 was subsequently removed from the program and had its payment subject to recapture.

[12] Incremental growth is the increased economic activity that a company has experienced because of the VEGI incentive. That growth would not have ordinarily occurred at all, or would have occurred in a materially different and less desirable manner, except for the incentive provided.

- Award-year[13] qualifying jobs and payroll levels are not maintained or have not been reestablished to 100 percent of award-year levels. (See conditions under "Delayed" above.)

- Withdrawn/Rescinded – When targets are not met within the prescribed period (see conditions under "Delayed" above), DOT is to recommend to VEPC that the Council rescind the company's authorization to earn an award for the specified project. Previous payments made to companies whose awards were rescinded may be subject to recapture under the circumstances described below.

- Recapture – Incentive payments made in previous periods to a company may be subject to recapture (i.e., repayment to the State) if the following occurs:

  - A business experiences a drop of 90 percent or more in application base jobs during any utilization year[14].

  - A business fails to invest the minimum qualifying capital investment as represented on the VEGI application by the end of the five-year award period. The amount recaptured is prorated to the extent of the deficiency in investment.

The Claims Process Could Benefit from Enhanced Controls

We found the Department of Taxes had established certain internal controls for the VEGI program to ensure claims and payments were complete, accurate and timely. However, some key processes were not documented or the documented procedures lacked sufficient guidance to ensure a consistent approach to validating claimant data and performing supervisory review. Claim activity and payments through February 2009 were low and based on the claims files we reviewed, we noted no errors in incentive payments distributed or recaptured. If claims volume increases, risk remains that undocumented procedures and the potential for an inconsistent approach to

[13] The year in which VEPC approves a company in the program is the award year. An approved company must maintain or increase existing payroll and jobs in future periods to qualify for an incentive payment each year.

[14] A utilization year is a year in which incentives may be claimed. The entire utilization period includes each year of the award period plus the four years immediately following each year of the award period. See Appendix I for a sample payment schedule.

claims validation and supervisory review could lead to inaccurate incentive payments or recaptures.

Documented procedures are an essential component of internal controls. The State's internal control standards, produced by the Department of Finance and Management, describe documentation of policies and procedures as "critical to the daily operations of a department. These documents set forth the fundamental framework and the underlying methods and processes all employees rely on to do their jobs. They provide specific direction to, and help form the basis for, decisions made every day by employees. Without this framework of understanding by employees, conflict can occur, poor decisions can be made and serious harm can be done to the department's reputation. Further, the efficiency and effectiveness of operations can be adversely affected."[15]

Furthermore, Finance and Management's internal control guidance suggests that those with the responsibility for supervision should:

- Systematically review each staff member's work.
- Approve work at critical points to ensure quality and accuracy.
- Provide documentation of supervision and review (for example, initialing examined work).

Basic Controls in Place

The internal controls in place at DOT include written procedures for many of the steps required to process VEGI claims, including verification of base payroll data, calculation of incentive payments, and follow-up to ensure that claimants maintain prior-year target levels.

Some internal controls have also been established for the VEGI program as they pertain to electronic controls. For instance, the software used for the VEGI system, IntelliGrants™, utilizes a security model based on defined roles, which can limit the types and levels of access and the actions an individual may take (depending upon the assigned role). Access to applicant system files and other confidential data is restricted to assigned individuals

[15] *Internal Control Standards, A Guide for Managers*. Vermont Department of Finance and Management. Page 15.

within the applicant organizations, VEPC staff, and individuals within DOT who are responsible for validating application data and claims.

The software also provides automated notifications by e-mail that send immediate updates to VEGI management and to the applicant as events occur. These messages are system-generated for items like filing deadlines, while others are the result of a user-triggered event, such as the approval or denial of an application or the change in the status of a claim.

Much of DOT's process, however, requires manual processing, such as data validation or determining if a claim is filed completely. Some controls have been implemented on the manual processes such as consistent organization of the files and standardized forms and workbooks claimants must use when submitting claims data. Since each claim may bring unexpected challenges, DOT continues its efforts to develop a form to ensure claimants provide data to DOT consistently, and in a format useful to DOT.

To date, the volume of claims processed by DOT has been low, allowing DOT to refine its processes during the first few years of the program. See Table 1 for claimant activity filed in 2009 for the 10 companies with growth activity in 2008. The table also shows the payments made in 2009 that were subsequently subject to recapture.

Table 1. Claimant Status and Payments

Status	Number of Companies	2009 Payment
Approved and paid	4	$186,427
Delayed	5	$0
Rescinded	1	$0
Total claimants and amount paid	10	$186,427
Subsequently subject to recapture	1	$132,613
Net payment for calendar year 2008 economic activity	3	$53,814

Additional Written Procedures

DOT had not documented the procedures and level of management review required to pursue recapture of previous payments. Although recapture volume has been low and our testing found no errors in recaptures, risk remains that undocumented procedures could lead to poor decisions and recapture inappropriately pursued or not pursued.

One of the claims we tested demonstrated a drop in payroll that triggered the need for recapture. Since no formal process had been developed for recapture, the tax examiner determined what and how to bill the claimant. Our testing showed that even though no formal process had been developed the tax examiner determined the amount due from the claimant subject to recapture and invoiced the claimant appropriately and timely.

According to the Internal Audit Section chief the program has had a long learning curve as DOT addressed situations as they became aware of new information, such as a dramatic decrease in payroll, not previously considered. While new scenarios, such as recaptures, may arise during the early years of a program, as these situations present themselves, it is prudent business practice to consider, document and implement controls to ensure a consistent, systematic approach in the future.

For other aspects of claims processing, DOT had established written procedures but the procedures (1) lacked sufficient detail or (2) did not address supervisory review.

1) DOT had established procedures requiring validation of claimant payroll jobs and capital expenditure detail to assess incremental growth in a company, but did not detail the extent of validation required for the tax examiner to corroborate the growth claimed. As a result, for certain of the claims we reviewed, it was difficult to discern how the tax examiner and management concluded that adequate data had been validated and growth targets achieved.

   For example, for one claim the tax examiner selected only 7.2 percent of employees' wage information to verify during the evaluation of payroll data, comparing the claimant data to withholding reconciliations filed with DOT (W-2s) to ensure consistency with other required tax filings. In another claim, the tax examiner verified 66.7 percent of the claimant payroll data to withholding reconciliations. Since DOT had not established a methodology to determine the appropriate level of corroboration to validate claimant data, there is a risk that insufficient procedures will be performed or that validation performed will be inconsistent from claim to claim, therefore increasing the risk that determinations regarding whether to approve or deny an incentive payment will be incorrect.

2) According to the Internal Audit Section chief, decisions made by the tax examiner were reviewed by management. However, DOT's written procedures did not address supervisory review nor was it documented on any of the claims we tested, so it was difficult to determine the nature and scope of management's review.

   There are multiple judgments made during the review of claimant data which seem to warrant systematic management review. For example, a critical point in the process is determination of whether a claim is complete at the due date for claims to be filed. Per the instructions on the program's website[16], claims will not be considered complete and will not be processed unless all forms and the required attachments are filed. An incomplete claim may not be processed, according to Vermont statute. 32 VSA §5930b(c)(9) reads:

   > "Incentives must be claimed annually on an incentive return available from the Department of Taxes filed no later than the last day of February of each year of the utilization period. Incomplete returns shall not be considered to have been timely filed."

   The Intelligrants™ system, in which claims are filed, has a workflow process by which the tax examiner is automatically notified when a claim is filed at which time it is checked for completeness.

   The five claims that we tested were filed by the end of February 2009; however, one of them was filed incompletely as it was missing the required payroll workbook that allows the examiner to verify payroll growth. Nonetheless, the tax examiner determined it to be complete and continued to process the return.[17]

   Another critical judgment during the review of claimant data is determining whether reported capital expenditures relate to the approved

[16] http://economicdevelopment.vermont.gov/Portals/0/Claim_Instructions.pdf

[17] No payment was made to the company filing this claim as it was determined by the examiner that it did not maintain base payroll. The company subsequently had its award authorization rescinded.

project. Four of the five claims we reviewed included aggregated capital expenditure information rather than detail about each item purchased. DOT's procedures required the tax examiner to review capital expenditure data provided by the claimant to ensure that items listed were purchased after the date the project commenced and are part of the approved projects. It was difficult to discern how the tax examiner concluded that the expenditures related to the approved project, since aggregated capital expenditure information did not provide sufficient detail for the tax examiner to confirm that purchases reported by the claimant related to the growth project. We were unable to determine whether management concurred with the examiners judgment in these instances as there was no evidence of review in the files and the Internal Audit Section chief could not recall specifically approving the examiners judgments.

The VEGI statute allows a company its entire award period to meet its capital expenditure targets and the companies that submitted aggregated detail had the other two factors (i.e., payroll and jobs targets) considered more predominantly in the examiners status determination.[18] However, if the capital expenditure target is considered met annually without the examiner obtaining detail and verifying its validity, the risk is that information rolled forward to the end of the award period may include expenditures unrelated to the project and claimants may receive payments in error.

DOT's director of Taxpayer Services stated that they are in the process of developing a checklist to document supervisory review that will be used for future VEGI claims. Further, DOT has implemented a workbook for claimants which specifies that capital expenditures must be reported on an itemized basis. We believe DOT needs to obtain the detail previously approved in its aggregated state for claimants remaining in the program and to develop fully documented processes including steps for management review at crucial intervals.

[18] Only one of the four companies reviewed that had capital expenditure targets for 2008 is still in the program. The other three had their award authorizations rescinded in 2009 and 2010 for not having maintained base payroll.

Conclusion

The long learning curve DOT is experiencing in this program has the Department developing VEGI processes as situations occur. We recognize that especially for a new program unexpected challenges will arise. We commend the Department for its flexibility and commitment to continual improvement. Implementing certain internal controls, such as complete written procedures including requirements for management's supervision and review and clearly defined criteria for determining a level of validation of claimant data would reduce the risk of inaccurate incentive payments.

Recommendations

We recommend that the Department of Taxes:

1. Develop written procedures and controls over the activities required in the event recapture of a prior payment is required.

2. Develop written standards for the level of data validation that should be performed over information submitted by claimants in order to support approval or denial of a claim.

3. Implement additional controls surrounding management review to ensure systematic review of the tax examiner's work. These should include documenting when supervisory review is required and developing mechanisms to evidence supervisory review.

Management's Response and Our Evaluation

In July 2010, the acting commissioner of DOT and the chairperson of VEPC provided written responses on a draft of this report (reprinted in Appendices III and IV). Both the acting commissioner and the chairperson indicated acceptance of the recommendations. Further, DOT presented action plans for implementation of those recommendations, such as documenting the procedures for reviewing the information submitted by claimants including a sampling program for reviewing the data.

We agree that the action plans presented by DOT, when implemented, will satisfy the intent of the recommendations, which is to enhance controls and processes to ensure that the claims, payments and recoveries are accurate, complete and timely.

We appreciate the cooperation and professionalism of the staff of the Department of Taxes and the Vermont Economic Progress Council as we conducted our audit of the VEGI program.

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In accordance with 32 VSA §163, we are also providing copies of this report to the Secretary of the Agency of Administration, Commissioner of the Department of Finance and Management, and the Department of Libraries. In addition, the report will be made available at no charge on the State Auditor's web site, www.auditor.vermont.gov.

Appendix I Sample Authorized Incentive Payment Schedule

Vermont Employment Growth Incentive
Sample Authorized Incentive Payment Schedule

Example: A company has been awarded the opportunity to earn an incentive of $400,000. The anticipated incentive to be earned each year, set at the time of application, is based on the expected incremental growth in payroll. The company in this example has met it's annual targets and has maintained those targets for the remainder of the utilization period.

Definitions per 32 V.S.A. §5930b:

"Award Period"means the consecutive five years during which a business may add qualifying jobs and qualifying capital investments eligible for employment growth incentives under this section.

"Authorized Award Amount" means the amount of the incentive award as determined by VEPC.

"Utilization Period" means the period during which incentives can be claimed, and includes each year of the award period plus the four years immediately following each year of the award period.

Total Authorized Award Amount	$400,000	Utilization Period (Years during which incentives may be claimed)									Total Incentive Earned
		Award Period (Years of a company's economic growth activity)									
		Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	
Anticipated incentive earned during each year set at time of application		20,000	150,000	125,000	80,000	25,000					$ 400,000
		Payment Schedule									
Company meets and maintains first year annual target ***		4,000	4,000	4,000	4,000	4,000					$ 20,000
Company meets and maintains second year annual target			30,000	30,000	30,000	30,000	30,000				150,000
Company meets and maintains third year annual target				25,000	25,000	25,000	25,000	25,000			125,000
Company meets and maintains fourth year annual target					16,000	16,000	16,000	16,000	16,000		80,000
Company meets and maintains fifth year annual target						5,000	5,000	5,000	5,000	5,000	25,000
Total annual cash installment payments		$4,000	$34,000	$59,000	$75,000	$80,000	$76,000	$46,000	$21,000	$5,000	$ 400,000

*** VEGI payments are made in five installments, provided that the level of jobs and payroll that generated the incentive are maintained. The first payment is made if the company meets its targets for the award year and the subsequent four payments are made if the company continues to maintain the award period level during the next four utilization years.

NOTE: This illustration is simplified and does not address the adjustment that is statutorily required of the first year payment. The first installment of an incentive earned in any award period year will be paid to the extent that the full amount of qualifying payroll was actually paid in that year.

Appendix II Scope and Methodology

Our audit objective was to determine the extent to which the Department of Taxes has controls and processes in place to ensure that the claims, payments and recoveries are accurate, complete and timely.

To address our objective we reviewed the State's statutory requirements related to the VEGI program[19]. We also reviewed the application and claim instructions and forms provided to companies interested in participating in the VEGI program. We obtained and evaluated written procedures that DOT has developed for their internal claim review process including authorization, pre-claim procedures, calculation of the incentive installment, issuing installment checks and follow-up to ensure that claimants maintain prior year target levels.

We conducted interviews with the Internal Audit Section chief and the director of Taxpayer Services regarding their understanding of processes and controls. We also conducted interviews with the executive director of VEPC and the administrative assistant regarding the security features of the IntelliGrants™ system, which is a web-based system used by companies to file information required in the application and claim process. We considered internal controls for information systems only to the limited extent to which they were related to our objectives.

To test the processes and controls in place at DOT, we obtained a list of claims filed in 2009 for activity year 2008 from DOT. The list included 10 companies at various stages of review, including the following:

- Three companies approved for installment payments.
- Five companies whose status is delayed due to not having met targets for the year but have additional time to meet targets as specified in statute.
- One company with previous paid installments subject to recapture.
- One company whose award approval was rescinded by VEPC.

From the list of claimants obtained from DOT, we selected five of the 10 claims to test based on the status of the applicants following the claim as well as the size and complexity of the organization taking into consideration the relevant risks associated with claimants.

[19] 32 VSA §5930b; 32 VSA §5930a; 32 VSA §163 (10)

Appendix II Scope and Methodology

Using a data collection instrument, we evaluated the processes developed by DOT for administering the claims selected for testing, including but not limited to:

- Testing the accuracy of DOT's calculations for incentive payments and amounts subject to recapture.
- Assessing and re-performing procedures done by DOT to validate the incremental job growth, payroll growth and capital expenditure detail.
- Determining the extent to which claims were filed completely.
- Evaluating the timeliness of claims filing and review as well as the timeliness of the recapture process.

We conducted this audit in accordance with generally accepted government auditing standards except for the standard that requires that our system of quality control for performance audits undergo a peer review every three years.[20] Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[20] Because of fiscal considerations, we have opted to postpone the peer review of our performance audits until 2011.

Appendix III Reprint of the Department of Taxes Response

State of Vermont
Department of Taxes
133 State Street
Montpelier, VT 05633-1401

Agency of Administration

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JUL 27 2010
VERMONT
STATE AUDITOR

July 26, 2010

Thomas Salmon, CPA
State Auditor
132 State Street
Montpelier VT 05633-5101

Dear Mr. Salmon:

Thank you for the opportunity to respond to the draft of the audit report of our VEGI program's claims processes and internal controls. I have reviewed the report and your findings, conclusions and recommendations. I have addressed each of your recommendations below;

Recommendation The Department should develop written procedures and controls over the activities required in the event recapture of a prior payment is required.

Response We accept this recommendation. We will update our written procedures to include the processes involved once a claimant has been identified for recapture. This would include determining the amount of the incentive to be recaptured and the process for billing the recapture. We will update our pr ocedures to include the recapture processes during the current year's claim review process.

Recommendation The Department should develop written standards for the level of data validation that should be performed over information submitted by claimants in order to support approval or denial of a claim.

Response We accept this recommendation. We will document the procedures for reviewing the information submitted by claimants including a sampling program for reviewing the data. We will update our procedures to include the written standards for validation d uring the current year's claim review process. .

Recommendation The Department should implement additional controls surrounding management review to ensure systematic review of the tax examiners work. These should include documenting when supervisory review is required and developing mechanisms to evidence supervisory review.

VERMONT

http://tax.vermont.gov

Appendix III Reprint of the Department of Taxes Response

Response We accept this recommendation. We have developed a VEGI claim checklist which will document both the dates the examiner has completed the steps in the review process and the dates a supervisor has reviewed the work. The checklist will be used to document the review dates of the examiner and the supervisor in the current year's claim review process.

I would like to thank you and your audit staff for recognizing the challenges that administering the VEGI program has presented to the Department of Taxes. As noted in the report, the development of a system for reviewing and validating the VEGI applications has been an ongoing procedure. As the number and diversity of claimants in the VEGI program expands we are continually updating and improving our processes. We appreciate the efforts of your audit team and consider the audit review an opportunity to assist us in this procedure.

Sincerely,

Ellen Tofferi

Ellen Tofferi
Acting Commissioner

Appendix IV Reprint of the Vermont Economic Progress Council Response

Vermont Economic Progress Council
Department of Economic Development
National Life Building – North, Drawer 20 [phone] 802-828-5765
Montpelier, VT 05620-0501 [fax] 802-828-3383
www.thinkvermont.com/vepc

Agency of Commerce and Community Development

July 22, 2010

The Honorable Thomas Salmon
Auditor of Accounts
State of Vermont
132 State Street
Montpelier, Vermont 05633-5101

Dear Mr. Salmon:

We want to thank you and your staff for the professional and diligent audit and report on the Vermont Employment Growth Incentive program.

While this program is administered, in part, by the Vermont Economic Progress Council, this audit focused primarily on the incentive claim process, which is undertaken solely by the Tax Department. We concur with and support the recommendations made in the audit regarding documentation of procedures, consistency in determining the validity of the claims and management review.

These steps all represent best practices that will help ensure timely, consistent, and fair treatment of all VEGI incentive claims while at the same time continuing prudent stewardship of the program. We offer any assistance and support required and will work with the Department regarding any changes in the application and authorization process, especially in the Internet-based Intelligrants© application and claim system, that will support implementation of the audit recommendations.

Again, we want to thank you and your staff for helping to achieve a higher level of effectiveness and efficiency in our efforts to improve the quality of life for all Vermonters.

Sincerely,

Karen Marshall

Karen Marshall
Chairperson
Vermont Economic Progress Council

Cc: Ellen Tofferi, Acting Commissioner of Taxes

VERMONT

"Improving the economic vitality of Vermont and supporting a sustainable future for our citizens."