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FOR IMMEDIATE RELEASE
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November 29, 2017

Performance Audit Committee Releases Two Tax Incentive Audits

The Legislative Audit Office today released reports on two tax incentive programs. Performance Audit Committee Chairman John Kuehn said that the reports provide the Legislature with new information on the Nebraska Advantage Research & Development Act and the Nebraska Advantage Rural Development Act. He added that, "the Legislative Audit Office has now done three tax incentive audits. All have clearly shown that the Legislature needs to be able to gather more information in order to answer questions we have about how incentives work. I will be working with legislators, stakeholders, agencies and the executive branch to follow through on the Committee's recommendations in these reports."

The audits are the second and third performed under a 2015 bill that requires all economic development tax incentives to receive such a review by the Legislative Audit Office at least once every three years.

In the Research and Development audit, the Committee recommended that all future tax incentive legislation include a "Performance Statement". Senator Kuehn stated, "Performance Statements would detail the specific goals a tax incentive is intended to accomplish, how we think it will accomplish those goals, and what constitutes success or failure." The reports noted that current incentive programs have goals that are too broad and ill-defined to allow for a judgment on whether or not they have been successful.

The Research and Development audit found that the costs of the program are likely to increase in the future. The R&D credit is tied to the federal Research and Experimentation Tax Credit, which the Treasury Department expects to have a cost increase of 700% in the next ten years.

The R&D audit also reports that Nebraska was found to be the most competitive for R&D companies compared to neighboring states.

The audit of the Rural Development program reviewed 70 participants, who earned $5.62 million in tax credits between 2004 and 2015.

The audit found that the wages that companies are required to pay workers in order to earn employment credits were an average of 42% lower than the statewide average wage during the analysis period. Additionally, the Audit Office was unable to perform a cost per job analysis for the program. The Committee recommends that the Nebraska

Advantage Rural Development Act be amended to require that investment and employment credits be tracked separately so that information on the actual number of jobs subsidized by the program is available.

The audit also found that the program contains several fiscal protections including performance-based incentives, recapture provisions, and a yearly spending cap, placing it at low risk for exceeding expected costs.

Senator Kuehn said, “We have a lot of work to do on tax incentives. I believe that more information will lead to better public policy. The people of Nebraska deserve to know what they are getting for their tax dollars.”

Nebraska Advantage Rural Development Act Performance on Selected Metrics

Performance Audit Committee
Nebraska Legislature

November 2017

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Audit reports are available on the Unicameral's Web site (www.nebraskalegislature.gov) or can be obtained from the Legislative Audit Office at (402) 471-1282.

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I. Committee Recommendations

Audit Summary and Committee Recommendations

The Nebraska Advantage Rural Development Act (Act) is a tax incentive targeted to rural areas of the state. Three levels of participation exist. Levels 1 and 2 require both investment and employment expansion. Livestock Modernization, the third level, requires only investment. Credits are awarded by the Department of Revenue for newly created investment and/or employment.

The Audit Office reviewed projects that received Rural Development Act benefits between 2004 and 2015. Seventy participants qualified during this time period, using a total of nearly $5.5 million in credits.

Section I of the audit report describes the Rural Development program and additional details on benefit usage. Section II presents our analysis of program metrics, organized by the scope statement question to which they apply. The Findings and Performance Audit Committee recommendations for each scope question follow.

Analysis of Metrics

The metrics used in this audit were selected by policymakers several years after the Act's adoption, meaning the expected performance of the Act in relation to the metrics is largely unknown. Without a standard of expected performance, the Office could not make simple "yes" or "no" judgements about whether the reported performance meets policymakers expectations. Instead, the Office simply reports the results of the analysis for each metric.

The Audit Office does not assert that the actions of incentivized companies reported here were caused by their participation in the Rural Development Act. Because a company's actions may be the result of many factors, it is difficult, if not impossible, to prove the effect of participation in one program.

Performance Audit Committee Recommendations

Scope Question: *Is the Rural Development Act meeting the goal of strengthening the state's economy overall by attracting new business to the state, expanding existing businesses, increasing employment, creating high-quality jobs, and increasing business investment?*

Job Creation Metric

The Audit Office makes no finding for this metric because there was no standard to compare the results to.

Recommendation 1: Future performance audits would be improved if the Legislature established a benchmark for the amount of growth in full-time employees (or positions) necessary for the program to be considered successful on this metric.

Recommendation 2: If the Legislature wants to know about full-time positions, not full-time equivalents, it may need to modify the Act to reflect that.

Average Wages Metric

Finding: Statutorily required wages for Rural Development project FTEs were lower than state average and project county averages in all instances. (pg. 15)

Recommendation 3: If the Legislature is satisfied with the difference in program wages, no further action is required. However, if the Legislature feels the required wage in the Act should more closely reflect the Nebraska and respective county average wages, it should consider introducing legislation to adjust the requirements.

New to Nebraska Metric

The Audit Office makes no finding for this metric because there was no standard to compare the results to.

Recommendation 4: The Legislature should consider defining new to Nebraska, either by using the definition in this audit or by creating another.

Recommendation 5: The Legislature may want to consider approaches to attracting new businesses that research suggests are more important to businesses looking to relocate.

Investment Metric

The Audit Office makes no finding for this metric because there was no standard to compare the results to.

Recommendation 6: The Legislature should set a target amount for what it believes is sufficient investment by this program.

Other State Benefits Metric

The Audit Office makes no finding for this metric because there was no standard to compare the results to.

Recommendation 7: The Legislature should determine whether there should be any limits on taxpayer participation in multiple tax incentive programs. Such limits could be part of any discussion the Legislature may have on fiscal protections (Fiscal Protections metric), which could include capping the amount of state funds any individual company may receive.

Scope Question: *Is the Rural Development Act meeting the goal of revitalizing rural and other distressed areas of the state?*

Rural and Distressed Areas Metric

Finding: All of the projects are in rural areas as defined by the Rural Development Act. (pg. 23)

Finding: Using Areas of Substantial Unemployment as the definition of distressed areas, only one of the 70 projects (1%) in this analysis fell within a distressed area. (pg. 23)

Recommendation 8: The Legislature should consider defining distressed areas, either by using the definition in this audit or by creating another.

Scope Question: *What are the economic and fiscal impacts of the Rural Development Act?*

Administrative Cost Metric

Finding: The Audit Office is unable to report the cost to administer and promote the Nebraska Advantage Rural Development Act because those figures are not specifically tracked. (pg. 25)

Recommendation 9: If the Legislature would like more precise costs for the Rural Development Act administration and promotion, it may need to require that Departments of Revenue and Economic Development track expenditures by program. However, it may not be possible to do that in all instance. For example, according to the Department of Economic Development, all incentive programs are promoted together and cannot be broken down by individual program.

Scope Question: *Are adequate protections in place to ensure the fiscal impact of the Rural Development Act does not increase substantially beyond the state's expectations in future years?*

Fiscal Protections Metric

Finding: Because the Rural Development program contains several important fiscal protections recommended by the Pew Charitable Trusts, including performance-based incentives, recapture provisions, and a yearly cap, the program is at low risk for exceeding expected costs. (pg. 26)

The Committee makes no recommendation for this metric because adequate protections are in place to ensure the program does not exceed the state's expectations in future program years.

Section I Findings

Data Concerns

Finding: The Department of Revenue's Rural Development program data, which is maintained in two Excel spreadsheets, is not adequately updated or reviewed for completeness and consistency between the two spreadsheets. (pg. 6)

Recommendation 11: The Department should develop a single spreadsheet or database to track agreements throughout the process, and develop and implement policies to ensure the information is updated and consistent.

Cost-per-FTE

Finding: The Audit Office was unable to calculate the cost-per-FTE because the Act does not require the Department to track employment-related credits separately. (pg. 9)

Recommendation 10: In order to improve future audits, the Legislature should consider changing the Act to require that investment and employment credits be tracked separately so information on the actual number of FTEs subsidized by the Act is available.

Metrics Requiring Economic Modeling

Due to limitations on existing data and statutory protections on taxpayer confidentiality, the Audit Office was unable to answer some of the questions that the Performance Audit Committee was most interested in. Those questions include estimates of job growth and the larger impact of the program on the state economy that would have resulted from analysis using economic modeling software. The Office continues to work to find a way to accomplish the economic modeling analyses.

II. Legislative Audit Office Report

Legislative Audit Office Report

Nebraska Advantage Rural Development Act Performance on Selected Metrics

November 2017

Prepared by
Craig Beck
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INTRODUCTION

The Legislative Audit Office is required to conduct a performance audit of each business tax incentive program at least once every three years. In 2016, we released the first performance audit under the requirement. In 2017, we release this performance audit of the Nebraska Advantage Rural Development Act, and another of the Nebraska Advantage Research and Development Act. Both provide certain tax benefits to companies that meet specific requirements. In general terms, participating businesses must create jobs and/or make new financial investments in the state. In return, they are eligible for tax credits that may be used for a variety of purposes.

Nebraska Advantage Rural Development Act

The Nebraska Advantage Rural Development (Rural Development) program is the current version of a tax incentive program initially created in 1986 as a rural counterpart to the LB 775, the Employment and Investment Growth Act. Over the years, the Rural Development program was modified. In 2003, it was amended to create two application levels. In 2005, it was amended substantively and also renamed the Nebraska Advantage Rural Development Act, as part of the legislation that created the Nebraska Advantage Act incentive program, which replaced LB 775. In 2006, a third level—Livestock Modernization—was added.

Levels 1 and 2 have both investment and employment requirements, whereas Livestock Modernization only requires investment. Participants who meet the program requirements may use earned credits to obtain a refund of state sales taxes paid or reduce income tax liability. Additionally, the credits are refundable—meaning a participant may receive payment for the full value of credits earned even if the value of the credits is more than the sales tax paid or income tax owed.[1]

Measuring Effectiveness

In previous reports, the Audit Office (Office) has noted that it is more difficult to determine whether Nebraska's tax incentive programs are effective because the laws creating them do not have clear goals and specific measures for achieving those goals. In a 2013 report on the Nebraska Advantage Act and other tax incentive programs, the Office concluded: "the program goals expressed by the Legislature in the statutes and during legislative debate are too general to permit a meaningful evaluation of whether the programs are, in fact, accomplishing what the Legislature hoped they would accomplish."[2]

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[1] Neb. Rev. Stat. § 77-27,188.01(1). In this report, the term "sales tax" refers to both the state's sales tax and use tax. According to Revenue, the use tax applies when the sales tax has not been paid on a transaction that is subject to sales tax.

[2] Nebraska Legislature, Performance Audit Committee, *Nebraska Department of Revenue: An Examination of Nebraska Tax Incentive Programs*, February 2013.

In the 2014 legislative session, the Performance Audit Committee introduced and the Legislature passed LB 836, which added slightly more specific goal language to the tax incentives statutes. Nevertheless, the language remains quite broad. Also in 2014, the Performance Audit Committee established an interim legislative study (LR444) that identified metrics for tax incentive performance audits and directed the Audit Office to use those metrics if possible. We also use metrics contained in the statutes creating the incentive program or discussed in the legislative history, as available. Following are the metrics used in this audit and their source.

Metrics for Nebraska Advantage Rural Development Act Audit

Source	Description
LR444	New jobs created by incentivized companies
LR444	Average wages paid by incentivized companies compared to industry averages
Statute	Number of participating companies new to Nebraska
LR444	Jobs created in distressed areas of the state
LR444	Cost for agencies to administer & promote Advantage Act
LR444	Cost per FTE
LR444	Fiscal protections
LR444	Investment by incentivized companies
LR444	Other state financial assistance received by incentivized companies

Report Organization

Section I describes the Rural Development program and Section II contains our analysis of the metrics.

We conducted this performance audit in accordance with generally accepted government auditing standards. 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives. The methodologies used are described briefly in each section.

Acknowledgements

The Legislative Audit Office extends special thanks to Tax Commissioner Tony Fulton; Mary Hugo, Kate Knapp, and Liz Gau at the Department of Revenue; and David Dearmont at the Department of Economic Development.

SECTION I: Nebraska Advantage Rural Development Program

The Rural Development Act (Act) provides tax benefits to individuals or companies that increase economic activities intended to benefit rural Nebraska. The Act consists of three application levels, or tiers: Level 1, Level 2, and Livestock Modernization. It is scheduled to sunset on December 31, 2022.

Levels 1 and 2, created in 1987 and revised in 2003, require financial investment and increased employment in a qualified business. This includes businesses engaged in:

- Storage, warehousing, distribution, transportation, or sale of tangible personal property;
- Livestock production;
- Conducting research, development, or testing for scientific, agricultural, animal husbandry, food product, or industrial purposes;
- Selected types of data processing, telecommunication, insurance, or financial services;
- Assembly, fabrication, manufacture, or processing of tangible personal property;
- Administrative management of any activities, including headquarter facilities relating to such activities; or
- Any combination of the above activities.

To qualify, Level 1 and Level 2 activities must be located in areas below certain population thresholds or in certain census tracts, as identified in the Act.

The Livestock Modernization tier, added in 2006, is available to individuals engaged in livestock production and requires only financial investment, which may be made in:

1. Livestock modernization or expansion, defined as construction, improvement, or acquisition of buildings, facilities, or equipment for livestock housing, confinement, feeding, production, and waste management; or
2. Livestock production, defined as the active use, management, and operation of real and personal property for various commercial activities.

The Act defines livestock broadly to include cattle, horses, hogs, sheep and other common farm animals, as well as those subject to regulation by either the Game and Parks Commission or the Department of Agriculture.

Application Process

Entities wishing to participate apply to the Department of Revenue (Department or Revenue), which reviews applications as they are received and determines which are eligible based on the program's requirements. Applications for Level 1 and Level 2 projects must propose at least the minimum required new investment and FTE (full-time equivalent employee) growth shown in Figure 1.1, and they must be located in authorized geographic areas. Applications for Livestock Modernization projects must plan to invest at least $50,000 but do not have to meet employment or location requirements. Applicants may propose investment and employment increases greater than the statutory minimums.

The financial and employment requirements, as well as the eligible locations, for each tier are shown in Figure 1.1.

Figure 1.1. Rural Development Program Requirements

Tier	Investment Minimum	Employment Minimum	Location
Level 1	$125,000	2 new FTEs	Counties of < 15,000 residents, any village, or certain census tracts[3]
Level 2	$250,000	5 new FTEs	Counties of < 25,000 residents
Livestock Modernization	$50,000	No requirement	No restriction

Source: Audit Office compilation of information from Neb. Rev. Stat. § 77-27,188.

Different statutory requirements apply for signed agreements containing investment and employment increases *greater than* the statutory minimums. For these projects, participants must meet at least 75% of the investment and employment targets stated in the agreement in order to earn both investment and employment credits. If the 75% threshold is met for only one of the two (investment or employment), the participant only earns credits for that area.

Because the program is capped and Revenue considers applications as they are submitted, some applications may be submitted after the program funds have been completely committed. The 75% completion requirement serves to discourage a taxpayer from submitting an application for more benefits than they intend to use, to the exclusion of other participants who would have been granted an agreement but for the lack of funds.[4]

Once an application is approved, the Department and the applicant enter into a signed agreement stating the expected increase in investment and, when applicable, employment, the potential benefits, and the penalties for failure to meet the expected

[3] "… Any area within the corporate limits of a city of the metropolitan class consisting of one or more contiguous census tracts, as determined by the most recent federal decennial census, which contain a percentage of persons below the poverty line of greater than thirty percent, and all census tracts contiguous to such tract or tracts." Neb. Rev. Stat. § 77-27,188(1)(a)(i)(C).

[4] Additionally, according to the Department, benefits are prorated if more than one application is received on the day when the yearly funding maximum is met.

increases. By law, Level 1 and Level 2 participants have two years[5] to attain the investment and employment increases stated in the agreement in order to receive benefits.

While there is no statutory time limit for Livestock Modernization participants to attain the required investment, the Department of Revenue uses the same two-year attainment limits as for Levels 1 and 2. Benefits are generally paid out after the participant has met the agreement requirements and been audited to ensure compliance. It is possible for a participant to have two audits: one covering the first year of attainment and whether the statutory minimum requirements were met, and one later in the process to assess whether requirements above the minimums were met.

Data Problems

Before discussion of the audit results, we note several data review and maintenance issues that impeded the audit for a period of time. These issues required the Audit Office (Office) to request significant amounts of information to verify that the data provided was usable for the audit. The Office also created a separate spreadsheet for the population utilized in this report from the data initially provided by the Department and additional data requested. When the Office was confident in the data, the audit proceeded.

The problems encountered were:

Ineffective storage of program data
The Department initially provided the Office an incomplete and unusable database where program data was stored and tracked throughout the agreement process. The information in the database was inconsistently entered and not well-maintained. Several instances arose where participant information was incomplete and/or incorrect.

Inability to locate some audit files
The Office requested a random sample of participant audit files, which led Revenue to discover that not all of the audit files could be found. Revenue determined that the files were mistakenly destroyed prior to their "do not destroy by" date in an off-site storage facility.

Updating and checking of program data is lacking
Each year, the staff checks the database for errors. However, a global check, comparing audits to credits claimed, is not done on a regular basis, nor is there a Department policy requiring such activity. Furthermore, updating participant information through the agreement process is lacking. This includes things such as not noting when an agreement had been withdrawn or dropped, to not noting the amount of credits audited and used in both spreadsheets.

[5] The two years include the year of application and the year immediately following, based on the participant's taxable years.

The Department recognized that the data provided was insufficient and was helpful in providing the Office with usable and verifiable program data. The Department also acknowledged that a more reliable database was likely required for this program. The Office appreciates the Department's work in helping attain usable information for the audit.

Finding: The Department of Revenue's Rural Development program data, which is maintained in two Excel spreadsheets, is not adequately updated or reviewed for completeness and consistency between the two spreadsheets.

Program Funding and Usage

Since its creation in 2003, the program's funding has been statutorily capped at between $1 million and $4 million per year. As shown in Figure 1.2, in several years, the full amount of available benefits was not requested. Since the cap was reduced to $1 million for calendar year 2012, most of the funds have been used.

Figure 1.2. Rural Development Program Funding

Fiscal/Calendar Year	Statutory Cap on Benefits (in millions)	Total Requested Benefits	Percent of Available Benefits Requested
FY 2004-05	$2.5	$713,000	29%
FY 2005-06	$2.5	$2,086,000	83%
FY 2006-07	$3.0	$1,555,250	52%
FY 2007-08	$3.0	$3,000,000	100%
FY 2008-09	$3.0	$3,000,000	100%
FY 2009-10	$4.0	$1,271,854	32%
CY 2010*	$4.0	$829,750	21%
CY 2011	$4.0	$2,412,750	60%
CY 2012	$1.0	$1,000,000	100%
CY 2013	$1.0	$1,000,000	100%
CY 2014	$1.0	$1,000,000	100%
CY 2015	$1.0	$935,500	94%
Total	**$30.0**	**$18,804,104**	**63%**

Source: Audit Office compilation of data from Department of Revenue Annual Reports.
*In CY 2010, program administration shifted from fiscal to calendar year, meaning the year only ran from July 1, 2010 to December 31, 2010.

In 2015, the Legislature designated a portion of the capped amount specifically for Livestock Modernization projects. Prior to that, projects from all tiers competed against each other. Figure 1.3 shows the breakdowns of the program caps and expenditures.

Figure 1.3. Future Rural Development Program Funding

Year	Statutory Cap on Benefits		Total Requested Benefits	
	Levels 1 and 2	Livestock Modernization	Levels 1 and 2	Livestock Modernization
CY 2016	$1,000,000	$500,000	$1,000,000	$500,000
CY 2017	$1,000,000	$750,000	-	-
CY 2018	$1,000,000	$750,000	-	-
CY 2019	$1,000,000	$1,000,000	-	-
CY 2020	$1,000,000	$1,000,000	-	-
CY 2021	$1,000,000	$1,000,000	-	-
CY 2022	$1,000,000	$1,000,000	-	-

Source: Audit Office compilation of data from Department of Revenue Annual Reports and Neb. Rev. Stat. § 77-27,187.02.

Tax Credits—Use

Levels 1 and 2 projects receive a $3,000 credit for each new FTE created under the Act and a $2,750 credit for each $50,000 of increased investment. Livestock Modernization projects receive a credit of 10% of the total qualified investment[6] in the project, up to a current maximum of $150,000 per agreement. These benefits can be seen in Figure 1.4.

Figure 1.4. Rural Development Program Benefits

Benefits	Levels 1 and 2	Livestock Modernization
Investment Credit	$2,750 for each $50,000 of new investment	10% of qualified investment
Employment Credit	$3,000 for each new FTE	Not required
Capped?	No	Maximum credits of $150,000 per application*

Source: Audit Office compilation of information from Neb. Rev. Stat. § 77-27,188.
*Equates to a maximum investment threshold of $1,500,000, up from $300,000 prior to January 1, 2016, for which a participant would receive a 10% credit.

A participant may request an audit by the Department once it believes it has met the requirements of its agreement. However, the audit cannot actually occur until the participant's taxable year has been completed and the credit cannot be claimed until the appropriate tax return is filed.[7]

Earned credits that have been verified by Revenue may be used to obtain a state sales tax refund or reduce income tax liability. Additionally, the credits are refundable—meaning a participant may receive payment for the full value of earned credits even if that amount

[6] Qualified investment defined as "livestock production," Neb. Rev. Stat. § 77-27,188(2)(b).
[7] There is no language in the Act requiring usage in the year credits were earned, however, there is no specific statutory authority to carry them forward.

is more than the state sales tax paid or income tax owed. Credits can be used by an individual taxpayer or distributed to shareholders, but shareholders can only apply the distributed credits to their income tax liability for the year the credits were earned.[8]

The 70 participants included in this analysis earned a total of just over $5.6 million and used nearly $5.5 million, as seen in Figure 1.5 below.

Figure 1.5. Earned and Used Credits by Rural Program Participants

Level	Participants	Audited Credits	Used Credits	Used as a % of Audited
Livestock Modernization	49	$1,237,459	$1,237,040	99.9%
Level 1	16	$3,426,121	$3,296,371	96.2%
Level 2	5	$956,250	$956,250	100%
Total	**70**	**$5,619,830**	**$5,489,661**	**97.7%**

Source: Audit Office compilation of Department of Revenue data.
Note: Audited credits are higher than used credits because of two factors; 1) the "used" column includes some recaptured funds; and 2) some participants did not claim all of the issued credits for unknown reasons.

Breakdown of Investment and FTE Credits

For Levels 1 and 2, we could not report the amount of credits awarded for the creation of FTEs compared to the amount awarded for investment because that breakdown is not available. The Act does not require separate pools of credits for investment and FTEs, and the Department's emphasis is, by law, on the total credit amount a company is eligible for under its agreement.

In some instances, a company can reach the total without receiving credits for all of the FTEs created. For example, as long as both investment and FTEs are increased to the levels set in the agreement, any additional FTEs created over that amount cannot earn credits for the participant. While the Office was unable to say precisely how many credits were for FTEs and how many for investment, the following example demonstrates that the vast majority of credits were earned for investment.

Because some companies will have potentially created more FTEs than they could earn credits for, it is possible that not all of the 178 FTEs created during the review period actually earned credits. However, if they *had all earned credits*, the credit total would amount to $534,000.[9] Subtracting that number from the $5,619,830 total audited credits nets $5,085,830. This shows that if *all* new reported FTEs earned credits, they would only represent about 10% of all credits. More than $5 million (at least 90%) of the credits earned under Levels 1 and 2 were earned on investments.

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[8] Participants in this program are also subject to a three year statute of limitations. This means that participants have three years *beyond* the year in which the credits were earned to claim them on their tax return. The statute of limitations applies broadly, and is not just applicable to this program. In some instances, it is possible for the participant to claim credits more than three years beyond the year they were earned, but that requires filing a form with the Department requesting an extension.
[9] 178 FTEs multiplied by $3,000 (the available credit) equals $534,000.

Without a breakdown of the number of FTEs that earned credits, we were unable to estimate the cost per FTE.[10]

Finding: The Audit Office was unable to calculate the cost-per-FTE because the Act does not require the Department of Revenue to track employment-related credits separately.

Tax Credits—Recapture

For Level 1 and Level 2 project agreements, the project must maintain the statutory minimum increases for at least three years after the year the credit was first earned. If the participant fails to maintain the required increase in investment or employment, all credits they have used must be repaid to the state and any unused credits are forfeited. Livestock Modernization projects require no maintenance, and consequently, there is also no repayment provision.

[10] We did not calculate the cost-per-FTE using the total of investment and FTE credits, as we did in our 2016 tax incentive audit report, because we believed it unfair to provide that figure without the FTE-only figure, which would be much lower.

SECTION II: Analysis of Metrics

Before presenting the Rural Development Act's audit scope questions and the metrics used to answer each, we note several points that will aid in the understanding of the audit results and findings.

Causation

The number one problem when evaluating tax incentives programs is that is it often impossible to show that a program *caused* the specific results because there are many other factors that could have influenced the participants' decision-making. In this report, we do not claim that the program caused the results we report.

Standards

For many of the metrics reviewed in this report, the Legislature has not created a standard that indicates how much the Legislature expected the metric to improve under the program. When possible, we have identified reasonable standards that we compare the program performance to, but we acknowledge there may be other legitimate standards that could be used as well.

Results

The results for each metric describe the product of the analysis we conducted. For example, if the metric was whether program spending increased over time, we report whether it did or not as the result. Results do not include judgments about how well the program is succeeding.

Findings

Findings involve making a judgment about how the program results on a given metric compare to a standard. For a program that had increased spending over time, the standard could be the increase or decrease in that type spending for the United States as a whole. Our finding would be whether there was a difference in Nebraska's rate of spending and the U.S. rate of spending.

Taxpayer Confidentiality

Federal and state law restrict release of most taxpayer data, with certain specified exceptions. In general terms, laws protecting taxpayer confidentiality require reporting figures that include three or more companies if the results are statewide, and 10 or more companies if the results are from a smaller portion of the state.

The Performance Audit Committee asked the Audit Office to answer four questions regarding the Rural Development Act, utilizing the metrics listed below each question:

1. Is the Rural Development Act meeting the goal of strengthening the state's economy overall by attracting new business to the state, expanding existing businesses, increasing employment, creating high-quality jobs, and increasing business investment?

    - **Job Creation:** Did the number of full-time equivalents at incentivized projects increase between 2004 and 2015?

    - **Average Wages:** Were the average wages of full-time equivalents at incentivized projects higher or lower than the statewide average?

    - **New to Nebraska:** How many of the incentivized companies were new to Nebraska?

    - **Investment:** How much investment was made by Rural Development program participants?

    - **Other State Benefits:** What other state benefits have companies participating in the Rural Development received?

2. Is the Rural Development Act meeting the goal of revitalizing rural and other distressed areas of the state?

    - **Rural and Distressed Areas:** How many incentivized projects have locations in rural or distressed areas of the state?

3. What are the economic and fiscal impacts of the Rural Development Act?

    - **Administrative Cost:** What is the cost to administer and promote all tax incentive programs?

4. Are adequate protections in place to ensure the fiscal impact of the Rural Development Act does not increase substantially beyond the state's expectations in future years?

    - **Fiscal Protections:** What are the fiscal protections in the Act?

Following is a discussion of each of these metrics.

Job Creation

Did the number of full-time equivalents at incentivized projects increase between 2004 and 2015?

Results

Levels 1 and 2 participants must increase the number of full-time equivalent positions (FTEs)[11], but Livestock Modernization participants have no FTE requirement. Between 2004 and 2015, 21 participants met their agreement requirements and were publicly reported, resulting in the creation of 178 FTEs. One hundred and seventy-eight FTEs over 11 years equates to just over 16 new FTEs per year the program has been in existence, as can be seen in Figure 2.1.

Figure 2.1. Increase in FTEs under the Rural Development Act

Tier	Participants	FTEs Created
Level 1	16	147
Level 2	5	31
Livestock Modernization	49	Not Required
Total	**70**	**178**

Source: Audit Office analysis of Department of Revenue data.

As noted in Section II, Levels 1 and 2 projects no longer have to compete for funding with Livestock Modernization projects. It is reasonable to think that in the future, more Level 1 and 2 projects will be approved and therefore more FTEs created because of this change.

There is no finding on this metric because there is no standard to compare the program data to in order to judge whether the amount of the increase is enough to meet policymakers' expectations.

Discussion/Methodology

Due to data limitations, the Audit Office (Office) answered a slightly different question than the one asked by the LR 444 Committee. The Committee wanted to know the number of full-time jobs created by incentivized companies, however, the Office was unable to answer this question because there is no single source for determining the number of jobs (positions) created by Rural Development participants. Instead, we used full-time equivalents, because they are required by law. We did not attempt to determine how many of these FTEs represent actual new *full-time workers,* as we did in the 2016 Advantage Act Audit.[12]

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[11] An FTE is defined as an employee who works 2,080 hours in one year (52 weeks multiplied by 40 hours/week).

[12] We chose not to do this additional analysis because of budget constraints and the fact that the number of FTEs for the Rural Development program is small, at least compared to the Advantage Act.

The number of FTEs created from 2004 to 2015 was calculated by using only the participants who had completed their agreements and which had been publicly reported. The Department of Revenue (Department or Revenue) provided the Office data on those 70 companies, from which the Office compiled the information for this metric. The data provided to the Office came from the database that Revenue uses to track participants in the Act.

Average Wages

Were the average wages of full-time equivalents at incentivized projects higher or lower than the statewide average and county averages for counties in which they were located?

Results

Our analysis showed that between 2004 and 2015, the statutorily required wage rate for Rural Development FTEs was lower than the statewide average in every year, by an average of 42%. For the same period, project counties with the highest average annual pay were, on average nearly 37% higher than the required program wage. Project counties with the lowest average annual pay were, on average, 19% higher than the required program wage.

Finding: Statutorily required wages for Rural Development project FTEs were lower than state average and project county averages in all instances.

Discussion/Methodology

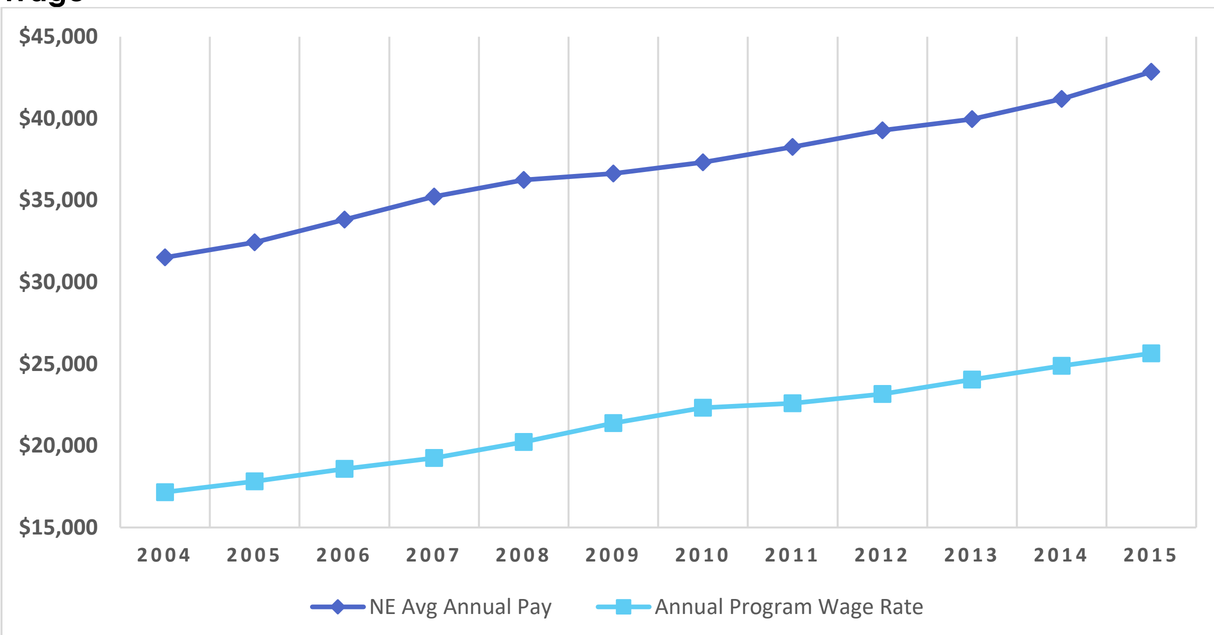
Participants in Levels 1 and 2 have a statutory wage rate they must pay new FTEs, if they wish to count them towards increased employment. The required wage is adjusted yearly by the Department, based on a formula outlined in the Act.

The LR 444 Committee was interested in incentivized wage comparisons with statewide industry sectors. However, as discussed in the Job Creation metric, the law requires and Revenue tracks FTEs, not positions. Consequently, the actual wages for those jobs was also unavailable, so the Office could not compare them to the statewide industry averages. As an alternative, the Office analyzed the required wage rates throughout the life of the program and compared them to the Nebraska annual average wage and the specific-incentivized counties' wages for their respective years.

Nebraska Annual Average Wage

The required wages for the Rural Development Act were lower than the Nebraska annual average wage in every year the program has been operating (see Figure 2.2). From 2004 to 2015, the required wages for the Act were an average of 42% lower than the Nebraska average wage in each year.

Figure 2.2. Rural Development Act Wages Compared to the Nebraska Average Annual Wage



Source: Audit Office analysis of Department of Revenue and Bureau of Labor Statistics data.

County Average Annual Wage

We also compared the average annual wages in counties where projects received Rural Development credits to the required wage set by the program. For each year, we identified the county with the highest average wage and the county with the lowest average wage for the time period analyzed. We then averaged the difference between the county and program wages. For example, of the counties that had Rural Development participants in 2008, Platte County had the county average wage of $32,632. For that same year the program required an average annual wage of $20,218, or $12,414 less than the county average.

For program years 2004-2015, counties with the highest average annual pay were, on average, nearly 37% higher than the required program wage, as shown in Figure 2.3.[13]

Figure 2.3. Participating Counties with Highest Average Annual Wage as Compared to Program Wage Requirements

Year	Annual Program Rate	Highest Participating County Wage Rate	Difference from Program Rate
2008	$20,218	$32,632 (Platte)	$12,414 (38%)
2009	$21,382	$34,897 (Thurston)	$13,515 (39%)
2010	$22,318	$44,815 (Stanton)	$22,497 (50%)
2011	$22,589	$34,927 (Platte)	$12,338 (35%)
2012	$23,150	$35,310 (Platte)	$12,160 (34%)
2013	$24,045	$34,413 (Madison)	$10,463 (30%)
2014	$24,877	$36,974 (Hamilton)	$12,097 (33%)
2015	$25,646	$39,052 (Phelps)	$13,406 (37%)
		Average Difference	**$13,611 (37%)**

Source: Audit Office analysis of data from Bureau of Labor Statistics and Neb. Rev. Stat. § 77-27,188(1)(b).

For the same years, counties with the lowest average annual pay were, on average, 19% higher than the required program wage, as shown in Figure 2.4.

Figure 2.4. Participating Counties with Lowest Average Annual Wage as Compared to Program Wage Requirements

Year	Annual Program Rate	Lowest Participating County Wage Rate	Difference from Program Rate
2008	$20,218	$25,800 (Pierce)	$5,582 (22%)
2009	$21,382	$26,402 (Richardson)	$3,722 (19%)
2010	$22,318	$27,483 (Burt)	$5,165 (19%)
2011	$22,589	$27,258 (Brown)	$4,669 (17%)
2012	$23,150	$27,217 (Nuckolls)	$4,067 (15%)
2013	$24,045	$30,763 (Polk)	$6,718 (22%)
2014	$24,877	$28,397 (Franklin)	$3,520 (13%)
2015	$25,646	$36,415 (Cuming)	$10,769 (30%)
		Average Difference	**$5,526 (19%)**

Source: Audit Office analysis of data from Bureau of Labor Statistics and Neb. Rev. Stat. § 77-27,188(1)(b).

[13] Figures 2.3 and 2.4 start with 2008, which is the first year the participants were reported.

New to Nebraska

How many of the incentivized companies were new to Nebraska?

Results

Of the 70 program applicants between 2004 and 2015, 12 (17%) were not established in Nebraska two years prior to their year of application.

There is no finding for this metric because there is no standard to compare the program data to in order to judge whether the amount of the increase is enough to meet policymakers' expectations.

Additionally, the small number of new companies is consistent with site selection research, which suggests that tax incentives are not among the most important factors influencing a company's location decisions.

Discussion/Methodology

While attracting new businesses to the state is not a stated goal of the Rural Development program, this metric was selected by a 2014 legislative study committee to be applied to all tax incentive programs. There is no definition of "new" business in the Act, nor any indication of how many "new" businesses policymakers intended to attract with the incentive. Instead, the Act indicates that the primary goal of policymakers in the passage of the program was to help small rural entities stay in business. It was also intended to help rural areas by providing direct cash incentive to new businesses, especially for startup costs.

The Audit Office considered a participant to be new if in the two years prior to its year of application it had not filed tax return for business activity in Nebraska.[14] This definition includes new company formulation and companies that existed elsewhere but were new to Nebraska, and is the same definition used in the Office's 2016 performance audit of the Nebraska Advantage Act.[15]

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[14] "New to Nebraska" for this report was considered based on the year of application. If in two years prior to application a participant had filed no Nebraska return, the participant was considered "new."

[15] In the Nebraska Advantage Act report, we noted that the definition does not include two types of participants that are arguably bring new economic activity to the state: A participant that had a minimal level of business activity prior to participating in the Rural Development Act and increased activity in Nebraska significantly through participation in the Act; and Expansion of an existing company into a different industry. That remains true for the Rural Development Act as well, however because participants in this program are likely to be smaller entities, we believe the exclusions likely play a smaller role in this case.

Investment

How much investment was made by Rural Development program participants?

Results

The 70 participants who completed agreements and were publicly reported from 2004 to 2015 invested a total of just over $100 million.

There is no finding for this metric because there is no standard to compare the program data to in order to judge whether the amount of investment is enough to meet policymakers' expectations.

Of the program tiers, the 16 Level 1 participants invested the most—nearly $67 million. The 49 Livestock Modernization participants invested just over $19 million, and the five Level 2 participants invested just over $14 million, as shown in Figure 2.5.

Figure 2.5. Investment by Rural Development Program Participants, by Tier

Level	Participants	Investment
Livestock Modernization	49	$19,246,652 (19%)
Level 1	16	$66,691,425 (67%)
Level 2	5	$14,194,510 (14%)
Total	**70**	**$100,132,587**

Source: Audit Office analysis of Department of Revenue data.

Discussion/Methodology

The Department of Revenue provided the Audit Office with the data. It was not independently verified, though it was verified against the Department's annual reports.

We were unable to include a breakdown of the 70 participant's investment by industry sector code because:

1. The 49 Livestock Modernization participants all must have investment in certain areas as required by statute (Neb. Rev. Stat. § 77-27,187.01); and
2. The 21 Levels 1 and 2 participants had a variety of business activities, which limited the Office's ability to report such information while adhering to Revenue's reporting requirements of confidential information, which requires three companies aggregated in any number that represent a statewide sample.

Other State Benefits

What other state benefits have companies participating in the Rural Development received?

Results

Of the 70 participants who received benefits under the Act in the Office's population, 11 (16%) received at least one other state benefit from programs administered either by the Department of Economic Development (DED) or the Department of Revenue. As shown in Figure 2.6, four Rural Development participants received benefits from another Revenue-administered program, three received benefits from a DED-administered, and the remaining four received benefits under programs administered by both departments.

Figure 2.6. Rural Development Recipient's Participation in DED- and Revenue-administered Programs

Program	Rural Development Participants
Department of Revenue-administered programs **only**	4
DED-administered programs **only**	3
Revenue-administered and DED-administered programs	4
Total	**11**

Source: Audit Office compilation of data from each agency.

There is no finding for this metric because there is no standard to compare the program data to in order to judge whether this level of participation in other programs meets policymakers' expectations.

Discussion

Programs Administered by the Department of Economic Development

DED administers four programs that provided benefits to Rural Development participants: the Business Innovation Act Prototype Grant; Customized Job Training; Intern Nebraska; and the State Trade and Export Program (STEP) Grant. In total, as shown in Figure 2.7, seven Rural Development participants received nearly $105,000 from these programs. Of the seven:

- Five received benefits from a single program;
- One received benefits from two programs; and
- One received benefits from three programs.

Figure 2.7. Use of DED-administered Programs by Rural Development Participants, 2004-2015

Program	Rural Development Companies Participating	Number of Awards	Final Grant Amount (%)
Customized Job Training	5	5	$52,400 (50%)
STEP Grant	1	2*	$27,326 (26%)
Intern Nebraska	3	4*	$22,963 (22%)
BIA Prototype Grant	1	1	$1,918 (2%)**
Total	**7**	**12**	**$104,608**

Source: Audit Office compilation of Department of Economic Development data.
*One company received two awards.
**A $50,000 grant was awarded to a company prior to a feasibility study that determined the project was not viable. The company returned 96 percent of the original award to DED.

Programs Administered by the Department of Revenue

Rural Development participants that the Office reviewed earned or received benefits from four incentive programs administered by the Department of Revenue: the Nebraska Employment and Investment Growth Act (LB 775), the Nebraska Employment Expansion and Investment Incentive Act (LB 270), the Nebraska Advantage Research and Development Act, and the Nebraska Advantage Act (LB 312). Some of the Rural Development participants received benefits from these programs prior to participating in the Rural Development program and some received benefits during participation.

Eight companies in the Office's population received nearly $530,000 from these programs. Four of these eight companies had agreements with other programs but had not earned or received benefits during the period the Office reviewed: three in the Nebraska Advantage Act and one in the Employment and Investment Growth Act. Additionally, as shown in Figure 2.8, of the eight:

- Four received benefits from a single program;
- Three received benefits from two programs; and
- One received benefits from three programs.

Figure 2.8. Use of Revenue-administered Programs by Rural Development Participants, 2004-2015

Program	Rural Development Companies Participating	Number of Awards	Amount Used (%)	Years Program Was Active
Employment Expansion and Incentive Act	6	6	$477,801 (90%)	1987-2004
Nebraska Advantage Research and Development Act	3	3	$51,251 (10%)	2007-2015
Employment and Investment Growth Act	1	1	$0*	1987-2015
Nebraska Advantage Act	3	3	$0**	2006-2015
Total	**8**	**13**	**$529,052**	

Source: Audit Office analysis of Department of Revenue data.
*Credits have been earned but not used.
**Agreements in place but no benefits earned or approved.

Methodology

The Audit Office analyzed data provided by DED and Revenue. The Office provided DED with the names of Rural Development participants in the population (which were publicly reported) and DED looked for those participants in their records to identify the recipients that had participated in the:

- Business Innovation Act Prototype Grant (2011): "a matching grant that provides financial assistance for product development to businesses operating in Nebraska." The program is eligible to businesses with less than 500 employees and limited to $150,000 per project;[16]
- Customized Job Training (1989): a grant "to provide employee training assistance to businesses that maintain, expand and diversify the state's economic base" to create and retain jobs in the state;[17]
- Intern Nebraska (2011): provides financial assistance to businesses that create new internships in Nebraska; and
- State Trade and Export Program (STEP) Grant: a grant provided to the state from the US Small Business Administration that helps increase the number of business that export in the state and increase the export value of existing businesses.

The Department of Revenue conducted a similar review to identify the Rural Development participants in the population that had participated in the following:

- Employment Expansion and Investment Incentive Act (270, 1987): the precursor to Nebraska Advantage Rural Development; a program that incentivized companies to invest and grow employment by refundable tax credit;
- Nebraska Advantage Research and Development Act (R&D, 2005): A refundable tax credit to entities engaged in qualified research and development activities for 21 years;
- Employment and Investment Growth Act (775, 1987): Nebraska's largest incentive program before it was replaced by Nebraska Advantage in 2005, which provided tax credits and sales tax refunds for companies that met minimum hiring and investment requirements; and
  Nebraska Advantage Act (312, 2005): Nebraska's largest current incentive program that provides tax credits, property tax exemptions, and sales and use tax refunds for increased investment and employment in the state.

[16] Nebraska Department of Economic Development, "Nebraska Innovation Fund Prototype Grants," https://opportunity.nebraska.gov/program/prototype-grant/ (accessed July 5, 2017).
[17] Nebraska Department of Economic Development, "Customized Job Training," http://www.neded.org/program/customized-job-training/ (accessed July 5, 2017).

Rural and Distressed Areas

How many incentivized projects have locations in rural or distressed areas of the state?

Results

The Act designates the rural areas in which projects may be located and all of the projects we reviewed are located in those areas. We defined distressed areas as Areas of Substantial Unemployment (ASU) and of the 70 projects, only one fell within a distressed area.

> **Finding:** All of the projects are in rural areas as defined by the Rural Development Act.

> **Finding:** Using Areas of Substantial Unemployment as the definition of distressed areas, only one of the 70 projects (1%) in this analysis fell within a distressed area.

Discussion/Methodology

Regarding rural and distressed areas, we answered a slightly different question than the one asked by the LR 444 Committee. The Committee asked: Do incentivized companies create more new full-time jobs in areas of the state identified as distressed or non-distressed? The Office was unable to identify the actual number of *full-time jobs* created in distressed versus non-distressed areas because the Rural Development Act requires FTEs, not actual jobs. The question the Office answered instead is: Are incentivized companies' *project locations* in areas of the state identified as distressed or non-distressed?

Definition of Rural

The Act identifies areas where projects receiving benefits can be located. Level 1 projects can be located in:

1. Counties with fewer than 15,000 residents;
2. Villages; or
3. Selected census tracts in metropolitan class cities (see discussion below).

Level 2 projects can be located in:

1. Counties with fewer than 25,000 residents; or
2. Second class cities.

As described above, the Act has a provision that allows selected Census tract in metropolitan class cities in the state to obtain benefits under Level 1. The Act originally contained a provision that allowed taxpayers in enterprise zones to be eligible for Level 1 participation. When the Enterprise Zone Act expired, LB 895 (2008) was passed by the

Legislature that allowed census tracts in metropolitan class cities in the state with high levels of poverty to participate in the Act.

Definitions of Distressed Area

Because the Rural Development Act does not require projects to be located in distressed areas, it does not define such areas and the Office did not find a useable definition in other tax incentive statutes. In the absence of a statutory definition, the Office used Areas of Substantial Unemployment as defined by the Department of Labor. According to the federal Department of Labor Employment and Training Administration, ASUs are defined as contiguous Census tracts that have an unemployment rate of higher than 6.5% and a combined population of at least 10,000 residents. For 2015, the Department of Labor identified ASUs in Census tracts in in 10 of the state's 93 counties.

In order to determine if a participant's location was located in a distressed area, as defined by ASU, the Office cross-referenced each of the seventy participant's project address with the ASU Census tracts. As previously stated, only one of seventy projects (1%) was located in an area that met the ASU definition.

Under the 2015 ASU definition, there were five ASUs: two in portions of a single county and three in portions of several counties (8 counties total). Figure 2.9 shows the number and percent of Census tracts in each county that met the ASU criteria.

Figure 2.9. 2015 Nebraska Census Tracts Designated as Distressed

Name	Counties Included	Census Tracts		
		All	Number Distressed	Percent Distressed
Single County ASUs				
Lancaster County ASU	Lancaster	74	19	26%
Scotts Bluff County ASU	Scotts Bluff	11	4	36%
Multi-county ASUs				
Johnson, Nemaha, and Richardson Counties ASU	Johnson	2	1	50%
	Nemaha	2	2	100%
	Richardson	3	1	33%
	Total	**7**	**4**	**57%**
Douglas-Sarpy County ASU	Douglas	156	83	53%
	Sarpy	43	12	28%
	Total	**199**	**95**	**48%**
Burt, Dakota, and Thurston County ASU	Burt	3	1	33%
	Dakota	4	4	100%
	Thurston	2	2	100%
	Total	**9**	**7**	**78%**

Source: Audit Office analysis of data from the Nebraska Department of Labor, *Nebraska Workforce Trends*, March 2015.

Administrative Cost

What is the cost to administer and promote all tax incentive programs?

Results

The total cost for administering all tax incentive programs from 2004-2015 was $20.5 million.

Finding: The Audit Office is unable to report the cost to administer and promote the Nebraska Advantage Rural Development Act because those figures are not specifically tracked.

The Rural Development Act is one of several tax incentive programs administered by the Department of Revenue and promoted by the Department of Economic Development. Neither agency tracks their expenditures specific to the Act because administration and promotion are done in conjunction with those activities for all of the other tax incentive programs. Figure 2.10 shows each department's costs for all tax incentive promotion from 2004 to 2015.

Figure 2.10. Estimated Cost to Administer and Promote Tax Incentive Programs, 2004-2015

Function	Department	Amount
Program Administration	Revenue	$10,749,315
Program Promotion	Economic Development	$9,751,000
	Total	**$20,500,315**

Source: Audit Office compilation of data provided from the Departments of Revenue and Economic Development. The Audit Office did not verify the figures provided.

Discussion

The Rural Development Act is less complex than two other programs administered by Revenue and promoted by DED—the Nebraska Advantage Act and the Employment and Investment Growth Act (LB 775)—so it is responsible for a proportionally smaller part of the cost.

Fiscal Protections

What are the fiscal protections in the Act?

Results

The Rural Development Act has fiscal protections in place, including performance-based incentives, recapture provisions, and a yearly cap to ensure the program does not exceed the state's expectations.

> **Finding:** Because the Rural Development program contains several important fiscal protections recommended by the Pew Charitable Trusts, including performance-based incentives, recapture provisions, and a yearly cap, the program is at low risk for exceeding expected costs.

Discussion

A 2015 report by The Pew Charitable Trusts noted the difficulty placed on state policymakers when an unexpected decrease in state revenue occurs and stated that tax incentives programs can contribute to such situations if fiscal controls are not in place.

The Rural Development Act contains an annual cap on expenditures, which the Pew report characterized as "one of the strongest protections against surprise increases in tax incentive costs."[18] Additionally, the Act meets several other Pew recommendations, including timely sharing of information across relevant agencies, linking incentives to company performance, and requiring companies to provide advance notice of program participation.

One recommendation that is not met by the Act is to limit participants' benefits to only the extent of their tax liability. In most circumstances, the Act provides participants a fully refundable benefit—meaning they receive payment for any amount over their actual tax liability. Other recommendations that are not met are arguably less necessary because the cost of the program is capped, and it is a relatively small program.

Figure 2.11 describes all of the Pew recommendations and the Audit Office judgment about them in relation to the Rural Development Act. In comparing the Rural Development Act to recommendations by the Pew Charitable Trusts, the Office found that the Act does have fiscal protections in place.

[18] The Pew Charitable Trusts, *Reducing Budget Risks: Using Data and Design to Make State Tax Incentives More Predictable*, December 2015, p. 12.

Figure 2.11. 2015 Pew Report Fiscal Protection Recommendations

Pew Report Recommendations	Rural Development	Audit Office Remarks
Gather and share high-quality data on the costs of incentives by:		
Regularly forecast the cost	**Not Applicable**	The program is capped (credits cannot be issued beyond what is stated in statute)
Monitor costs and commitments of large and high-risk programs	**Not Applicable**	The program is small and capped.
Share timely information on incentives across relevant agencies	**Yes**	Adequate language in statute exists that gives Audit Office access to information
Design Incentives in ways that reduce fiscal risk:		
Capping how much programs can cost each year	**Yes**	The program has caps on available benefits each application cycle for both L1/L2 and LM and caps on individual agreements for LM
Controlling the timing of incentive redemptions	**No**	Controlling the timing of incentive redemption is difficult, but because the program is capped, Revenue should know how much liability the state has at any given time
Requiring lawmakers to pay for incentives through budget appropriations	**No**	The program is based on refundable credits and tracking when those credits are issued is impossible
Restricting the ability of companies to redeem more in credits than they owe in taxes	**No**	Program credits are refundable
Linking incentives to company performance	**Yes**	Program has both performance standards and recapture provisions
Requiring businesses to provide advance notice of program participation	**Yes**	Application and signed agreement required before any benefits received

Source: Audit Office analysis of information from The Pew Charitable Trusts, *Reducing Budget Risks: Using Data and Design to Make State Tax Incentives More Predictable*, December 2015.

Methodology

The Office compared the Pew Charitable Trusts recommendations with the legislative history and current statutes for the Act.

III. Agency Response and Fiscal Analyst’s Opinion

NEBRASKA

Good Life. Great Service.

DEPARTMENT OF REVENUE

October 25, 2017

Martha Carter
State Capitol
PO Box 94604
Lincoln, NE 68509

Ms. Carter,

The Department is in receipt of the Performance Audit Office Draft Report of "Nebraska Advantage Rural Development Act Performance on Selected Metrics" which was provided to the Department of Revenue (Department) on September 25, 2017. Over the past several months, I have observed the hard work and professionalism of the Legislative Audit Staff. The Department appreciates their efforts and willingness to work through issues that arose during the process.

In this report, the Legislative Audit Office (Office) raises several issues under the heading "Data Problems." To address those issues, I will first describe the manner in which the data for this program is stored and the problems that the Office ran into during the audit. Over the life of the program, the Department has received between two and forty-five applications per year under the Nebraska Advantage Rural Development Act. The data related to the program is tracked on two Excel spreadsheets instead of in a database. One section within the Department uses one spreadsheet to track the applications and the credits reserved. A second spreadsheet is used by a separate section of the Department to process claims for credits once they are earned. These spreadsheets track only the information needed to reserve credits, process claims, and produce statutorily required reports. Additional information, including the initial application and the documents collected during the qualification audit, are retained in paper form for several years in accordance with the Department's document retention schedule.

When the audit began, the Office requested information that was contained in both spreadsheets and some data that was recorded only in the paper files. The Excel file the Department initially provided to the Office combined the information from the two spreadsheets and the files were merged incorrectly. The mistake made in merging the files did cause confusion and delayed the work of the Office while the Department worked to identify the issue and to provide a correctly merged Excel file. Pursuant to the Office's request for paper files, the Department was able to produce all but one requested file. The normal retention schedule for Department Audit and Docket files is seven (7) years pursuant to the Department's Record Retention Policy 26. The file requested contained information from the years 2007 and 2008, which would have been outside the retention policy. The Department's document tracking database indicated that the box had been destroyed in error in 2016, and this information was shared with the Office. However, under the retention policy, the records requested would have been properly discarded prior to 2016.

This report finds that the Department's "data maintenance is lacking due to ineffective storage, improper updating, inability to locate files, and the incompleteness of updating and checking program data." Contrary to this finding, the Department was able to provide all information requested, in the manner required for its intended purpose; and therefore the Department respectfully disagrees with this finding. While the information may not be kept in a manner that expedited the evaluation of each of the specified metrics, the data is kept in a manner that enables the Department to properly execute its administrative duties in an efficient and effective manner. Therefore, the Department does not agree that a new database for this program is warranted. The size of the program does not warrant the expenditure of resources necessary to create a database.

Respectfully Submitted,

Tony Fulton

Tony Fulton
Tax Commissioner

Legislative Auditor's Summary of Agency Response

This summary meets the requirement of Neb. Rev. Stat. § 50-1210 that the Legislative Auditor briefly summarize the agency's response to the draft audit report and describe any significant disagreements the agency has with the report or recommendations.

Tax Commissioner Fulton's written response to the draft audit report raises concerns about the portion of the report dealing with data problems the Audit Office encountered during the audit. We carefully considered those concerns and agree that the original language of the finding and recommendation should be modified.

Original Finding: The Department of Revenue's data maintenance is lacking due to ineffective storage, improper updating, inability to locate files and the incompleteness of updating and checking program data.

Revised Finding: The Department of Revenue's Rural Development program data, which is maintained in two Excel spreadsheets, is not adequately updated or reviewed for completeness and consistency between the two spreadsheets.

Comment: In discussions with program staff during the audit, they agreed that there was a need to improve data management for this program. In the draft report we state that "The Department also acknowledged that a more comprehensive database, like that utilized for the Nebraska Advantage Act, was likely required for this program." (p. 11) (Revenue staff meeting with auditors on April 12, 2017.) Consequently, we disagree with the Commissioner's implication that the data problems we identified were only problems because of the data needed for the audit. There were inconsistencies and omissions in the two spreadsheets used by the program that could impact the program administration not just the audit.

Original Draft Recommendation: The Department should develop a better database to track agreement throughout the process and develop and implement policies to ensure the information is updated and consistent.

Commissioner's response to draft the recommendation: "the Department does not agree that a new database for this program is warranted. The size of the program does not warrant the expenditure of resources necessary to create a database." (Commissioner's Letter, p. 2)

Revised Draft Recommendation: The Department should develop a single spreadsheet or database to track agreements throughout the process, and develop and implement policies to ensure the information is updated and consistent.

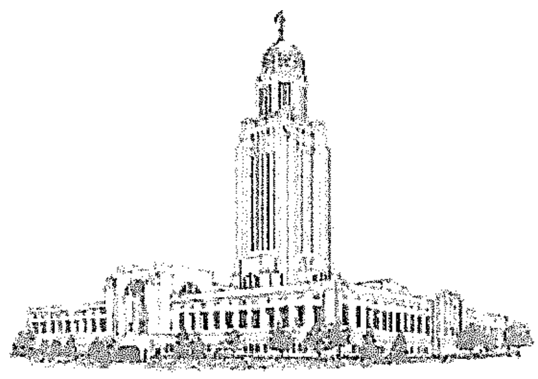
Comment: Our primary concern is with the reliability of the data; if the Department can improve the data using Excel our concerns will have been addressed.

Finally, regarding a program participant's audit file that we requested but the Department could not provide, the Commissioner states that the file was outside the Department's records retention schedule so auditors should not have expected to review it. However, during the audit, the auditors were never told the file was potentially unavailable due to records retention policies or anything else. Only after the file had been requested from the off-site storage facility did the Department's program staff realize that it had been mistakenly destroyed. In the discussion about the files, program staff stated they did not know the number of years the files were required to be maintained under the retention policy (Meeting with auditors, April 3, 2017).

Our point is that the program staff believed the file was available when it wasn't. In and of itself, that single instance does not support an audit finding—and we do not use it that way—it is one piece of evidence relevant to our general finding about the need for improvement in data management for this program. It also brings to light a question about how long agencies *should* maintain key program data on tax incentive programs, which we will discuss with the Audit Committee when it meets to discuss this report.

State of Nebraska

LEGISLATIVE COUNCIL



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Legislative Fiscal Office
PO Box 94604, State Capitol
Lincoln, NE 68509-4604

October 19, 2017

Martha Carter
Legislative Auditor
Performance Audit
11th Floor, State Capitol
Lincoln, NE 68509

Dear Martha;

You have asked for Fiscal Office comments regarding costs associated with your draft reports submitted for our review. The reports are identified below along with our comments.

Fiscal Office comments on Draft Report, Nebraska Advantage Rural Development Act Performance on Selected Metrics

On page 5, the draft recommendation for "Other State Benefits Metric" we need to first clarify our understanding of current law, whereas under current law it is possible for a taxpayer to apply for and qualify for more than one state incentive, as long as the incentives are for separate projects. From that perspective if the recommendation is to become more restrictive, limiting the taxpayer to only one incentive, some potential exists for reduced future revenue and/or expenditures depending on the financial structure of an incentive. If the recommendation is intended to become less of a restriction, where the taxpayer can qualify for multiple incentives for a project, the potential exists for greater cost consequences to the state. The recommendation also mentions capping state funding "any individual company may receive." The financial consequence, if any, will depend on the specifics of any cap, ie, does it apply to benefits paid in any one year or duration of the qualification period; does it apply at a company or project level? In the first instance a cap applied in a year may not reduce the total liability of the state for future years' incentive payments, in other words, cost consequences are deferred to future years, not held to an absolute limit less than a qualified amount. In the second instance, a cap at a company level may be difficult to track, given the possibility of multiple incentive programs under agreement with a company, whereas a cap at a project level could become manipulated by a company by managing the number of projects it may seek for incentive support. Given these unknowns, any general assessment of cost consequences is not possible.

On page 7, the draft recommendation for "Data Concerns" we believe that costs to develop a data base could be in the range of $15,000 to $20,000.

Fiscal Office comments on Draft Report, Nebraska Advantage Research and Development Act Performance on Selected Metrics.

On page 7, the second draft recommendation for "Brain Drain Metric" would probably require legislation to implement an evaluation program similar to the state of Washington. If passed, there would likely be some cost to implement, for personnel and operating costs, estimated at approximately $50,000 per year.

If you have any questions, please contact me.

Michael Calvert
Legislative Fiscal Analyst

Martha Carter 10/19/17.doc