Opportunity Grant Program

A Special Performance Audit of The Pennsylvania Department of Community and Economic Development

October 2007

Jack Wagner, Auditor General

Pennsylvania Department of the Auditor General

October 31, 2007

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania
225 Main Capitol Building
Harrisburg, Pennsylvania 17120

Dear Governor Rendell:

Enclosed is a special performance audit of the Pennsylvania Department of Community and Economic Development and its administration of the Opportunity Grant Program for the period of July 1, 2000, through June 30, 2005, with updated information through July 31, 2007, or later as indicated. We conducted our audit in accordance with generally accepted government auditing standards.

The Department of Community and Economic Development has reported that the state gave out $214.7 million in taxpayer-funded grants during the five-year audit period. The Department of Community and Economic Development has also reported that, through July 31, 2007, those grants resulted in the retention or creation of 169,322 jobs. Please note that this number is self-reported by grantees and is not otherwise corroborated by the Department.

The Opportunity Grant Program is a valuable tool to use for economic development and has become even more important because of today's competitive business environment. However, based on our audit work, the Department of Community and Economic Development must improve its administration of the program in a way that maximizes each and every grant award and that also promotes accountability. Overall, the Department can achieve this goal by focusing on better oversight and monitoring of the grant awards. These actions will result in the retention and creation of more jobs and greater competition and accountability for grantees.

Of particular importance is our concern with the Department's acceptance and reporting of grantees' self-reported job creation/retention numbers without otherwise corroborating those numbers, and also with how the Department measures and reports program success in a way that favors the best possible outcome. These issues are addressed in Finding One of our report.

In addition, we also found that the Department of Community and Economic Development did not routinely check on or otherwise communicate with grantees until at least three years after grants were awarded, which is when the Department says it is "required" to begin checking based on its contract with the grantees. Our position is that the Department could check much earlier, which the Department has now agreed to do. We discuss this issue in Finding Two.

In Findings Three and Four, we discuss the ineffectiveness of enforcement actions by the Department with respect to its assessment and/or waivers of penalties for grantees who fail to meet their contractual requirements. However, we have found that the current Department administration has improved its performance in these areas.

In Finding Five, we discuss the Department's failure to develop a comprehensive plan—required by law—that sets targets and goals for program measurement.

Please refer to our report for the complete discussion of the Department's performance as well as for the Department's response. The improvements we suggest in our 5 findings and 17 recommendations address all the preceding issues and will also position the Department to become further accountable to the public.

You should know that, despite our fundamental disagreement with the Department about issues such as grantees' self-reported data, its selective measurement and reporting of program success rates, and its position that legislative amendments are not required to address some of the issues we raised, we found that Department officials were conscientious in providing us with information, were agreeable in making this audit engagement a collaborative one, and were committed to making sure that the public understands the value of the Opportunity Grant Program. We thank Secretary Dennis Yablonsky and his staff for their cooperation.

As provided by the government auditing standards under which the audit was conducted, we will follow up on our findings and recommendations to determine whether significant findings and recommendations are being addressed. Accordingly, we will contact Secretary Yablonsky and his staff to follow up on these matters within the next 12 to 24 months.

Sincerely,

JACK WAGNER
Auditor General

Enclosure

Opportunity Grant Program in Pennsylvania

A Special Performance Audit
of the
Pennsylvania Department of
Community and Economic Development

October 2007

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General

Opportunity Grant Program

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
October 2007

Table of Contents

Table of Contents

Opportunity Grant Program

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
October 2007

Opportunity Grant Program

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
October 2007

Results in Brief

Established in 1996, Pennsylvania's Opportunity Grant Program is an important tool for economic development. The Pennsylvania Department of Community and Economic Development administers the Opportunity Grant Program and is the entity whose performance we evaluated in this special performance audit. Our audit work was conducted in accordance with generally accepted government auditing standards and covers the period primarily from July 1, 2000, through June 30, 2005, with additional information through July 31, 2007, or later.

The Opportunity Grant Program has a long history of awarding funds to applicant companies that, in return, commit to creating and retaining jobs. From the program's inception through July 31, 2007, the state has given out $388 million in taxpayer-funded grants and has reported the creation and retention of 303,047 jobs in total. During our five-year audit period, the Department of Community and Economic Development reported that it gave out $214.7 million in taxpayer-funded grants. Through July 31, 2007, the Department reported that those grants resulted in the creation or retention of 169,322 jobs.

The Opportunity Grant Program is a valuable tool that has become even more significant because of today's competitive business environment. As such, it is critical for the Department of Community and Economic Development to administer the program in a way that maximizes and accounts for each and every grant award. The Department can achieve this goal by focusing on better oversight and monitoring of the grant awards, thereby positioning its grantees to create and retain more jobs. The improvements we recommend will also position the Department to discharge its responsibilities in ways that better emphasize accountability to the public, particularly to taxpayers.

Results in Brief

Opportunity Grant Program

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
October 2007

The audit report includes 5 findings and 17 recommendations, all of which are summarized as follows:

1. **Success measurement. (pages 14 - 32)**
   Finding One: To measure the success of the Opportunity Grant Program, the Department of Community and Economic Development used grantees' self-reported data that it did not otherwise corroborate.

   For the Department to address this finding, we recommend that it (1) develop an effective evaluation process that can provide success and failure statistics on a grant-by-grant basis; (2) accept only grantee-reported job data signed and certified by the company's highest-ranking official *and* the chief financial officer; and (3) independently verify the grantee-reported numbers, at least on a sample basis.

2. **Monitoring. (pages 33 - 56)**
   Finding Two: The Department of Community and Economic Development did not routinely check on or otherwise communicate with grantees until on or after the first "required" monitoring date, which was at least three years after grants were awarded.

   To address Finding Two, we recommend that the Department should (4) perform periodic site visits beginning within the first year of a grantee's initial disbursement; (5) communicate regularly with the grantees prior to the first "required" monitoring date; (6) consider pursuing legislation to require grantees to submit progress reports at least annually; (7) develop standard procedures to evaluate grant applications consistently; (8) require two signatures—the company's highest-ranking official and chief financial officer—on every grant application, letter of intent, and contract;

(9) develop guidelines setting a maximum grant amount; and (10) not agree to any grant conditions that are not directly and precisely tied to job creation/retention.

3. **Assessing penalties. (pages 57 - 72)**
Finding Three: The Department of Community and Economic Development improved its performance in assessing and collecting penalties when companies fell short of their job projections, but it did not use its enforcement authority to the fullest extent possible.

 To address Finding Three, we recommend that the Department should (11) increase the number of grants in which the full amount of funding is not disbursed until certain measurable benchmarks have been achieved; (12) further improve its collection of penalties/repayments; (13) more frequently exercise its authority to impose a collateral requirement on grantees; and (14) track the names of grantee company owners—not just the company names—in order to screen future grantee applicants to ensure they have not been associated with former grantees whose projects failed.

4. **Waiving penalties. (pages 73 - 80)**
Finding Four: The Department of Community and Economic Development waived more than $49 million in penalties/repayments to 187 noncompliant companies.

 To address Finding Four, we recommend that the Department should (15) standardize the waiver determination process; and (16) review similar grant programs in other states to identify best practices with regard to the waiver process.

5. **Strategic planning. (pages 81 - 87)**
   Finding Five: The Department of Community and Economic Development did not have an overall plan for using program dollars and did not set goals to measure program effectiveness.

   To address Finding Five, we recommend that the Department should (17) outline goals and performance measures in its legislatively mandated *Annual Financing Strategy*.

In its response, which appears in Appendix C of this report, the Department of Community and Economic Development has generally concurred with our findings and has agreed to implement many of our recommendations. We also note that, throughout our audit work, Department officials were conscientious in providing us with information, were agreeable in making this audit engagement a collaborative one, and expressed enthusiasm for their role in economic development and, in particular, the Opportunity Grant Program.

The page that follows contains examples of six Opportunity Grants to illustrate both the successes and challenges of the program. The examples are helpful in illustrating our point in Finding One about how the Department of Community and Economic Development evaluated program success.

Measuring success: Opportunity Grants

See note below table for varying interpretations

	County and company	Grant amount	Jobs created or retained – projected versus actual	Comments
Successful	Allegheny *FedEX Package Systems, Inc.*	$750,000 *Awarded in FY 00-01*	*Created:* *500 projected vs. 900 actual* *Retained:* *1,062 projected vs. 1,062 actual*	Created 900 jobs—400 more than projected.
	Butler *Cellco Partnership*	$750,000 *Awarded in FY 01-02*	*Created:* *728 projected vs. 1,318 actual* *Retained:* *1,271 projected vs. 1,271 actual*	Created 1,318 jobs—590 more than projected.
	Montgomery *Merck and Company, Inc.*	$1.2 million *Awarded in FY 00-01 for expansion project*	*Created:* *1,350 projected vs. 2,500 actual* *Retained:* *8,500 projected vs. 8,500 actual*	Created 2,500 jobs—1,150 more than projected.
Not Successful	Allegheny *AcceLight Networks, Inc.*	$900,000 *Awarded in FY 01-02 for equipment and capital*	*Created:* *900 projected vs. 0 actual* *Retained:* *14 projected vs. 0 actual*	Created <u>no</u> jobs and actually lost 14 existing jobs when company closed 16 months after receiving grant. $900,000 penalty assessed but not collected.
	Bucks *Laclede Steel*	$250,000 *Awarded in FY 00-01 for heating equipment*	*Created:* *100 projected vs. 0 actual* *Retained:* *120 projected vs. 0 actual*	Created <u>no</u> jobs and actually lost 120 existing jobs (company went out of business). $250,000 penalty assessed but not collected.
Mixed Success	Chester *subsidiary of The Vanguard Group, Inc.*	$12 million *Awarded in FY 00-01 to expand existing facility and build another*	*Created:* *6,000 projected vs. 2000 actual* *Retained:* *n/a*	Bought land but did not build new facility and thus created <u>no</u> jobs at that site. Accordingly, the company paid a $3 million penalty/ repayment to the state in July 2007. On the positive side, the company reported that it did create 2,000 jobs at its existing site.

Interpreting the data: The data above can be interpreted in the aggregate—as the Department of Community and Economic Development would do—or in conjunction with individual grantee results in a way that would lend more balance to the aggregate reporting. Specifically, the use of aggregate results alone would indicate an 85 percent success rate based on 17,551 actual jobs created and retained compared to 20,545 projected jobs created and retained. However, that interpretation by itself does not illustrate that 50 percent of the grantees above failed to meet their job goals and, in fact, actually lost jobs.

Introduction and Background

Importance of economic development

Pennsylvania's governors throughout the years have sought to invigorate the Commonwealth's economy and thereby enhance the quality of life for all Pennsylvanians. For example, in the 1950s, Governor George M. Leader called for state financing to create jobs in economically distressed communities.[1] A half century later, Governor Mark S. Schweiker talked about creating a "job-friendly" and "entrepreneur-friendly" Pennsylvania.[2] More recently, in the state's budget plan for fiscal year (FY) 2006-2007, Governor Edward G. Rendell proposed a "combination of job creation, worker training, and company investment and expansion programs to transform Pennsylvania's economy and create new opportunities for employment and investment."[3]

The state's Department of Community and Economic Development (referred to throughout this report by either its full name or by "Department") has the primary responsibility for administering Pennsylvania's economic development programs.[4] Pennsylvania's programs include loans, grants, and tax incentives for maintaining companies in and attracting companies to the Commonwealth, that is, retaining and creating jobs. This special performance audit

---

[1] "Governor George M. Leader, (1918 -)," *Pennsylvania Governors Past to Present*, Pennsylvania Historical and Museum Commission, <http://www.phmc.state.pa.us/bah/dam/governors/leader.asp?secid=31>, Accessed July 5, 2006; re-verified July 2, 2007.

[2] Commonwealth of Pennsylvania, FY 2002-2003 Governor's Executive Budget, February 5, 2002, <http://www.oit.state.pa.us/budget/lib/budget/2002-2003/ex_budget/ex_budget/04_Overview&Summaries/OverviewNarrative/OverviewMerge.pdf>, Accessed July 5, 2006, A3; re-verified July 2, 2007.

[3] Commonwealth of Pennsylvania, FY 2006-2007 Budget in Brief, February 8, 2006, <http://www.budget.state.pa.us/budget/lib/budget/2006-2007/bib/2006_07_Budget_In__Brief.pdf>, p. 10, Accessed July 5, 2006; re-verified July 2, 2007.

[4] The Department of Community and Economic Development was created by Act 58 of 1996 (71 P.S. § 1709.101 *et seq.*) through the merger of the Department of Commerce and the Department of Community Affairs.

addresses one such economic development program, the Opportunity Grant Program, and covers the period from July 1, 2000, through June 30, 2005, unless otherwise indicated, thereby spanning the administrations of several governors.

Purpose of Opportunity Grant Program

The primary purpose of the Opportunity Grant Program is to create and retain jobs within Pennsylvania. With the Opportunity Grant Program's appropriation of $226 million over our five-year audit period, the program has been one of the largest grant programs of the Department of Community and Economic Development since both the Department and the program were established in 1996.[5] The current Governor has noted that the program is a key component of his plan "to develop and maintain a flexible and effective arsenal of economic development incentives for Pennsylvania companies to lead the way into the 21st century."[6]

According to the Department of Community and Economic Development's own guidelines, the Opportunity Grant Program was established for the following purpose:

> …securing job-creating economic development opportunities through the preservation and expansion of existing industry and the attraction of economic development prospects to the Commonwealth of Pennsylvania.[7]

[5] The original Opportunity Grant Program was provided for under Sections 701 through 706 of the Job Enhancement Act, 73 P.S. §§ 400.701 - 400.706 (Act 67 of 1996). Act 12 of 2004 repealed and replaced these provisions with those now found at 12 Pa.C.S. §§ 2101 - 2107.
[6] Opportunity Grant Program Guidelines, March 2004, <www.fcadc.com/financial_assist/OG.pdf>, Accessed October 11, 2005, p. 1; re-verified July 2, 2007.
[7] Ibid. This statement from the Department of Community and Economic Development is based on 12 Pa.C.S § 2103, which states, in pertinent part, that "[t]he program shall be administered by the department to provide grants to eligible persons for certain projects which encourage **job-creating economic development** within this Commonwealth." [Emphasis added.]

Opportunity Grants are typically part of a package

It is important to note that an Opportunity Grant is not typically awarded by itself. Companies routinely receive Opportunity Grants as part of a larger package of assistance from the state, such as other grants, loans, tax credits, and technical assistance:

- ***Grants*** are awarded with no expectation of repayment unless grantees do not meet contract requirements.
- ***Loans*** are offered to borrowers who are expected to repay the money with interest over a specified time period.
- ***Tax credits*** give companies reductions in their taxes for making investments in the following: research and development, real property improvements, and education improvement organizations.
- ***Technical assistance and consultant services*** are offered to communities, businesses, local governments, and individuals to assist with strategic planning and affordable housing efforts and to strengthen the socio-economic fabric of a community.

Governor's Action Team and others play key roles

A group that plays a key role in the Opportunity Grant Program is the Governor's Action Team, which works with the Department of Community and Economic Development to provide a single point of contact for companies interested in locating or expanding in Pennsylvania.[8] This "seasoned group of economic development professionals"[9] operates within the Department and reports directly to the Governor.

The Governor's Action Team has discretionary use of the Opportunity Grant Program funding, not only with regard to which companies are awarded grants but also with regard to the dollar amount of the grants and the amount of time by which job creation/retention projections should be fulfilled.

In addition to the Governor's Action Team, the Department of Community and Economic Development also received information on company start-ups from the following:

- Team Pennsylvania Foundation, a public/private partnership that initiates and supports innovative programs to improve Pennsylvania's competitiveness and economic prosperity. The Foundation is working to make the Commonwealth a national leader in economic growth.[10]
- The Department's Center for Entrepreneurial Assistance, which encourages the creation, expansion, and retention of successful small companies.[11]
- The Pennsylvania Small Business Development Centers, which provide high quality one-on-one business management consulting, information, and education programs that build small companies'

[8] There are approximately 30 people currently working on the Governor's Action Team.
[9] "Governor's Action Team," *NewPA.com: Governor's Action Team*, <http://www.newpa.com/default.aspx?id=32>, Accessed October 25, 2005; re-verified July 2, 2007.
[10] "Team Pennsylvania Foundation," http://www.teampa.com/foundation/Who.aspx. July 2, 2007.
[11] "Center for Entrepreneurial Assistance," *NewPA.com: Center for Entrepreneurial Assistance*, <http://www.newpa.com/default.aspx?id=34>, Accessed March 12, 2007; re-verified July 2, 2007.

capacity to compete effectively in domestic and international markets.[12]

- Regional and local economic development groups.[13]

Awarding and monitoring grants is not a simple process

Reaching agreement on awarding Opportunity Grants is not necessarily a simple process for either the applicants or the Department. Companies must complete application materials, submit company plans, provide references, and—especially important—commit to investing $4 of their own money for every $1 of Opportunity Grant funding, or to raising investment monies according to that same ratio.

As part of the state's role in the process, officials from the Department of Community and Economic Development and/or the Governor's Action Team correspond, sometimes at length, with officials from the companies that apply for the grants. Officials from the Department, in some cases, visit the companies at their current or proposed locations. Department personnel review applications to determine whether the applicant is qualified for the award and whether the applicant will use the grant for eligible purposes as required by the guidelines outlined in the chart on the next page.

[12]"Small Business Development Centers," *NewPA.com: Small Business Development Centers*, <http://www.newpa.com/default.aspx?id=263>, Accessed March 12, 2007; re-verified July 2, 2007.
[13]"Program Information," *NewPA.com: Program Information*, <http://www.newpa.com/programDetail.aspx?id=56>, Accessed March 12, 2007; re-verified July 2, 2007.

Opportunity Grant Program

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
October 2007

Opportunity Grant Program: Guidelines[14] at a Glance		
Average grant during audit: Nearly $300,000	*Eligible Applicants*	**1. Who can apply for Opportunity Grants?** ▪ Municipalities and various industrial development authorities ▪ Private developers, certain private companies *Private companies must operate at a Pennsylvania location, invest private capital there, and create or preserve jobs there.*
	Eligible Uses	**2. How may Opportunity Grants be used?** ▪ Must operate the company in Pennsylvania ▪ May *not* be used to refinance or retire existing debt ▪ Examples of eligible uses are job training, acquisition of land and buildings, construction or rehabilitation of buildings, purchase or upgrading of machinery and equipment, site preparation, remediation of hazardous materials.
Range of grant amounts = $153.00 to $12 million	*Requirements*	**3. What are private applicants required to do?** ▪ Invest at least $4 for every $1 received ▪ Create or preserve a minimum of 100 full-time jobs at the site within three years, *or* increase employment in Pennsylvania by at least 20 percent, *or* create new jobs within a high-growth industry, *or* create/preserve fewer than 100 jobs if area is economically distressed ▪ Pay employees at least 150 percent of minimum wage ▪ Operate at the project site for at least five years
	Penalties	**4. Are there penalties for not meeting the above commitments?** ▪ Up front, companies can be asked to pledge collateral as security against a possible penalty. ▪ For not meeting commitments, companies can be asked to return the entire grant, *plus* penalty, *plus* interest.

[14] Summarized from the Department of Community and Economic Development's *Opportunity Grant Program, Program Guidelines*, March 2004, available at <www.newpa.com/programDetail.aspx?id=41> Accessed July 12, 2006; re-verified July 2, 2007, guidelines updated December 2006.

The range of grant awards during our audit period, from the smallest grant of $153 to the largest grant of $12 million as referred to in the chart on the previous page, represents two extremes within the program. Sixty-five percent, or 476 of the 724 grant awards during the audit period, were for amounts between $153 and $200,000. Thirty percent, or 219, were for amounts between $200,001 and $1 million. The remaining five percent consisted of 28 grants between $1 million and $4 million and 1 grant of $12 million.

After the Department of Community and Economic Development approves an Opportunity Grant, the grantee/company submits proof of eligible project expenditures to the Department and request reimbursement. Companies may receive the entire grant award at one time or the grant may be disbursed in response to multiple requests for reimbursements.

The Department of Community and Economic Development's performance monitoring division was established in 2003 and is responsible for monitoring the progress of grants awarded, particularly the program requirements related to job creation, job retention, private investment, and maintenance of the facility location. The projects usually run between three and five years. Companies must meet their private investment, as well as job creation and retention requirements within the time frame specified in their grant contracts.

As illustrated in the table on the following page, during the audit period of July 1, 2000, through June 30, 2005, and as of January 24, 2006, the Department of Community and Economic Development awarded 724 Opportunity Grants totaling nearly $215 million. These grants were projected to retain 172,714 jobs and create 105,236 new jobs. The average grant was $296,611 and the average cost per job to be created or retained was $773.

Our review of the grants shows they were awarded to companies throughout the state. See Appendix A for a breakdown of grants awarded by county. Accordingly, it appears that the Department of Community and Economic Development did comply with its mandate to achieve geographical diversity in awarding Opportunity Grants.[15] Our review of the grants also reveals that almost half were awarded to companies in the manufacturing industry; the others were awarded to companies representing a variety of other industries. See Appendix B for the breakdown of grants by industry.

Opportunity Grant Program Overview

For the audit period July 1, 2000, to June 30, 2005

Source: The Department of Community and Economic Development

Fiscal year	Number of grant recipients	Actual program appropriations	Grant funds awarded	Unspent appropriations	Projected jobs to be retained	Projected jobs to be created
2000-2001	181	$63,000,000	$62,755,314	$ 244,686*	51,199	37,615
2001-2002	101	35,000,000	32,301,415	2,698,585*	21,681	15,301
2002-2003	78	28,000,000	31,895,500	(3,895,500) **	19,426	18,653
2003-2004	137	50,000,000	43,521,958	6,478,042	45,244	16,702
2004-2005	227	50,000,000	44,272,270	5,727,730	35,164	16,965
Total	**724**	**$226,000,000**	**$214,746,457**	**$11,253,543**	**172,714**	**105,236**

* A total of $2.9 million in unspent program funding was returned to the General Fund from fiscal years 2000-2001 and 2001-2002.

**The 2002-2003 grant awards exceeded the actual program appropriation in the Commonwealth budget because the Department added $3,895,500 in penalties collected from noncompliant companies to that fiscal year's available funding to be awarded to other eligible companies that applied for assistance.

[15] Pursuant to 12 Pa.C.S. § 2109(4), the guidelines that must be developed by the Department must address requirements for "geographic diversity of funded projects."

Objectives, Scope, and Methodology

The Department of the Auditor General conducted this special performance audit in order to provide an independent assessment of the Pennsylvania Department of Community and Economic Development's administration of the Opportunity Grant Program. We conducted our work according to *Government Auditing Standards* as issued by the Comptroller General of the United States.

Our expectation is that the findings presented here will improve public accountability and facilitate corrective action where necessary.

Objectives

We based our work on the following objectives:

- Success and Effectiveness. Determine if the Department of Community and Economic Development, using the Opportunity Grant Program, successfully and effectively supported the creation and retention of jobs in Pennsylvania. *See Finding One, Finding Two, and Finding Five.*
- Monitoring. Determine whether the Department of Community and Economic Development monitored companies adequately and imposed and collected penalties if those companies did not perform as they agreed. *See Finding Two, Finding Three, and Finding Four.*
- Eligibility. Determine whether grants were provided in accordance with program guidelines and requirements. *See Finding Two.*

Scope

Our audit covered the period of July 1, 2000, through June 30, 2005, unless otherwise indicated. For example, after meetings with Department of Community and Economic

Development officials to review drafts of this report, we agreed to review and include more current data that the officials said would better reflect successes of the program.

Methodology

The Opportunity Grant Program is one of the Department of Community and Economic Development's largest programs, distributing an average of about $43 million in taxpayer dollars every year of the audit period. To understand the program and accomplish our objectives, we reviewed applicable laws, policies, and program guidelines; visited project sites; conducted interviews with Department officials; and examined numerous grant documents and other records from the Department.

To compile statistics and other data for analysis, we used reports that the Department of Community and Economic Development provided to us, including the following:

- Reports listing the economic development programs managed by the Department.
- Fiscal year reports listing the award recipients, grant amount, projected job retention and creation rates, and, if applicable, actual job retention and creation rates.
- Job retention and creation *Survey Response Data*.
- Opportunity Grant Program *Penalty Reports*.
- Penalty collection reports prepared by the Department.

To evaluate program success, effectiveness, monitoring, and penalties, we focused our most extensive testing and analysis on a sample of 40 companies that received Opportunity Grants during the audit period. We selected the 40 companies randomly from grantees that the Department said did not meet the job creation/retention commitments. By basing our testing on this population of noncompliant grantees, we were therefore able to test the entire process, from awarding grants to assessing and collecting penalties.

In addition, we consulted numerous other resources, including, but not limited to, those that follow:

- An October 2000 audit report issued by the Legislative Budget and Finance Committee of the Pennsylvania General Assembly. The report discussed the Department of Community and Economic Development's various programs, including the Opportunity Grant Program.
- Audit reports about similar programs in the states of Georgia, Kansas, Massachusetts, New York, and Tennessee.
- Interviews with state economic development officials of Illinois, New York, Ohio, and Texas. (States were selected due to their similarities with Pennsylvania in the areas of population, and economic development program diversity.)
- A September 2000 report from the Institute on Taxation and Economic Policy and Good Jobs First that analyzed 122 audits of state economic development programs.[16]
- A March 2002 report, also from Good Jobs First.[17]

[16] Sara Hinkley, et al., *Minding the Candy Store: State Audits of Economic Development*, <http://www.goodjobsfirst.org/pdf/stateaudits.pdf >, Accessed July 5, 2006; re-verified July 2, 2007. This report is a cooperative project of two nonprofit organizations, the Institute on Taxation and Economic Policy ,< http://www.itepnet.org/,> and Good Jobs First <http://www.goodjobsfirst.org/>. Good Jobs First seeks to "ensure that subsidized companies are held accountable for family-wage jobs and other effective results." The mission of the Institute on Taxation and Economic Policy, based in Washington, D.C., is "to keep policymakers and the public informed of the effects of current and proposed tax policies on tax fairness, government budgets and sound economic policy."

By March 1, 2006, we completed most of our audit work on-site at the Department of Community and Economic Development or by visiting several company job sites throughout the state. We continued our audit work in our offices by following through with questions, interviews, meetings, and further data requests through August 31, 2007. We provided an initial draft report to the Department of Community and Economic Development on July 31, 2007, and met with Department officials about the draft on August 21, 2007. We provided another draft to the Department on September 14, 2007, after reviewing updated data; we received a final written response on September 24, 2007 (see Appendix C).

We developed five findings as a result of our work, and we present 17 recommendations to address the issues we identified. We included time frames for the implementation of our recommendations, and we will follow up within the next 24 months to determine the status of the findings. In so doing, we will work collaboratively with the Department to meet an important government auditing standard that promotes government accountability:

> Providing continuing attention to significant findings and recommendations is important to ensure that the benefits of audit work are realized. Ultimately, the benefits of an audit occur when officials of the audited entity take meaningful and effective corrective action in response to our findings and recommendations. Officials of the audited entity are responsible for resolving audit findings and recommendations directed to them and for having a process to track their

---

[17] Greg LeRoy et al., *No More Secret Candy Store: A Grassroots Guide to Investigating Development Subsidies*, <http://www.goodjobsfirst.org/pdf/nmscs.pdf >, Accessed October 12, 2005; re-verified July 2, 2007.

status. If the audited entity did not have such a process, they may wish to establish their own process.[18]

At the time of our follow up, we will determine a subsequent course of action. For example, we may issue a status update jointly with the audited entity, issue an update independently, or conduct a new audit entirely.

[18] Standard 7.30, *Government Auditing Standards*, 2003 revision, U.S. Government Accountability Office.

Finding One

To measure the success of the Opportunity Grant Program, the Department of Community and Economic Development used grantees' self-reported data that it did not otherwise corroborate.

The Department of Community and Economic Development used self-reported data from company officials to support its claims of the success and effectiveness of the Opportunity Grant Program. Other than this self-reporting, the Department did not authenticate the job creation and retention data reported by the grantees.

There is no question that the Opportunity Grant Program is a valuable tool for economic development and an effective incentive for companies to create and retain jobs. As such, the narrative that follows should not be interpreted to mean that the program has been unsuccessful. Instead, the questions we raise in Finding One relate solely to how the Department of Community and Economic Development measured the successes, whether the statistics were completely reliable, and how the Department must improve its internal controls to ensure that its claims of success are more reliable going forward.

We have broken this finding down into a discussion of three questions: What were the Opportunity Grant job numbers in the Department of Community and Economic Development's database? How did the Department substantiate the job numbers in its database? How did the Department interpret the job numbers in its database to calculate the success of the Opportunity Grant Program?

Question 1 -
What were the Opportunity Grant job numbers in the Department of Community and Economic Development's database?

During the five-year period between July 1, 2000, and June 30, 2005, the Department of Community and Economic Development disbursed nearly $215 million in grants to 724 companies. As part of their signed contracts with the Commonwealth, the companies projected that the state's assistance would allow them to create and/or retain more than 277,000 Pennsylvania jobs over a specified time period. The specified time period, which was set at the discretion of the Commonwealth based on various factors, was typically three or five years. (Our review of the written guidelines for the Opportunity Grant Program shows that grantees must achieve their projected job goals within 3 years of receiving the funds. The written guidelines as we reviewed them did not mention a 5-year time period that Department officials told us they set at their discretion.)

As of January 24, 2006, which was our first date of testing, the 724 companies referenced above were in various stages of progress with their grant projects. By that date, companies that received their grants early in the period would have had more than five years to show results; companies that received their grants late in the period would have had less than a year to show results and were not required to do so at that point. Accordingly, it did not cause us particular concern when we found that, overall, the reported percentage of jobs created or retained at that point was just 35 percent, or about 98,600 of the 277,000 projected jobs. The Department of Community and Economic Development said—and we agreed—that the 35 percent figure would grow as the companies reached the status-reporting benchmark period of three or five years.

More recently, on August 30, 2007, the Department gave us updated numbers for the period between January 2006 and July 2007.[19] According to those updated numbers, 458 of the 724 companies by then had reported the creation or retention of an additional 77,589 jobs. The addition of those reported jobs, if corroborated, would mean that 176,189 jobs had been reported in total, or 64 percent of the 277,000 jobs projected by all 724 grantees.

The Department further noted that, of the 724 grantees, there were 130 as of July 2007 that had still not reached their first required reporting dates or that had not responded to the Department's request for information. Therefore, the Department told us that by sometime in 2008, if all the grantees report as required, the job creation and retention success rate for all grantees since the program's inception—including the 724—will equal or exceed 88 percent.[20]

Throughout our audit work, the Department cited similar high rates to define the success of the program overall. However, as we explain later, we found that the Department uses calculations that result in the best possible percentages when other interpretations would provide more of a balance.

Whatever the success rate for the Opportunity Grant Program, it is clear that it will vary widely at any particular date depending on how much time is remaining for each grantee to meet its goals. Looking ahead, our concern is not that the Department gives grantees time to meet their goals; rather, our concerns are that, when the time comes, the Department should do more to corroborate the grantees' self-reported numbers (discussed next in Question 2) and,

[19] August 30, 2007. E-mail to the Department of the Auditor General from Dorothy Kaplan, Deputy Secretary for Business Assistance, Pennsylvania Department of Community and Economic Development.
[20] Ibid.

furthermore, should interpret its statistics in more than one way to present the most balanced picture (discussed in Question 3).

Question 2 - How did the Department substantiate the numbers in its database?

As already noted, the numbers maintained in the Department's database were self-reported by the grantees. It was not in the Department's routine to otherwise corroborate those numbers by making site visits, for example, or by requesting payroll records to verify employee totals.

We recognize that requesting self-reported data is the most practical and efficient way to collect job statistics from grantees. However, because self-reported data is inherently less reliable than independently corroborated data, the Department must place a greater priority on its internal controls to lessen the risk of unreliability. Good Jobs First, a national clearinghouse tracking best practices in economic development, says this about self-reported data:

> Relying on companies to self-report accurate data is simply not good business practice.…Failure to verify accurate performance data submitted by a…company [subsidized with public dollars] is no different than a state highway department asking a contractor how many miles of road it paved, rather than inspecting the road itself.[21]

[21] Sara Hinkley, et al**.,** *Minding the Candy Store: State Audits of Economic Development*, The Institute on Taxation and Economic Policy and Good Jobs First, Washington, D.C., September 2000, p. 18.

In defending its position to trust grantee-reported data without independent corroboration, the Department of Community and Economic Development said it had followed its Operating Procedures Manual. The manual requires a "responsible officer" from each company to certify its job numbers by signing and dating a project status report (known as the *Project Update Report* form) before submitting it to the Department.[22] The Department said that the signed reports provided adequate assurances that the companies had reported valid information.

By requiring responsible officials of a grantee company to certify job numbers, the Department implemented an internal control to minimize the risk that grantees would report inaccurate data. However, during our testing of that internal control, we identified three weaknesses:

- First, the *Project Update Report* form itself did not convey a concept of accountability to the officials responsible for signing it. By including language on the *Project Update Report* subjecting the responsible officer to penalties for unsworn falsification to authorities, the Department would have obtained greater assurances of the accuracy of the information. For example, the Department could have advised the company official signing the form of the following summary of state law: *A person commits a misdemeanor of the second degree if he or she intentionally misleads a public servant in performing his official function by making any written false statement which the person does not believe to be true.*[23]

[22] Pursuant to 12 Pa.C.S. § 2106(3), the Department may impose any other terms and conditions on the grant as the Department determines is in the best interests of the Commonwealth.
[23] 18 Pa.C.S. § 4904(a)(1).

- Second, the Department's requirement to have a signature from simply a "responsible officer" from each company was not strong enough. Specifically, the Department should change its requirement so that the company's chief executive officer will be the signatory or, if no one is so titled, the company's highest-ranking official. In addition, the Department should require a second signature, specifically that of the chief financial officer or comparable official. By requesting the signatures of officials who are most responsible for the company's overall performance (and more likely to be ultimately accountable for that performance than lower-ranking officials would be), the Department of Community and Economic Development would thereby increase the strength of its internal controls.

- Third, the Department did not always adhere to its own internal control procedures that would have helped lower the risks associated with the grantees' self-reported data. Specifically, when we sampled the files of 40 grantees, we found only 13 with a grantee-signed *Project Update Report* containing the same job results (i.e., number of jobs created and retained) that the Department had already put into its database at the time of our test. Stated another way, the Department added job creation and retention numbers into its database without precisely following its internal control procedures to tie those numbers into a grantee-signed *Project Update Report.* This issue is significant because the Department relied on the database numbers to measure and report the success of the program.

Test: How well did the Department of Community and Economic Development use internal controls to support job numbers for its Opportunity Grant Program? *Sample = 40 grantees*	
13 grantees	For 13 of the 40 grantees, the Department had the required *Project Update Reports* that contained the same job numbers that were in the database.
6 grantees	For 6 of the 40 grantees, the Department had <u>some</u> documentation (but not the required *Project Update Reports*) that contained the same job numbers that were in the database.
7 grantees	For 7 of the 40 grantees, the Department could not prove how it came up with job numbers in its database. The Department did have various documents in each grantee's file but had <u>none</u> to match the numbers in the database.
14 grantees	For 14 of the 40 grantees, the Department had no job numbers in the database either because the grantees (a) went out of business before their three- or five-year required reporting date or (b) failed to report their job numbers.

In response to the preceding, the Department said that it accepted other forms of communication as a substitute for the signed certifications—for example, conversations between Department officials and grantees, e-mails from grantees, or newspaper articles about grantees. In addition, because grantees typically obtained concurrent funding via loans or other programs offered elsewhere in the Department, Opportunity Grant Program officials said they sometimes obtained job numbers using data from those other programs.

We acknowledge that signed *Project Update Reports* were not the only source used by the Department to tally job creation and retention numbers, and we noted the use of other sources in our testing of other issues. But the point of this particular test was to determine whether or not the Department followed its own internal control procedures to minimize the risks associated with the self-reported data. Accordingly, we found that the Department must strengthen its internal controls significantly to improve the integrity of the data it uses.

The Department has been especially sensitive to our criticism that it relies on otherwise-uncorroborated data from grantees to gauge the effectiveness of the Opportunity Grant Program. In that regard, Department officials have told us they will commit to improving their internal controls with respect to self-reported data and will also commit to taking more proactive steps in monitoring the progress of grantees as discussed later in this report.

Question 3 - How did the Department use the job numbers in its database to calculate the success of the Opportunity Grant Program?

As stated previously, companies typically have three to five years to report job numbers. Because of this time lag, we limited our review to grants that were awarded between July 1, 2000, and June 30, 2003. Otherwise we would not have had complete statistics to review because, at the time of our audit work, the companies that received grants after June 30, 2003, would not have had a full three years to report their results.

We started our analysis by reviewing the Department's calculations of success for grants awarded during the three years. As of January 2006, the Department awarded $126.9 million to 360 companies and claimed a combined success rate of 81 percent even though only 286 companies had reported their job results.[24]

A positive spin:
Success rate of the Opportunity Grant Program
as reported by the
Department of Community and Economic Development
as of January 2006

Fiscal year	**Success rate %**
2000-2001	77 %
2001-2002	84 %
2002-2003	94 %
Three-years combined	**81 %**

Source: The Department of Community and Economic Development

As part of our audit work, we developed some alternative interpretations of the Opportunity Grant Program numbers. These alternative interpretations lend more balance to the information made available to the public, grantees, legislators, and other interested parties.

Before we present our interpretations, we note that the Department of Community and Economic Development disagrees with our assessment. On the other hand, both we and the Department of Community and Economic Development agree that differences in interpretation can lead to productive dialogue as each party examines its position. At the same time, however, a different interpretation does not change our underlying concern about using self-reported numbers that were not corroborated.

[24] See Finding Two for additional detail of the analyses of the 286 companies.

With the preceding qualifier in mind, we found three areas in which the Department could have interpreted and presented its data with more balance:

- **The Department excluded companies that failed to report their progress.** We found that the Department presented its numbers for only those grantees who reported results—i.e., only for 286 grantees, not for all the 360 grantees who received money. Therefore, the Department's resulting "success rate" of 81 percent, as shown in the previous table, did not factor in the projected results of the 74 grantees who had not yet reported their progress, whether or not they were required to report at that particular time. The success rate would have been 59 percent if the Department had factored in the projections of the remaining 74 companies.

  Presenting the success rate as the Department did is not wrong. However, the exclusion of non-reporting companies may be significant in cases where companies had passed their reporting dates but may not have reported because they had little or nothing to report.

- **The Department combined jobs created with jobs retained.** In our review of the 286 grantees (of 360) who had reported results, we found that the Department did not report separate totals for jobs created and jobs retained. Specifically, the Department *combined* the number of reported jobs created with those retained and then compared that number to the total job projections. Presenting the combination of created and retained jobs is not wrong, but the Department should also have reported separate totals for jobs created and jobs retained since grantees themselves are required to commit to separate totals in the grant contracts.

- **The Department used aggregate numbers.** Likewise, the Department did not base its evaluation of the program on a grant-by-grant basis and instead based results on companies in the aggregate. Using aggregate numbers means that, statistically, companies exceeding projections will compensate for companies falling short of projections.

  The Department defended its use of aggregate numbers by noting that, overall, it is the totals that matter. But based on the Department's interpretation, for example, overall goals are met and program success is measured at 100 percent if two separate companies each commit to create/retain 200 jobs but one company creates/retains 400 jobs and the other creates/retains 0 jobs or goes out of business.

  It is worth repeating that presenting alternative interpretations would present a more balanced picture. In presenting aggregate numbers only, some of the individualized details are obscured. Therefore, the Department is suggesting, however unintentionally, that individual grantees may not be as accountable as the grantee population taken as a whole. Likewise, the Department is diluting the successes of individual grantees who are stellar performers by aggregating them with grantees who are poor performers.

  It is the matter of aggregate-versus-individual results in which we and the Department are perhaps the farthest apart, and our solution would be that the Department should not limit itself to presenting only aggregate numbers and other data. Aggregate numbers show success overall, while individual results enhance individual grantee accountability and give the Department a tool to fine-tune its assistance to grantees based on each grantee's needs. Ultimately, by analyzing and presenting individual numbers in addition to aggregate numbers, the program would be more reflective of successes and failures instead of being reflective of a weighted average.

The Department of Community and Economic Development must do more to exhibit accountability to taxpayers

Acknowledgment of the preceding problems is the first step to resolving them, but the Department must go further. Accepting company-reported data in the manner described does not show the highest possible level of accountability to taxpayers by both the Commonwealth and the grantees. The Department's suggestion that company-provided numbers for both private investment and job data are always accurate is not realistic, and the Department's practice should be changed to require the performance of procedures such as asking for payroll records to corroborate the employee complements reported by the grantees. Furthermore, the lack of a verified certification of the job numbers and program investment dollars increases the chances for falsified data.

In short, the Department of Community and Economic Development personnel must seek out and maintain documentation to support any numbers upon which it relies.

By contrast, economic development officials from Illinois, New York, Ohio, and Texas require grant recipients to report ***annually*** on the status of projects funded with state grant funds. Like Pennsylvania, the reports require the certification by an officer or official designee of the company. However, officials from these four states reported that employment numbers are also crosschecked and verified through information provided from state labor and workforce agencies in their states.

During the course of our audit, we contacted officials at Pennsylvania's Department of Labor and Industry and determined that the Department of Community and Economic Development could crosscheck and verify company employment data on file with the Department of Labor and Industry. That agency already shares company opening and closing information with the Department of Community and Economic Development on a biweekly basis, and additional information might be both available and valuable.

This is not the first time that the issue of reliable and accurate performance data has been raised. In October 2000, the General Assembly's Legislative Budget and Finance Committee released an audit report citing similar concerns. The audit report included a recommendation that the Department of Community and Economic Development should "consider using employment data from the Department of Labor and Industry to validate company-reported job creation/retention statistics. Such data…may be better able to identify site-specific information."[25]

Concurrent with the release of the Legislative Budget and Finance Committee's report, the Department of Community and Economic Development's then-Secretary said that the Department would pursue the recommendations "with vigor."[26] However, as noted in our current audit report, serious problems remained throughout our audit period.

Summary

In summary, the Department of Community and Economic Development claimed that its Opportunity Grant

[25] Legislative Budget and Finance Committee Audit, *Economic Development Programs of the Pennsylvania Department of Community and Economic Development: A Performance Audit in Response to Act 1996-58,* October 2000, p. S-12.
[26] Ibid, Appendix H.

Program—with the primary goal of retaining and creating jobs—is a success. However, the Department used calculations based on self-reported data to make that assessment. The Department did not otherwise corroborate the job creation and retention statistics on which it based its calculations. We also found that the Department was weak in applying internal controls that would have lessened some of the risk inherent in grantee-reported statistics that are not corroborated. Finally, we found that the Department measured the success of the Opportunity Grant Program by making some interpretations and excluding other interpretations.

One alternative to assess the program's success may be measuring and monitoring the success of individual projects, rather than aggregating jobs created and retained numbers where some fail and others exceed their projections. For a true measure of success regarding the Opportunity Grant Program, stakeholders such as taxpayers, legislators, company leaders, and Department officials must have an objective and realistic picture of jobs created and retained. While Opportunity Grant Program monies are clearly tools for creating and maintaining jobs in the Commonwealth, there is room for improvement in the program's administration and management.

Recommendations

1. The Department of Community and Economic Development should develop a process for a more accurate and effective evaluation of program performance. The process should, at a minimum, be able to provide success and failure statistics on a grant-by-grant basis.

Target date: Begin planning immediately; implement this recommendation in full by June 30, 2008.

---

2. The Department of Community and Economic Development should, at a minimum, adhere to its Operating Procedures Manual and not accept any other method of reporting job and investment data except the *Project Update Report,* signed/certified by the company's highest ranking official *and* by the company's chief financial official. The *Project Update Report* should also be amended to include a standard notification informing the signatories that misrepresentations of requested information are punishable under the law. Furthermore, in Recommendation 6 of Finding Two, we recommend that these updates be required annually.
Target date: Begin immediately.

3. The Department of Community and Economic Development should implement procedures that would validate or verify the job and investment numbers reported on the *Project Update Reports*. These procedures should include:

- Obtaining, on at least a sample basis, company payroll records to support the job numbers reported to the Department.
- Using employment data from the Department of Labor and Industry to confirm the self-reported data submitted by companies receiving Opportunity Grants.
- Performing, on a sample basis, periodic site visits to confirm the existence of employees.

Target date: Begin planning immediately; implement this recommendation in full by June 30, 2008.

<u>Summary of the Department of Community and Economic Development's response to Finding One</u>

followed by*, in italic type,*

<u>Evaluation of the Department of Community and Economic Development's response by the Department of the Auditor General</u>

[Note: See the Department of Community and Economic Development's full response beginning on page 90.]

- In its response, the Department of Community and Economic Development states its belief that aggregate data provides the most accurate measure of program success and that, by that measurement, the Opportunity Grant Program has achieved a 98 percent success rate for job creation and retention under the current administration. The Department's response also includes additional program performance statistics, again based on aggregate data. The Department did say that it recognizes the need to evaluate individual company project information. Finally, the Department also raised an issue about information we present in the next finding (Finding Two), saying that we have created an inaccurate picture of program success by categorizing companies as "failures" for not meeting 100 percent of the job requirements, "even if they fell short by only a few jobs."

  → *What the Department of Community and Economic Development does <u>not</u> reveal in its response is that the 98 percent figure comprises the results of only <u>20 percent</u> of the companies who received a grant during the period. The Department develops its figures based on a selective aggregate of companies that have been successful, and leaving out the remaining companies that have either been*

Opportunity Grant Program

unsuccessful or that have not yet reported their results.

Regarding other statistics now cited by the Department of Community and Economic Development in its response, those statistics have simply not been authenticated—either by our auditors or by the Department of Community and Economic Development itself. This type of discrepancy in interpreting statistics is what has concerned us throughout our audit work. In fact, the statistics now cited in the Department's response are typically based on the same unreliable data collection and verification procedures that we reported in this finding.

Finally, in response to the Department's criticism that we inaccurately categorized certain companies in Finding Two as "failures," we did not categorize those companies as "failures." Instead, we clearly stated factually that certain companies either "failed to meet projections" or, in some cases, "failed to meet projections and actually lost jobs."

- In its discussion of recommendation 2, the Department of Community and Economic Development responds that its contracts will now include language to advise grant recipients that misrepresentation of information is punishable by law; that it will require annual reports; that signatures of the highest-ranking executive and the chief financial officer (or comparable officials) will be required on reports; and that it will make sure that consistent performance documentation exists for every project by attaching a Project Update Form to all other employment verification documents.

In its response to recommendation 3, the Department of Community and Economic Development said (1) its Opportunity Grant Program contract will require "that payroll records be made available to the Department," (2) that it will work with the Department of Labor and Industry to obtain updated employment data, and (3) that it will make site visits during the contract period.

→ *We acknowledge the Department of Community and Economic Development's agreement with most of recommendation 2, although we question whether attaching a Project Report Form to other employment verification documents fixes the existing problem whereby the Department already accepts other forms of documentation without requiring signed certifications. However, if the Department means that it will follow up on every piece of self-reported documentation to obtain an actual signed Project Report Form, then we would consider the matter resolved.*

We also have concerns regarding the Department's three responses to recommendation 3: (1) The Department's Opportunity Grant Program contract already requires that payroll records be made available to the Department; accordingly, the Department's response should have explained what will now be different. For example, not only should payroll records "be made available to the Department," but they should also be actively sought and evaluated at regular intervals by Department officials as a means to verify job numbers. (2) The Department says it will work with the Department of Labor and Industry to obtain employment data but does not explain whether it will obtain data for all grantees or a sample of them, or to what information the data will be compared or benchmarked. (3) The Department is

Opportunity Grant Program

especially vague about making site visits during the contract period, not explaining how often these visits will be made and what monitoring procedures will be performed.

Finally, we have an overall concern about how the Department of Community and Economic Development will monitor all of its promised new procedures and policies, and what it will do to bring about compliance with any such new requirements when grantees do not adhere to them. (For example, regarding the new requirements, the Department could strengthen its commitment letter/contract to grantees by including language about enforcement and penalties to the full extent of the law.) Our concern is based on the fact that the Department did not always monitor and enforce its requirements as they exist now and, accordingly, will have to step up its oversight to an even greater degree when it implements new requirements.

Finding Two

The Department of Community and Economic Development did not routinely check on or otherwise communicate with grantees until on or after the first "required" monitoring date, which was at least three years after grants were awarded.

The Department of Community and Economic Development required companies that were awarded grants during the audit period to submit proof of project expenditures prior to receiving the actual grant funding in the form of reimbursements. However, other than the review of expenditure documentation, Department officials responsible for monitoring compliance with grant requirements typically did not correspond or communicate with company officials to check on their job creation and retention results until a minimum of three years later.

It is important to note that the Department of Community and Economic Development is not required to check on or otherwise evaluate the progress of grantees before the specified three or five years have passed. Therefore, during our audit period, the Department violated no specific rule by not setting interim benchmarks or requesting other reports or updates to check on the companies' progress. Nevertheless, the ultimate result is that the Department routinely did not know how its grantees were doing until on or after the first required monitoring date, or whether grantees were progressing successfully toward their job goals. Equally important, this information was not made available to Pennsylvania taxpayers who should be told how their millions of tax dollars are being spent.

In defending the policy of not monitoring grantees prior to their first required monitoring date, Department officials said that such early monitoring would not contribute to improving program results. Conversely, the Department considered it an achievement upon assessing and collecting an early $3 million repayment/penalty from one grantee prior to the grantee's required monitoring date. In that case, the grantee actually volunteered to make a repayment/ penalty, a fact contradicting the Department's position that earlier communication with grantees would not bring about improvements. (See page 49 for more detail.)

Again, the Department of Community and Economic Development is not required to check on grantees prior to at least three years after the grantees are given thousands, or even millions of dollars. However, the Department does not need a specific requirement to do so. Stated another way, there is nothing to prohibit the Department from conducting "early" monitoring and, in fact, such monitoring is a matter of good judgment and accountability. Furthermore, the Department sets the stage for early monitoring in its written agreements between itself and grantees by saying that the Department may request progress reports at any time.

Early monitoring aside, how did the Department of Community and Economic Development perform its required three- or five-year monitoring?

Any testing of the Department's required monitoring process would have presented an inaccurate picture if we had included all the grantees who had not yet had their allotted three- or five-year period to fulfill their job commitments. Therefore, even though our audit period spanned five full years, we determined it would be more fair to limit our testing of the Department's monitoring procedures to only the 360 grantees who were awarded funds between the three years from July 1, 2000, and June 30, 2003. For approximately 90 percent of these grantees, the required first monitoring dates had already passed by the time of our testing in January 2006.

The "required" monitoring of grantees at the three- or five-year mark includes knowing how they have progressed and whether they met their job creation and retention requirements as well as their private investment requirements. Our testing showed that there is still more room for improvement in this required monitoring process as it was performed. Specifically, we found that—as of January 2006—the Department of Community and Economic Development was unable to provide job creation data for 21 percent of the companies (or 74 of the 360) that received grants between July 1, 2000, and June 30, 2003, even though approximately 45 of the companies were past their required monitoring date. Stated another way, as of January 2006, the Department did not know whether one-fifth of the 360 grantees had reached their employment goals by the allotted time. Conversely, on the positive side, the Department did receive job creation data from nearly four-fifths of the grantees, or 286 of the 360 of the grantees who received Opportunity Grants between July 1, 2000, and June 30, 2003, and who should have reported their results.

In analyzing the 286 grantees' reported job results, we divided the 286 grantees into four categories:

- **73 of the 286 grantees—26 percent—created or retained more jobs than required.** These grantees received $30.6 million and created or retained 18,370 jobs, which is 7,000 more than they projected.

- **24 of the 286 grantees—8 percent—created or retained the number of jobs required.** These grantees received $10.9 million to create 3,368 jobs and retain 10,571 jobs as expected.

- **104 of the 286 companies—36 percent—created or retained fewer jobs than required**. Together, these grantees received more than $25.8 million and retained all 7,449 jobs as required, but they created just 7,114 of the required 13,027 jobs.

- **85 of the 286 companies—30 percent—failed to create or retain any jobs and, in 80 of those cases, actually lost jobs**. These grantees, who received $20.3 million in Opportunity Grants, did not create any of the 11,678 jobs as required. Furthermore, instead of retaining 12,112 jobs as promised, the grantees reported a loss of 4,704 of those jobs.

A table with more detailed figures is on the next page. It should also be noted that, among the 189 grantees who failed to create/retain any jobs or who created/retained fewer jobs than promised, at least 5 of the 189 did not invest the required $4 for every $1 received.

Based on our analysis, the Opportunity Grant Program experienced successes as indicated by the first two categories. Unfortunately, for every reported success, we found at least two companies that did not create or retain the jobs to meet the requirements of their grants. By working even more diligently to switch that ratio to two successes for every failure, the Department of Community and Economic Development would provide even more support for its claim that the Opportunity Grant Program is successful in transforming Pennsylvania's economy and creating new opportunities for employment and investment.[27]

[27] See Commonwealth of Pennsylvania, 2006-2007 Budget in Brief, February 8, 2006, <http://www.budget.state.pa.us/budget/lib/budget/2006-2007/bib/2006_07_Budget_In__Brief.pdf>, Accessed July 5, 2006, p. 10; re-verified July 2, 2007.

As of January 24, 2006

Analysis of job retention and creation data for 286 grants totaling $87.6 million awarded during the period of July 1, 2000, to June 30, 2003

Reported job retention/creation results	# of grantees	% of total grantees	Total dollar amount of grants	Total reported jobs actually retained	Total jobs lost	Total reported jobs actually created	Total jobs projected but not created
Exceeded job projections	73	26%	$30.6 million	38,380	-0-	18,370	-0-
Met job projections	24	8%	10.9 million	10,571	-0-	3,368	-0-
Failed to meet projections	104	36%	25.8 million	7,449	-0-	7,114	13,027
Failed to meet projections and actually lost jobs	85	30%	20.3 million	12,112	4,704	-0-	11,678
Totals	**286**	**100%**	**$87.6 million**	**68,512**	**4,704**	**28,852**	**24,705**

At our meeting with Department officials to discuss the first draft report, officials were eager to report that, as of July 31, 2007, the number of companies that reported their results had increased from 286 to 348. As indicated earlier in this report, we agreed with Department officials to include their updated numbers, which we present in the next table.

Opportunity Grant Program

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
October 2007

--Updated--
As of July 31, 2007

Analysis of job retention and creation data for 348 grants totaling $117.8 million awarded during the period of July 1, 2000, to June 30, 2003							
Reported job retention/creation results	**# of grantees**	**% of total grantees**	**Total dollar amount of grants**	**Total reported jobs actually retained**	**Total jobs lost**	**Total reported jobs actually created**	**Total jobs projected but not created**
Exceeded job projections	98	28%	$41.4 million	44,196	-0-	25,950 *	-0-
Met job projections	38	11%	$13.9 million	11,971	-0-	4,986	-0-
Failed to meet projections	125	36%	$43.6 million	14,330	-0-	9,484	20,413
Failed to meet projections and actually lost jobs	87	25%	$18.9 million	12,636	6,430	-0-	11,021
Totals	**348**	**100%**	**$117.8 million**	**83,133**	**6,430**	**40,420**	**31,434**

* includes 8,649 more jobs than projected

With 348 of the 360 grantees included in the above numbers as of July 31, 2007, almost 97 percent of all the grantees reported their job results as required. The actual number of grantees that exceeded job projections increased by 25 in the intervening year and a half, and the number of grantees that met projections rose by 14 as well. The number of grantees who failed to meet projections increased by 21, and the grantees who actually lost jobs increased by 2. However, the overall percentages compared to the earlier data stayed about the same or improved by 5 percent at the most:

Comparison of reported job results between January 2006 and July 2007: Percentages did not change substantially			
	Results as of 1-24-06	**Results as of 7-31-07**	**Change**
No. of grantees reporting	286	348	**+ 62**
Percent of grantees exceeding job projections	26%	28%	**Improved by 2%**
Percent of grantees meeting job projections	8%	11%	**Improved by 3%**
Percent of grantees failing to meet job projections	36%	36%	**Stayed the same**
Percent of grantees that actually lost jobs	30%	25%	**Improved by 5%**

More frequent and timely communication with grantees could bring better results

According to interviews with Department officials, typically the only standard communications initiated by the Department to grantees were written requests for companies to complete their *Project Update Reports.* Again, these requests were sent out to the companies at the end of the project period. Department personnel did not visit the companies at their project sites to ensure they were complying with the requirements of their grant contracts.

Site visits and operational reviews would have provided the Department with greater assurances that the data on the *Project Update Reports* completed by company officials and submitted to the Department were valid. Because of the lack of communications and/or site visits, the Department had little knowledge of the project's development during the typical three- or five-year project period. On-site visits and communications between the parties might also have prevented the situations described later in this finding.

In comparison, economic development officials of Illinois, New York, Ohio, and Texas perform on-site monitoring/audits of the project sites to ensure that grant recipients report accurate information.

The "project monitoring date"—three to five years after grant funding begins—is the date when the Department starts monitoring grantees' progress

According to interviews with Department of Community and Economic Development officials, and also according to program guidelines, the Department determines the project monitoring date—which is the date the company is expected to meet the job retention/creation requirements and the project investment requirements. These requirements are based on the terms and conditions outlined in the commitment letter.

The commitment letter itself is a contract stipulating the terms of the grant and requiring the signature of an official representing the company as well as the Secretary of the Department of Community and Economic Development. As we have already noted, the Department typically sets the monitoring date for job retention and creation at three or five years after the date of the grant award. The monitoring date for the company to meet its private investment obligation (as required by law) may be different from the monitoring date for job creation/retention, but the Department's overall monitoring procedures are based on the job creation/retention date.

According to the Department's procedures, the Department is supposed to send a letter on the project monitoring date asking the company to complete the *Project Update Report* with job creation and/or job retention data and the private investment expenditures for the project. If the company does not respond, the Department is supposed to send a second and then a third and final request, both at 60-day intervals.

If a company does not respond after the third request, or did respond but failed to comply with its contract requirements, the Department considers the company noncompliant and begins the process of attempting to recover the grant funds.[28]

Thirteen of 40 sampled noncompliant grantees went out of business after having little or no communication from the Department

Our audit of the Department's grant monitoring procedures showed that the Department's procedures were not as effective as they could have been. We made this determination after examining 40 grant files in October 2006 and finding that, as of that month, 13 of the 40 companies had already gone out of business.[29]

[28] The penalty/repayment collection process is discussed further in Findings Three and Four.

[29] Because the Department of Community and Economic Development is not a secured creditor of the grantee business under Pennsylvania's Uniform Commercial Code, 13 Pa.C.S. § 1101 *et seq.*, or any other

- **Six of the 13 companies ceased operations <u>before</u> their monitoring date arrived, and the Department was unaware of the closures of at least three of the six companies until after those closures occurred.**

  Altogether, the 6 companies had been awarded $1.6 million in grants but, as of October 2006, the Department had collected penalties/repayments[30] totaling only $125,000 from just 2 of the 6 noncompliant companies.

  With respect to 3 of the 6 companies, we found the following:

  1. A steel manufacturing company in Bucks County received a grant for $250,000 in November 2000 and was out of business eight months later.

  2. A telecommunications company in Allegheny County was granted $900,000 in September 2001 and was out of business 16 months later.

  3. An electric generation company in Lebanon County received a grant for $100,000 in April 2002 and was out of business nine months later.

In all three of the preceding cases, the Department was unaware of the operational status of the companies until *after* they had ceased operations. The failure of the

applicable law, the Department is not entitled to participate in the bankruptcy proceedings other than to file a proof of claim to take a portion of what may be left after all secured claims have been paid.

[30] Please note that it is more accurate to refer to penalties as a **penalty(ies)/repayment(s)** throughout this report. Pursuant to 12 Pa.C.S. § 2107(c), the penalty amount to be imposed by the Department "shall be equal to the amount of the grant received **plus** an additional amount of up to 10% of the amount of the grant received." [Emphasis added.] However, as discussed later in this report, while the Department has a process in place for pursuing the recovery of an amount equal to the grant received from a noncompliant grantee, it has **<u>never</u>** sought to impose an additional penalty amount of up to 10% of the grant as it is authorized to do by law.

Department to communicate routinely with officials from the companies and to monitor the status of the grant-funded projects in a timely manner left it in a poor position to recoup the grant funds that had been disbursed. In some cases when companies closed, the Department became aware of the closures only from media reports or sources other than the company itself.

- **The remaining 7 of the 13 out-of-business companies shut down *after* their monitoring dates.**

  The following three examples further reflect weaknesses in the Department's monitoring and communication.

  1. In August 2001, a pharmaceutical company in Cumberland County received a grant of $150,000. The grant contract required the company to invest $5 million in private funds by August 2003, and to create 50 full-time jobs by August 2004.

     The Department's file contained no evidence of <u>any</u> communications with the company prior to July 2005, when a letter went out asking the company for a project update. That date was <u>four years</u> after the grant was awarded, <u>two years</u> after the date that private funds should have been invested, and <u>one year</u> after the date that 50 full-time jobs should have been created.

     Unbeknownst to the Department, the company had actually merged with a Maryland-based company in April 2004 and ceased operations at the Pennsylvania facility. The Department only became aware of the merger in July 2005, when it did not receive a response to the request for a project update. The Department confirmed the merger via its own research and also determined that it was unable to pursue a penalty/repayment from the new company. Accordingly, the penalty/repayment was deemed to be unrecoverable.

2. In June 2001, a solar power company in Westmoreland County received $100,000 to purchase machinery and equipment. The grant contract required the company to invest $16 million in private funding by August 1, 2002, and to retain 77 jobs and create 43 jobs by July 1, 2003.

   Again, for more than three years after the grant was awarded, the Department had no contact with the company. Then, in September 2004, which was <u>two years</u> after the private investment contribution was due and <u>one year</u> after the jobs should have been created, the Department requested the project update report from the company. We do not know if anything more specifically prompted the Department's request at that time other than a need for an update. However, the company did not respond to this request so, four months later in January 2005, the Department sent a second request for job creation and retention information. The company once again did not respond.

   As the Department would soon learn, the company had shut its doors in November 2002, which was only 17 months after receiving the grant but still <u>after</u> the first project monitoring date had passed.

   In this case, the Department did assess a penalty/repayment for the full amount of the grant but also deemed any other penalty over and above the grant amount to be uncollectible.

3. In September 2002, a manufacturing company in Jefferson County was awarded a $100,000 grant to

purchase machinery and equipment. The company promised to retain 205 employees, create 70 jobs, and invest $10 million in private funding by April 2005.

The Department of Community and Economic Development had no contact with this company for almost three years when the Department, in accordance with its monitoring procedures, sent the request for the *Project Update Report* to the company in May 2005. The next communication in the file is another letter from the Department in October 2005 informing the company that it was noncompliant and requesting a check for the full amount of the grant. Had the Department communicated earlier, it would have found that the company had already filed for bankruptcy protection and ceased operations in July 2005.

Once again, the Department was unable to pursue a penalty/repayment and instead deemed the funds to be uncollectible. We did not find evidence that the Department took action as a creditor to seek company assets, if any existed.

In all three of the preceding examples, the Department appeared to have no knowledge of the companies' operating status until after it had allowed the required monitoring dates to pass, by which time the companies had gone out of business. Had the Department periodically monitored each company's compliance with its investment and job requirements from the start of the project, the Department may have been able to intervene and assist each grantee to move toward success or, if not, to recoup funds prior to a grantee's going out of business.

Stronger monitoring would result in greater accountability

In all the preceding cases, the Department's monitoring resulted in too little accountability regarding the spending of taxpayer dollars. The companies in our sample of 40 each signed contracts in order to receive the taxpayer-funded grants, but the contracts did not ensure successful results.

We also found the Department was sometimes late when we looked at the timeframe for <u>required</u> monitoring. In our 40 sampled files, there were 34 companies still in operation as of their first required monitoring date (as noted in their grant commitment letters), and the Department was late in requesting project status reports in 22 of the 34 cases. For 12 of those 22 cases, the Department was late by more than a year.

The Department's failure to comply with its own timeliness requirements indicates a problem in management's internal control procedures. On the project monitoring date—which the Department itself determines—the Department was supposed to have sent letters to company officials requesting them to forward project updates. Allowing three or five years to pass before requiring the first project update is already too long, but allowing even more time to pass only exacerbates the problems related to infrequent or untimely communications.

What the Department should do better

The Department of Community and Economic Development must be more aggressive at monitoring grantees. It can do so by standardizing and documenting the "due diligence" activities performed by the specialists in the field even before a grant is awarded, by setting individual grant award limits, by communicating more, and by asking questions sooner than three years after grants are awarded.

The Department of Community and Economic Development should implement standardized and documented procedures for the application process. Due diligence activities are performed by the Governor's Action Team development specialists[31] for grants processed as part of a GAT offer. A small number of grants are non-GAT projects and are subject to due diligence performed by economic development analysts in the Grants division of the Department. Department officials explained that the Opportunity Grant application process includes, but is not limited to, the following review steps:

- Review the company's history.
- Determine if the company has received previous awards from the Department (applicants may not receive assistance for more than two consecutive fiscal years for the same project).[32]
- Review the status of all current projects of the company.
- Review the company's financial position and tax status.
- Meet with company officials to discuss the company's business plan, including future expansions.
- Assist company officials in the development of a grant proposal.

[31] According to a Department official, 15 development specialists work on 300 to 500 active projects with Pennsylvania companies annually.

[32] 12 Pa.C.S. § 2108(1). *See also* Department of Community and Economic Development's *Opportunity Grant Program, Program Guidelines*, March 2004 and December 2006, available at www.newpa.com/programDetail.aspx?id=41. Accessed July 12, 2006; re-verified July 2, 2007.

Unfortunately, we found—and Department officials confirmed—that the preceding procedures were not documented in the Department's procedure manual. Therefore, it was not possible for us to verify that Department staff actually followed the procedures. In fact, our review of grant files of both the GAT specialists and the Department analysts, showed that documentation of any such steps varied from file to file, thereby raising a legitimate question about the performance of the procedures as prescribed.

The importance of evaluating companies during the application process is essential not only for ensuring Opportunity Grant eligibility, but also to determine—through detailed analysis—the likelihood that a company will successfully comply with its contract requirements. Without standardized and documented procedures, the Department cannot ensure that all applications are processed consistently and that grants are disbursed prudently.

It's important to note that we did find, in our review of applications for Opportunity Grants, that the applications indicated that eligibility criteria had been met. However, we did not find evidence of <u>how</u> Department officials had verified the criteria.[33] Nor did we find that, on the part of the applicant, the highest-ranking company official had been required to sign application materials such as the

[33] Prior to our audit period, the Department of Community and Economic Development used a "scoring matrix" as a basis for determining whether a company and its project were suitable for the Opportunity Grant Program. Although a high score on the matrix could not guarantee success, it was a consistent and fair method to evaluate all prospective companies and their projects. According to a Department official, the use of the scoring matrix to determine eligibility was discontinued in late 1999 or early 2000. The electronic record for each Opportunity Grant Program project still contains the scoring of the project but it is now used as a tool, after the grant is offered, to ensure that all criteria information was captured. It should be noted that the program guidelines were never revised to reflect this change in procedure for determining eligibility.

application, letter of intent, or contract.[34] As discussed previously, the Department should require at least two signatures on company-prepared applications and reports, including the highest ranking official and the chief financial officer.

Grant award limits for any single project must be set. We also found during our review that the Department has yet to comply with the grant program's governing legislation that requires the Department to develop guidelines that, among other things, establish a grant size limitation for any single project.[35] As of October 2006, the Department had not set such a maximum dollar limit. As we previously reported, the grant size varied from just $153 for flood relief to $12 million for land acquisition to construct a new facility.

Not setting a grant amount limit leaves the door open for the Department of Community and Economic Development to award excessively large grants, a situation that actually occurred following application by The Vanguard Group, Inc., for an Opportunity Grant of $12 million in November 2000. The grant was intended to assist with Vanguard's acquisition of land in Chester County and construction of a building on that land and also with Vanguard's expansion of its existing corporate offices nearby. In return for the grant, Vanguard promised to create 6,000 full-time jobs at the two project sites within ten years—or five years following the completion of a highway upgrade—and also to invest $500 million in private funds.

Subsequently, in April 2002, the Department of Community and Economic Development issued a check to Vanguard for $12 million. However, as of June 2007,

[34] These application materials include the Opportunity Grant Program contract containing standard terms and conditions applicable to all grantees and the commitment letter that is attached to the contract as an appendix and contains the project specific terms and conditions.
[35] *See* 12 Pa.C.S. § 2109(1).

construction of the highway upgrade had yet to begin and is not expected to begin until sometime in 2008. Consequently, the construction of the building has not begun either and, therefore, no jobs have been created at the new site. Subsequently, in August 2007, Department officials informed us that as of July 2007 the company did create an additional 2,000 jobs at its existing facility and also paid a $3 million penalty for not meeting the additional job requirements as specified in the grant agreement.

In this case, it is clear that the Department of Community and Economic Development agreed to at least one condition—that is, the upgrade of a highway—that was far outside the control of both the Department and the grantee. The Department's agreement to an ancillary condition such as that one, or to any other such ancillary conditions that are not directly and precisely responsible for job creation or retention, is not a good use of the Department's discretion.

The Department must communicate with grantees sooner and more often and must make visits a part of the process. While the Opportunity Grant Program contracts do not require recipients to communicate with the Department and/or the Governor's Action Team during the initial three-year period, the contract does require companies receiving grants to make all grant-related files available for inspection by the Department.[36] The contract also gives the Department "the right to make reasonable inspections to monitor the Grantee's performance under this Contract."[37]

In October 2005, a Department official responded to our concerns regarding the lack of grant monitoring by stating that "the level of staff available to handle grant processing

[36] Article X, Records, "Standard Opportunity Grant Program Contract," the Department of Community and Economic Development, The Commonwealth of Pennsylvania.
[37] Article XI, "Progress Reports," ibid.

does not allow us to conduct field visits. However, with the addition of new staff to handle new Stimulus Programs, staffing capacity should permit periodic field visits on a selected basis."[38] This official also stated that *some* companies do receive a site visit through the Department's Business Retention and Expansion Program (BREP). Business outreach specialists are supposed to visit companies awarded Opportunity Grants at the end of the second year of having received the grant. According to BREP officials, the purpose of the visit is to identify issues and problems facing the companies and provide solutions from an extensive network of service providers, when appropriate.

While this process appears to be a step in the right direction, it does not go far enough in actually monitoring a grant recipient for the following reasons:

- These visits did not determine company compliance with their grant requirements.
- The results of the visits were not reported to the Department's Performance Monitoring Division.
- The visits were conducted only for projects identified by the Governor's Action Team.
- The visits were not scheduled until two or more years after the grant was awarded.

Summary

The Opportunity Grant Program has had both successes and failures. To encourage further successes and to

[38] October 26, 2005, memorandum from the Deputy Secretary for Business Assistance (Department of Community and Economic Development) to the Deputy Auditor General for Performance Audits (Department of the Auditor General).

make both the grantees and the Department of Community and Economic Development more accountable for the Opportunity Grant Program, there must be more effective monitoring and more frequent communications. To that end, the Department of Community and Economic Development should visit ***all*** project sites periodically and maintain open and ongoing communications with company officials and, internally, with the Governor's Action Team. The Department should also perform more due diligence activities when grant applications are received, and it should include in its grant guidelines a maximum grant limit for any single project as required by law. By increasing its efforts in all these areas, the Department will be better able to intervene with supplementary offers of assistance that may promote increased project success. In addition, the Department will be in a better position to validate the job statistics that grantees currently self-report.

Overall, monitoring of Opportunity Grants should be an ongoing process that begins with the application process and ends only when the company meets its contractual requirements. In allowing years to pass with little or no communication with grantees, the Department is compromising its responsibility and accountability for this taxpayer-funded program.

Recommendations

4. The Department of Community and Economic Development should develop and implement additional monitoring procedures that would include performing periodic site visits by Department staff throughout the project period, beginning within the first year of the initial disbursement, as a condition of the grant agreement. The visits should also involve a review of project expenditures and employee payroll records.

Target date: Begin planning immediately; implement recommendation in full by June 30, 2008.

5. The Department of Community and Economic Development should maintain regular communications with companies between the time that the Department announces the grant award and the date that the Department begins to monitor the project. The regular communications could include the exchange of electronic mail between the Department and company officials.

Target date: Begin planning immediately; implement recommendation in full by December 31, 2007.

6. The Department of Community and Economic Development should consider pursuing legislation that would require companies to submit *Project Update Reports* at least <u>annually</u>. Furthermore as noted in Finding Three, Recommendation #11, the Department should require grantees to report <u>immediately</u> any changes or potential changes in operating status, such as a merger or closure, before that change actually occurs. These reports should include language that subjects the highest-ranking company officials to penalties for unsworn falsification to authorities.

Target date: *Begin immediately*.

7. The Department of Community and Economic Development should develop standard procedures so that grant applications are evaluated consistently.

Target date: Begin planning immediately and implement recommendation in full by June 30, 2008.

Opportunity Grant Program

8. The Department of Community and Economic Development should require two signatures on every grant application, letter of intent, and contract[39] including the signature of the applicant company's highest ranking official as well as the company's chief financial officer.
Target date: Begin immediately.

9. The Department of Community and Economic Development should develop guidelines setting a maximum grant amount as required in the law establishing the Opportunity Grant Program.
Target date: Begin immediately.

10. The Department of Community and Economic Development should not agree to any grant conditions that are not directly and precisely tied to job creation/retention. For example, the Department should not agree to conditions or contingencies that are far outside the control of either the grantee or the Department, and for which Opportunity Grant funds will not be used.
Target date: Begin immediately.

[39] This includes the standard contract applicable to all grantees and the commitment letter that is attached to each contract. Also, we note that while the current contract does require the signatures of two officers of the company, it does not specifically require the signatures of the highest-ranking official and the chief financial officer.

<u>Summary of the Department of Community and Economic Development's response to Finding Two</u>

followed by*, in italic type,*

<u>Evaluation of the Department of Community and Economic Development's response by the Department of the Auditor General</u>

[Note: See the Department of Community and Economic Development's full response beginning on page 90.]

- The Department of Community and Economic Development responded to recommendations 4 through 10 as follows: (4) its contracts will require companies to make payroll records available for review; (5) it will institute the recommendation to make early and regular contact with grantees; (6) it would not need legislation to require grantees to report job results annually; (7) it would "continue" to use standardized criteria in evaluating the impact of projects; (8) it would require two signatures on applications, letters, and contracts as recommended; (9) it would establish a maximum grant amount as required by law; and (10) it already has a policy by which it should not agree to conditions or contingencies that are outside the control of either the Department or its grantees.

  → *We acknowledge that the Department of Community and Economic Development appears to agree with recommendations 4, 5, 8, and 9.*

  Regarding recommendation 6, the Department believes it can improve program oversight without an amendment to the Opportunity Grant Program's governing legislation. It is unclear why the Department would not seek legislation as a way to provide additional weight to its program oversight, *and also to ensure that future administrations will be subject to stronger oversight requirements.*

Regarding recommendation 7, the Department asserted that it "continues" to use standardized criteria, thereby suggesting that standardized criteria are already in use. However, we saw no such evidence and, in fact, a Department official informed us during our audit work that written evaluation procedures did not exist.

Regarding recommendation 10 and the Department of Community and Economic Development's response that its program guidelines already address our concerns, we disagree. Specifically, our position is that the Department, when awarding grants, should not agree to conditions that are outside the control of either the grantee or the Department. However, the Department did agree to such conditions when it gave the $12 million grant to the Vanguard Group in 2002 as we explain in our report. Most recently, on October 19, 2007, the Department told us verbally that the contingency was an anomaly, that such a contingency would not be agreed to by the current administration, and that the program guidelines clearly make grant awards contingent on job creation and retention results and not on other conditions. For our part, we believe that just because the program guidelines do not discuss such contingent conditions does not mean that the Department would not agree to such contingencies in the future. Therefore, our recommendation remains unchanged.

Finding Three

The Department of Community and Economic Development improved its performance in assessing and collecting penalties when companies fell short of their job projections, but it did not use its enforcement authority to the fullest extent possible.

As provided for in statute and in the program guidelines, the Department of Community and Economic Development expected companies that received Opportunity Grant Program dollars to meet three requirements:

- First, that the companies retain and/or create the number of projected jobs in Pennsylvania
- Second, that they raise the funds—$4 of private investment for every $1 of grant—for the project
- Third, that the company operate at the project site for a minimum of five years[40]

The companies receiving Opportunity Grants had, in most cases, at least three years to complete the project and begin to comply with the job creation/retention and private investment requirements. During this three-year period, as we reported previously, the Department of Community and Economic Development rarely verified the status of the project or intervened in its progress.

When a company failed to meet any of the requirements noted above, the Department of Community and Economic Development should have assessed a penalty/repayment as mandated by state law.[41] "The amount of a penalty shall be equal to the full amount of the grant received plus an

[40] 12 Pa.C.S. § 2107(a).
[41] *See* 12 Pa.C.S. § 2107.

additional amount of up to 10 % of the amount of the grant received," according to the state law.[42] The Department also has flexibility in determining whether to charge interest and whether to require repayment in one lump sum or in installments.[43] The Department may waive the penalty/repayment completely or partially if it determines that a company's failure to satisfy its obligations was due to circumstances outside of the company's control.[44]

Companies cannot deny their awareness of the grant's penalty/repayment provisions. The following penalty/repayment clause appeared in each commitment letter and contract we reviewed:

> If the Company fails to create the number of jobs specified above, fails to invest the amount of private funding specified above, or fails to operate at the Project site for at least five years, the Company shall be liable for a penalty equal to the full amount of the grant awarded to them or to an Applicant on their behalf, unless the penalty is waived by [the Department of Community and Economic Development] because failure is due to circumstance outside the control of the Company.[45]

Our audit revealed three concerns relating to the Department of Community and Economic Development's process of holding companies accountable for their failure

[42] 12 Pa.C.S. § 2107(c).
[43] Ibid.
[44] 12 Pa.C.S. § 2107(b).
[45] Excerpt from standard Opportunity Grant Program Commitment letter, Department of Community and Economic Development, Commonwealth of Pennsylvania. Please note, however, that (as recommended in the previous finding following the discussion of Vanguard) the Department of Community and Economic Development should never agree to award grants based on conditions that it <u>knows</u> are outside the company's control from the outset.

to meet contract requirements. These three concerns pertain to the Department's rate of securing penalties/repayments, its failure to utilize its legal authority to improve collections, and company eligibility for future grants.

1. **During the audit period, July 1, 2000, through June 30, 2005, the Department of Community and Economic Development collected only a fraction of the $26.2 million in penalties/repayments it assessed. However, improvement has been made with Department officials reporting that penalty collections have doubled in the past two years.**

   In July 2006, when asked about projects in which companies created no jobs and penalties/repayments were not collected, the Secretary of the Department of Community and Economic Development told a television reporter, "If there were no jobs created, we're going to recover money if there's money to recover."[46]

   As of September 13, 2005, the Department of Community and Economic Development assessed $26.2 million in penalties/repayments over the life of the program. As of October 2005, the Department collected only 13 percent, or $3.35 million, of the $26.2 million assessed. Therefore, more than $22 million, or 87 percent of assessed penalties/repayments, had not been collected as of October 2005. The Department levied this $26.2 million, or 63 percent of the $41.6 million total dollars awarded in grants, against 156 companies that failed to comply with their contractual obligations. The Department voluntarily gave up the

[46] Paul Van Osdol, "Team 4 Investigates: Where Are the Jobs?," WTAE-TV 4, The Pittsburgh Channel, July 14, 2006, <http://www.thepittsburghchannel.com/news/9521151/detail.html>, Accessed July 24, 2006; re-verified July 2, 2007.

right to collect the remaining $15.4 million, or 37 percent of the total dollar amount of the grant awards.

Many of the penalties/repayments assessed but uncollected were for grants dating back to before July 1, 2000. Of the $26.2 million in penalties/repayments, $13.5 million were for 67 grants awarded prior to July 1, 2000. As of October 2005, the Department collected only $1.9 million of the original $13.5 million due. Clearly, the Department should make a determination on these penalties/repayments by either taking action to collect the penalty/repayment or writing off the penalty/repayment as uncollectible, because, in some cases, ten years has elapsed since the awarding of the grant.

The table on the next page illustrates penalties/repayments assessed and collected as of October 31, 2005, for companies awarded grants from 1996 through 2004.

Opportunity Grant Program

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
October 2007

Penalties/Repayments Collected as of October 31, 2005, on Grants Awarded 1996 – 2004					
Fiscal Year of Grant Award	**Number of Companies Penalized**	**Dollar Amount of Penalties/ Repayments Assessed**	**Number of Companies That Paid Penalties/ Repayments**	**Dollar Amount of Penalties/ Repayments Collected**	**Dollar Amount of Penalties/ Repayments Not Collected**
1996-1997	7	$1,451,862	2	$211,862	$1,240,000
1997-1998	21	5,842,000	7	497,000	5,345,000
1998-1999	14	2,169,600	6	725,000	1,444,600
1999-2000	25	4,077,698	6	515,000	3,562,698
2000-2001	63	9,036,575	11	1,115,416	7,921,159
2001-2002	22	3,380,500	6	203,083	3,177,417
2002-2003	3	185,000	1	85,000	100,000
2003-2004	1	100,000	0	0	100,000
Total	**156**	**$26,243,235**	**39**	**$3,352,361**	**$22,890,874**

Data source: The Department of Community and Economic Development
Note: The Department of Community and Economic Development awarded $41.6 million in Opportunity Grants to these 156 companies.

The Department of Community and Economic Development performed its collection procedures in-house and, if the company was still in operation on the company's project monitoring date, the Department sent a series of letters to the company requesting payment of the penalty/repayment. If company officials failed to respond to the letters, the penalty/repayment was forwarded to the Department's Office of Chief Counsel for collection. Alternatively, in a case in which a grantee went out of business prior to its monitoring date, the Department would have designated the company as "noncompliant," assessed a penalty/repayment, and forwarded the file to the Department's Office of Chief Counsel to pursue collection.

According to a Department official, when a company files for bankruptcy, a review of case-specific financial information available through the U.S. Bankruptcy Court's electronic records system is performed by the Department to determine if assets exist. If assets exist, a *Proof of Claim*[47] is filed in court by the Department in an attempt to collect on all or a portion of the grant funds as an unsecured creditor. Further, if a company goes out of business without filing for bankruptcy, the Department also attempts to determine if assets exist. If assets are found to exist, a letter is sent to the company demanding repayment of the grant. If the company does not respond or if the company and the Department cannot reach an agreement on a repayment schedule, then the Department may pursue litigation against the company. In both cases, if the Department determines that the company does not have assets, then the Department will "write off" the grant as uncollectible.

During our audit period, more than 87 percent of the penalties/repayments assessed were not collected. In 2003, Department officials recognized that more emphasis was needed on the collections process and addressed the issue by centralizing the monitoring process to allow for what officials believed would be better oversight, and by hiring a full-time lawyer to deal exclusively with noncompliant companies.

The Department has continued to improve in the area of penalty collections. For example, in August 2007, officials reported to us that penalty collections have doubled since the end of the audit period. Specifically, the Department has collected more than $7 million in penalties since 2005. These latest collections bring the

[47] A "proof of claim" is a written statement, filed by a creditor, describing the reason a debtor owes the creditor money. (There is an official form for this purpose.) (www.bankruptcyaction.com/bankruptcydictionary.htm) Accessed July 5, 2007.

total collected as of August 2007 to nearly $11 million, which is 30 percent of the total amount of penalties assessed against 240 noncompliant companies (the percentage was 24 percent prior to the July 2007 penalty payment of $3 million by Vanguard that we discussed on page 49).

There is still room for improvement. For example, Illinois, New York, Ohio, and Texas actively pursued grant repayment from companies that failed to meet their grant requirements during the grant period. Because these states required annual status reports, it appears that they addressed noncompliance in a more timely manner than Pennsylvania. Illinois, New York, and Texas require companies to meet certain levels of employment before disbursing the total grant funds. These states did not release the remaining grant funds until the companies had met specific employment levels.

According to a Department of Community and Economic Development official, there were 36 Opportunity Grants that had job performance measures, such as those noted in the states above, included in their contract requirements. However, none of the grants reviewed during our audit contained language that the release of funds was contingent on a company's achieving performance measures.

The failure of the Department of Community and Economic Development to be more aggressive at pursuing penalties/repayments for noncompliance may lead to lax performance on the part of companies receiving Opportunity Grants. An effective collection process will provide a greater incentive for companies to comply with contract requirements.

2. The Department of Community and Economic Development did not use its full authority under the law to impose additional penalties or improve collections on noncompliant companies.

During the audit period, the Department failed to use its full legal authority to penalize companies that did not meet their commitment to create and/or retain jobs, invest private dollars, and operate for five years.[48] The Department did not include a clause in either the standard contract or the commitment letter requiring that a grantee pledge collateral as security for all or even a portion of grant funds to ensure grant repayment in the event a company was unable to fulfill its commitment.

- **The Department of Community and Economic Development did not impose the additional 10 percent penalty permitted by law.**

  Officials from the Department of Community and Economic Development indicated that the penalty/repayment amount was sufficient and that adding an additional penalty on top of a previously issued penalty/repayment would be detrimental to the company.

  Under state law, the Department of Community and Economic Development is required to impose a penalty of at least 100 percent of the grant amount plus an additional amount of up to 10 percent of the grant amount received by the company.[49] However, the Opportunity Grant Program guidelines state that the sum total of the penalty/repayment and the additional 10 percent is at the discretion of the

[48] 12 Pa.C.S. § 2107(a).
[49] 12 Pa.C.S. § 2107(c).

Department.[50] The guidelines state: Private companies that receive Opportunity Grant dollars "***are liable*** for a penalty of ***up to*** the full amount" of the award, plus an additional penalty of up to 10 percent of the grant amount.[51] [Emphases added.]

The Department could assess the additional 10 percent penalty when companies intentionally disregard the contract requirements and misuse the grant funds. The additional penalty could also be used as leverage against companies that fail to negotiate or pay their penalty in a timely manner. Finally, the additional penalty could be used as a tool to encourage company compliance with their grant requirements.

- **The law allows the Department of Community and Economic Development to require companies to post collateral, but the Department used this option on a very limited basis.**

State law also allows the Department of Community and Economic Development to "impose…a provision requiring collateral to secure repayment of any penalty imposed under the program."[52] To meet this requirement, companies would have to assign assets to reduce the risk assumed by the Department.

[50] As noted earlier, the Department is authorized under 12 Pa.C.S. §2107(b) to waive any penalty/repayment if it determines that noncompliance is due to circumstances outside the control of the grantee.
[51] Opportunity Grant Program Guidelines, March 2004 and December 2006, p. 4, www.newpa.com/programDetail.aspx?id=41, Accessed July 12, 2006; re-verified August 22, 2007.
[52] 12 Pa.C.S. § 2106(3). Because, as noted earlier, the penalty amount that the Department may impose pursuant to 12 Pa.C.S. § 2107(c) is "the full amount of the grant received plus an additional amount of up to 10% of the amount of the grant received," the Department is currently authorized to require collateral to secure repayment of not only the amount of the grant received but also an additional 10% of that amount.

According to a Department official, the Department required the attachment of collateral security, in the form of a demand note which requires payment upon demand of the lender, to only six of the 724 grants awarded. To date, only one of these companies has been deemed noncompliant.

According to the official, this noncompliant company actually went out of business but had started to pay back the penalty/repayment before the Department had to invoke the terms of the note. However, the company was unable to repay the full amount of the penalty/repayment and the Department has yet either to pursue reimbursement of the full penalty/repayment or to invoke the collateral security clause in the contract.

The Department has discretion and flexibility in using this provision but, generally speaking, the Department is hesitant to use this provision since "in most cases, because of demands by lenders, taking such collateral hampers a business's ability to secure bank financing and is therefore counter-productive to the OGP goal to spur economic development and job creation and retention in Pennsylvania."[53] We encourage the use of this provision not as a punishment, but as a program safeguard. The Department should use all authority granted under the law to ensure the proper use of the public tax dollars awarded through these economic development grants.

In addition, in exercising its current discretionary authority to impose a collateral requirement, the Department should use that authority far more frequently. This action is particularly important in

[53] August 21, 2007. Written response to the Department of the Auditor General's first draft report from Department of Community and Economic Development officials.

cases where the grant award is higher and/or the potential exists for the grantee to not meet its contract requirements.

3. **The Department of Community and Economic Development allowed companies that failed to meet their contract requirements to apply for and possibly be awarded future economic development grants within a few short years after their failure.**

According to Department guidelines for assisting noncompliant companies, a company that fails to meet program requirements may receive future grants under one of two conditions:

- The company subsequently achieves the previous program commitment or requirement.
- A three-year probation period elapses. (The probation period begins on either the date of the waiver or the date the penalty/repayment is applied.)

If the Department assesses a penalty/repayment on a grant award, the company must pay the agreed-upon penalty/repayment amount before the Department will consider additional funding requests.

An official from the Department emphasized that the Department tracks grants solely by company name, and that the guidelines apply only to the companies—not the owners or officers of the companies. If officials of a noncompliant company closed down operations shortly after receiving grant funds, they become eligible for grant funding when they open another company under a different name.

The Department could assess and pursue collection of a penalty/repayment against the company that went out of business. However, because the Department is not a secured creditor,[54] recouping grant funds after a company closes is unlikely.

Stakeholders expect the Department of Community and Economic Development to implement and enforce the provisions of the law that established the Opportunity Grant Program. Furthermore, taxpayers expect the Department to accept and carry out its administrative responsibilities and put tax dollars to good use. The Department must do a better job.

Summary

As of October 31, 2005, the Department of Community and Economic Development assessed $26.2 million in penalties/repayments over the life of the Opportunity Grant Program but had collected only 13 percent of that amount. The Department has made improvements in this area, as evidenced by the additional penalty collections in the past two years, and should continue to do so. Assessing and collecting penalties/repayments is important to convey to grantees—and to taxpayers who fund the grants—that companies must be accountable for the help they receive. The Opportunity Grant Program is not a "free lunch," the contract is clear about the implications for companies that fail to meet contract requirements, and there are strings attached to Opportunity Grant dollars. Recipients must meet job retention, job creation, and a four-to-one private/public investment ratio. When companies do not

[54] A creditor who has charge over the assets of a debtor in the event of the debtor failing to meet his/her obligations. http://www.finance-glossary.com/terms/secured-creditor.htm. Accessed January 8, 2007; re-verified July 2, 2007.

meet these figures, the Department should assess penalties to the full extent of the law.

Recommendations

11. The Department of Community and Economic Development should increase the number of grants for which the full amount of funding is not disbursed until certain performance goals (i.e., related to job results and investment amounts) have been achieved. Therefore, if the company is not on track to meet its job and investment goals, the Department can amend the grant award accordingly.
Target date: Begin immediately.

12. The Department of Community and Economic Development should implement additional procedures to improve its timeliness of actions in the collection of penalties/repayments, such as a clause in the contract that requires a company considering closure or any other changes in operating status to notify the Department immediately. Failure to notify the Department should result in additional penalties, which the Department should impose and enforce.
Target date: Begin immediately.

13. The Department of Community and Economic Development should more frequently exercise its authority to impose a collateral requirement on grantees, particularly for grantees who request higher grants and/or who are more at risk for not meeting job creation and retention requirements. In its contracts with grantees, the Department should incorporate language about the collateral and penalty provisions; the Department should then enforce these provisions. Furthermore, the Department should consider contracting out its collection services if it is unable to collect penalties effectively on its own, particularly in extreme cases.

Target date: Begin planning immediately; implement recommendation in full by June 30, 2008.

14. The Department of Community and Economic Development should develop procedures that would enable the Department to track the name of the company owners and other principals receiving grants in addition to the name of the company when noncompliance with grant requirements occurs. The Department should be wary of awarding grants to companies whose employees/officials were associated with failed companies that received previous grants.

Target date: Begin planning immediately; implement recommendation in full by December 31, 2007.

Summary of the Department of Community and Economic Development's response to Finding Three

followed by, *in italic type,*

Evaluation of the Department of Community and Economic Development's response by the Department of the Auditor General

[Note: See the Department of Community and Economic Development's full response beginning on page 90.]

- Recommendations 11 through 14 are covered in this summary. Regarding recommendation 11, the Department of Community and Economic Development responds that it has significantly increased the number of performance-based awards and will continue to do so. Regarding recommendation 12, the Department will modify its grant commitment letters and contracts to require grantees to notify the Department when they close or undergo any substantial adverse change in their operations. Regarding recommendation 13, the Department responds that it has placed an emphasis on enforcement, has collected $10.5 million from grantees that failed to meet performance objectives, is awaiting an additional $3.7 million in repayments/penalties, and has collected more repayments from grantees in each year of the current administration than had been collected over a three-year period of the previous administration. Regarding recommendation 14, the Department claims that it already tracks companies that fail to meet their contract requirements and considers such information on future grant decisions.

→ *Regarding recommendation 11, the Department of Community and Economic Development followed up our exit conference by providing us with a list of 36 grantees who were subject to performance-based awards. However, the Department provided us no details or supporting documentation to confirm that these grantees were, in fact, required to meet performance goals. Furthermore, even if all 36 grantees did have to meet performance goals, there are still more than 900 other grantees who have no such requirements.*

Regarding recommendation 12, and as we previously discussed with regard to recommendation 6, we acknowledge the Department of Community and Economic Development's response that program improvements will be made.

Regarding recommendation 13, we acknowledge the response by the Department of Community and Economic Development that it will improve its *enforcement of program and contract requirements. However, with regard to the $10.5 million in collections, it is important to note that, during the current administration, collections were made on only 94 out of a population of 240 penalized companies as of August 2007. The reported amount of $10.5 million includes a* ***voluntary*** *$3 million payment from one company and also a $250,000 amount that the Department wrongly recorded as collected. Again, as was the case with the Department's reporting of its program success as we discussed in Finding One, the Department fails to supply all the details necessary to provide the clearest picture of its performance.*

The Department's response is silent regarding our recommendation that it should more frequently exercise its explicit authority in law to impose a collateral requirement on grantees, particularly grantees who request higher grant amounts or who are more at risk for not meeting job goals. We deem the collateral requirement to be an effective tool for the Department to ensure greater compliance with grant requirements, thereby adding a safeguard to prevent losses of the taxpayer-funded grant monies.

Regarding its response to recommendation 14, the Department of Community and Economic Development did not address the tracking of individual owners or officers of companies that fail to comply with the grant requirements. We did acknowledge in the report that the Department already tracks <u>companies</u> that previously failed, but the Department should now implement additional safeguards to ensure that it does not award grants to owners and officers of companies that have failed to meet their contract requirements in the past.

Finding Four

The Department of Community and Economic Development waived more than $49 million in penalties/repayments to 187 noncompliant companies.

The Department of Community and Economic Development may waive penalties when it determines that the project is noncompliant "due to circumstances outside the control"[55] of the company. The Department Secretary may grant one of the following waiver options at any time—even before imposing a penalty/repayment:

- The Department may authorize a full waiver, that is, not impose a penalty/repayment, and forgive the entire amount of the Opportunity Grant.
- The Department may authorize a partial waiver, where the company is assessed a portion of the penalty/repayment and the Department forgives the remainder of the penalty/repayment.
- The Department may grant an extension, which allows the company additional time to meet the contracted number of retained and created jobs and the four to one public/private investment ratio.

According to a Department official, since 2004, the Department Secretary has been involved in determining the assessment of penalties/repayments against noncompliant companies and has thus placed an increased importance on this issue. Department officials also told us that penalties/repayments assessed against noncompliant companies are negotiable and can be amended upward or downward at any time from the time of assessment to the time of final payment. The officials emphasized that they evaluate penalties/repayments on a case-by-case basis and

[55] 12 Pa.C.S. § 2107(b).

that the final decision is left to the discretion of the Department Secretary.

As shown below, since the inception of the Opportunity Grant Program in 1996, the Department of Community and Economic Development waived more than $49 million in repayments by not assessing penalties/ repayments at all, or by modifying penalties/repayments that were initially issued to companies that failed to meet their contract requirements. Note that the low number of waivers in more recent years does not necessarily indicate that waivers have either decreased or disappeared in the recent years; rather, the low numbers simply reflect that most of the grantees have not yet passed the three-year mark at which they are required to report their progress.

Companies that Received Waivers Since the Inception of the Program

Fiscal year of grant award	Number of companies that received full waivers of penalties/ repayments	Dollar amount of full waivers	Number of companies that received partial waivers of penalties/ repayments	Dollar amount of partial waivers	Total number of companies that received waivers of penalties/ repayments	Total dollar amount of waivers
1996-1997	15	$4,621,066	2	$1,014,093	17	$5,635,159
1997-1998	28	8,285,000	6	838,000	34	9,123,000
1998-1999	35	9,416,207	8	3,540,400	43	12,956,607
1999-2000	30	6,633,758	7	877,302	37	7,511,060
2000-2001	9	2,475,000	28	7,043,425	37	9,518,425
2001-2002	2	750,000	11	1,569,500	13	2,319,500
2002-2003	2	1,050,000	3	515,000	5	1,565,000
2003-2004	1	375,000	0	0	1	375,000
2004-2005	0	0	0	0	0	0
TOTALS	**122**	**$33,606,031**	**65**	**$15,397,720**	**187**	**$49,003,751**

Note: This chart includes grants awarded from prior to the beginning date of the audit period, July 1, 2000, because the Department assessed these penalties/repayments during the audit period.
Source: The Department of Community and Economic Development

According to the same officials, the Department issued a full waiver to a noncompliant company if, after reviewing the factors which contributed to or caused the company to be unable to meet its contract requirements, the Department determined that the factors were **entirely** outside the company's control. In these instances, the Department did not require the company to repay any of the grant funds it had received. A partial waiver was granted in accordance with the same review process. However, the Department determined in these cases that the company's failure to meet contract requirements was at least partially within the company's control and that, therefore, the company should be required to repay at least a portion of the grant funds.

Although the Department waived more than $49 million in penalties/repayments since the program's inception, it did not develop any standard criteria to establish the specific factors to be used when making waiver determinations. Furthermore, the Department did not document the actual factors on which its waiver decisions were based.

Our examination of 40 companies revealed that 20 received either a partial or a full waiver of their penalties/repayments or were granted an extension to gain compliance. The waiver decisions were based on information provided to the Department in justification letters submitted by the companies to explain their reasons for failing to meet their contract requirements.

Our review of the grant files confirmed that the Department made waiver determinations based on the justification letter(s) provided by company officials. However, the Department did not prescribe a format for a justification letter, nor did it require companies to submit a standard set of documents, such as financial statements, to support the reasons for their failure to comply.

We also found that the Department did not independently verify the reasons and the documentation presented by the companies in their justification letters.

In comparison to the flexible process used in Pennsylvania, the Illinois' Corporate Accountability for Tax Expenditure Act dictates that economic development grant recipients who fail to create or retain jobs within a specified time period must repay a pro rata amount of the grant to the state. The Illinois law states in relevant part as follows:

> That amount shall reflect the percentage of the deficiency between the requisite number of jobs to be created or retained by the recipient and the actual number of such jobs in existence as of the date the [Illinois Department of Commerce and Community Affairs] determines the recipient is in breach of the job creation or retention covenants contained in the development assistance agreement. If a recipient… ceases operations at the specific project site during the 5-year period commencing on the date of assistance, the recipient shall be required to repay the entire amount of the grant….[56]

Pennsylvania law and program guidelines do not address a pro rata grant repayment based on the percentage of jobs either created or retained. As previously stated, the law gives broad reasons for assessing a penalty and the maximum penalty amount. The law also provides the Department with the authority to grant a waiver but does not provide specifics except that the Department must determine that the cause of the deficiency was outside the control of the company. The program guidelines mirror the law's requirements and provide no additional direction on the penalty/repayment and waiver process that has been implemented by the Department.

[56] 20 ILCS 715/25(a)(4).

Officials from the Department of Community and Economic Development need to balance assessing or waiving a penalty/repayment with the need to transform Pennsylvania into a business-friendly state that will offer its residents good quality jobs. We understand the need for discretion in determining which companies receive waivers. However, why one company received a waiver and another company did not—particularly when both are in a similar industry and cite the same reason for failure—should be clearly documented and easy to explain to both the companies and the taxpayers.

Summary

Our review of the waiver process revealed that the Department had not developed a standardized process for authorizing waivers, nor did it clearly document the justification or rationale behind its decisions. Nevertheless, the Department has waived more than $49 million in penalties/repayments from companies that did not meet the terms of their grant award contracts.

Recommendations

15. The Department of Community and Economic Development should develop standard procedures to direct the waiver determination process. Furthermore, the Department should consider pursuing legislation that would mandate standard waiver procedures that, at a minimum, address the following:

- A standard penalty formula calculated on the number of jobs the company failed to retain or create.

- Requirements for the specific documentation and data that should be included with the justification letters submitted by the company requesting the waiver.

- Methods for validating information contained in the company justification letter.

- Documentation of the Department's waiver decision and the factors upon which the Department personnel based the waiver.

  Target date: *Begin planning immediately: Implement recommendation in full by June 30, 2008.*

16. The Department should conduct a comprehensive review of all similar grant programs in other states to identify best practices to aid in determining how best to standardize the waiver process in Pennsylvania.
Target date: Begin immediately.

<u>Summary of the Department of Community and Economic Development's response to Finding Four</u>

followed by*, in italic type,*

<u>Evaluation of the Department of Community and Economic Development's response by the Department of the Auditor General</u>

[Note: See the Department of Community and Economic Development's full response beginning on page 90.]

- Regarding recommendation 15, the Department of Community and Economic Development responds that it employs an "equitable evaluation methodology" to determine penalties, that the current administration has reduced the percentage of waivers granted by the previous administration from 44 percent to 22 percent, and that the Department will "continue to ensure that its waiver and penalty processes are accountable to taxpayers while recognizing that in some cases businesses fail to meet the job creation and retention targets through no fault of their own." Furthermore, the Department stated again that it does not believe a change in legislation is needed to improve its administration of the waiver process.

Regarding recommendation 16, the Department responded that it will implement this recommendation to review other states' grant programs to identify best practices.

→ *We acknowledge the Department of Community and Economic Development's response to recommendation 15 but note that, during our audit work, the Department failed to provide us with the "equitable evaluation methodology" cited in its response.*

Subsequent to the audit exit conference, the Department did provide us with criteria that it said it used to make its waiver determinations. However, our review of that criteria revealed that, for waivers granted by the Department during the audit period and even for waivers granted in 2007, the Department did not consistently adhere to that criteria. Furthermore, if indeed the Department employed an equitable evaluation methodology as stated, it failed to document the application of that methodology. Therefore, we were unable to verify the consistent application of any criteria that the Department may have used to make waiver decisions. Finally, unlike the Department, we

Opportunity Grant Program

continue to believe that a change in legislation is necessary—not only to better empower the Department but also to ensure that future administrations are subject to the same standards.

Regarding recommendation 16, we acknowledge the Department's agreement to implement this recommendation to review the grant programs in other states to identify best practices.

Finding Five

The Department of Community and Economic Development did not have an overall plan for using program dollars and did not set goals to measure the program's effectiveness.

During our five-year audit period, the Department of Community and Economic Development's *Annual Financing Strategy* did not provide program stakeholders with either a description of program achievements for the preceding year or a plan for future program initiatives. The Department's financing strategy also did not include goals or benchmarks based on creating and retaining jobs in Pennsylvania. Finally, the Department did not complete financing strategies for fiscal years 2000-2001 through 2002-2003, but it did complete these strategies for fiscal years 2003-2004 and 2004-2005.

According to state law, the Department was required to develop and deliver an *Annual Financing Strategy* to the General Assembly concurrent with the Governor's submission of the annual state budget message.[57] The financing strategy should describe the terms and conditions under which economic development programs, such as the Opportunity Grant Program, will operate for the coming fiscal year. In developing the annual strategy, the Department should gather input from stakeholders—companies, community leaders and organizations, legislators, and private citizens, to name a few.

In its October 2000 report, the Legislative Budget and Finance Committee cited the importance of a required annual financing strategy:

> Aside from being a statutory requirement, such a plan would be a useful document to

[57] 12 Pa.C.S. §§ 303-304.

> communicate the Department's long-term goals and strategies and would provide a mechanism to assess the Department's progress in meeting those goals.[58]

The communication of an effective financing strategy would also help all stakeholders in Pennsylvania's economic expansion to understand how the Department of Community and Economic Development plans to spend economic development dollars. By including information on all the applicable Department programs—including Opportunity Grants—and describing how they become part of "a flexible and effective arsenal of economic development incentives for Pennsylvania companies to lead the way into the 21st century,"[59] the strategy complements the Department's mission.

State law specifically requires the following to be included in the strategy:

- A financial audit or statement of operations for each economic development program.
- A description of the accomplishments of each economic development program for the preceding fiscal year.
- A detailed description of the parameters of operation for each economic development program for the upcoming fiscal year, including the terms and conditions under which the program will be administered.

---

[58] Legislative Budget and Finance Committee Audit, *Economic Development Programs of the Pennsylvania Department of Community and Economic Development: A Performance Audit in Response to Act 1996-58*, October 2000, p. S-11.
[59] Opportunity Grant Program Guidelines, March 2004 and December 2006, <www.newpa.com/programDetail.aspx?id=41, Accessed October 11, 2005, p. 1; re-verified July 2, 2007.

- A description of the performance measurements and accountability factors to be applied and performance targets and goals to be met for each economic development program.

- A description of long-range planning for each economic development program for the next five fiscal years.

- A list of state assistance approved for each economic development program during the fiscal year. The list shall include a brief description, with details regarding each grant, loan, or credit, including penalties imposed by the Department.

- A review of pending projects. [60]

Our review of the strategies in the fiscal year 2003-2004 and 2004-2005 reports found insufficient information in these sections:

- A long-range plan for the next five fiscal years.

- A review of pending projects.

- Performance measurements, targets, goals, and accountability factors.

We use the term "insufficient" because, based on the information presented in the strategy, we were unable to evaluate program performance or specifics in the planning and distribution of Opportunity Grants. Furthermore, the Department did not provide any analysis or information on the types of industries that were awarded Opportunity Grants; nor did the Department analyze the success, or failure, of the grants based on industry type. This type of analysis would be beneficial for the Department because it

[60] 12 Pa.C.S. § 303.

would enable the Department to identify industry trends and target at least a portion of the grants towards industries that have the most growth potential and the higher success rates.

In performing our own analysis, we categorized, by industry, the 724 grants awarded during the audit period. We determined that nearly half of all the grants went to support projects in the manufacturing sector. The next highest number of grants—91 in total or 13 percent—went to projects in the field of information technology. There were 47 of the 724 grants, or 7 percent of the total, that went to the health care and social assistance field. (See Appendix B for categorization of all 724 grants).

We next attempted to determine if we could conclude on the success or failure rate of grants by industry.[61] Using the job creation/retention data that was reported by 286 companies that received grants during the first three years of the audit period, we noted the following information about the three highest-ranked industries in which Opportunity Grants were awarded:

- 125 were from companies in the business of manufacturing. Thirty-four of the 125 grantees, or 27 percent, failed to create any jobs. Forty-six of the 125 grantees, or 37 percent, failed to create all projected jobs.

- 66 were from companies in the business of information services. Thirty-one of the 66 grantees, or 47 percent, failed to create any jobs. Twenty-two of the 66

[61] Using business descriptions provided by the Department of Community and Economic Development, we coded each grant according to industry classifications of the Northamerican Industrial Classification System (NAICS). The NAICS groups businesses together in categories based on units that use similar processes to produce goods or services. For more information about NAICS, see “Development of NAICS” at http://www.census.gov/eped/www/naicsdev.htm.

grantees, or 33 percent, failed to create all projected jobs.

- 23 were from companies in the business of healthcare and assistance. One of the 23 grantees failed to create any jobs. Fourteen of the 23 grantees, or 61 percent, failed to create all projected jobs.

While our basic analysis shows that more than half of companies in each of the three industries failed to create and/or retain all the jobs projected, there is so much more analysis that can and should be done by the Department of Community and Economic Development to evaluate and measure the performance of the Opportunity Grant Program.

For example, starting with the manufacturing category, the Department should determine the reasons why the Opportunity Grant Program grantees failed to create or retain all the projected jobs. The data should be carefully examined to identify industry trends or commonalities that could help the Department increase success rates. In the manufacturing sector, for example, increased success rates could be critical to the state's economy:

> The manufacturing sector is the largest contributor to Pennsylvania's economy, generating 15.1 percent of Gross State Product and directly adding over $75 billion in value every year. Nearly 660,000 Pennsylvanians are directly employed in manufacturing. Pennsylvania manufacturers sell almost $21 billion worth of goods overseas, representing 94 percent of all Pennsylvania exports.[62]

[62] Pennsylvania Manufacturers Association Web site at http://www.pamanufacturers.org/. First accessed June 7, 2007, and re-verified on July 2, 2007. Accessed again and numbers updated on October 23, 2007.

Based on our audit work and our research regarding economic development programs of other states, we have determined that the Department officials overseeing Pennsylvania's economic development programs, and specifically the Opportunity Grant Program, should take steps to be more accountable to the public. This increased accountability can occur in three ways:

- First, by improving the monitoring of grants/projects through staff performing on-site visits and periodic reviews of employment data.
- Second, by completing a detailed plan to address program goals and to set a course of action to attain these goals.
- Third, by developing detailed performance measures for the program and annually evaluating the program by using the measures.

Summary

The absence of a specific strategic plan does not foster confidence that the Department of Community and Economic Development uses the Opportunity Grant Program dollars in innovative ways to promote Pennsylvania as a competitive location for industrial and economic growth. The Opportunity Grant Program is a worthwhile program and, while succeeding in creating and retaining jobs in many cases, could be even <u>more</u> successful if the Department of Community and Economic Development developed and met specific performance goals and objectives.

Recommendation

17. In the *Annual Financing Strategy* mandated by law, the Department of Community and Economic Development should outline specific program goals and performance measures for the Opportunity Grant Program. The Department should then develop procedures to evaluate the program using these measures. These goals and measurements will also allow interested stakeholders to evaluate the present and past performance of the program.

Target date: Begin planning immediately and implement recommendation in full for the 2008-09 fiscal year.

Summary of the Department of Community and Economic Development's response to Finding Five

followed by*, in italic type,*

Evaluation of the Department of Community and Economic Development's response by the Department of the Auditor General

[Note: See the Department of Community and Economic Development's full response beginning on page 90.]

- The Department of Community and Economic Development agrees with and plans on implementing the recommendation.

  We acknowledge the Department's response and note that the establishment of program-specific goals and performance measures will provide the Department and taxpayers with benchmarks to evaluate program performance.

Appendix A

Opportunity Grants to Companies by County
July 1, 2000 – June 30, 2005

	County	Total grants	Total dollars		County	Total grants	Total dollars
1	Allegheny	123	$33,339,782	35	Columbia	5	$ 785,000
2	Philadelphia	40	22,110,000	36	Crawford	5	1,220,000
3	Chester	36	26,900,000	37	Jefferson	5	615,000
4	Bucks	30	7,893,375	38	McKean	5	725,000
5	Luzerne	30	8,687,445	39	Mifflin	5	1,945,000
6	Montgomery	25	7,155,000	40	Northumberland	5	775,712
7	Erie	23	6,570,000	41	Adams	4	875,000
8	Lehigh	23	8,625,000	42	Carbon	4	180,000
9	Cumberland	21	5,464,000	43	Clarion	4	625,000
10	Lancaster	19	2,584,314	44	Clinton	4	2,725,000
11	York	18	6,535,000	45	Elk	4	550,000
12	Dauphin	17	2,984,078	46	Fayette	4	1,775,000
13	Lackawanna	17	4,915,606	47	Fulton	4	1,525,000
14	Northampton	16	2,887,817	48	Indiana	4	450,000
15	Washington	16	3,431,810	49	Lawrence	4	165,000
16	Blair	15	3,429,948	50	Clearfield	3	375,000
17	Beaver	14	3,380,208	51	Tioga	3	525,000
18	Centre	14	1,975,000	52	Wayne	3	231,000
19	Westmoreland	14	2,962,000	53	Armstrong	2	265,000
20	Butler	13	2,715,396	54	Snyder	2	550,000
21	Delaware	13	4,860,000	55	Venango	2	575,000
22	Franklin	11	3,760,000	56	Wyoming	2	1,050,000
23	Berks	10	2,520,000	57	Juniata	1	150,000
24	Cambria	9	2,530,000	58	Monroe	1	1,000,000
25	Mercer	9	2,160,000	59	Potter	1	150,000
26	Schuylkill	9	2,438,000	60	Susquehanna	1	150,000
27	Somerset	9	2,950,750	61	Cameron	0	0
28	Lebanon	7	1,150,000	62	Forest	0	0
29	Lycoming	7	1,895,000	63	Montour	0	0
30	Bedford	6	1,005,000	64	Perry	0	0
31	Greene	6	296,067	65	Pike	0	0
32	Huntingdon	6	294,149	66	Sullivan	0	0
33	Warren	6	1,000,000	67	Union	0	0
34	Bradford	5	3,385,000		**Overall totals**	**724**	**$214,746,457**

Data Source: The Department of Community and Economic Development

Appendix B

Opportunity Grants, Ranked by Number per Industry

July 1, 2000 – June 30, 2005

Rank	Type of company/industry	Total grants	% of total	Grant totals in dollars
1	Manufacturing	335	46.3 %	$78,489,464
2	Information (Telecommunications, publishing)	91	12.6 %	24,033,446
3	Health care/social assistance	47	6.5 %	25,297,445
4	Finance and insurance	40	5.5 %	16,968,856
5	Retail trade	33	4.6 %	11,247,015
6	Professional/technical services	31	4.3 %	7,576,412
6	Wholesale trade	31	4.3 %	8,003,094
8	Accommodation/food services	22	3.0 %	4,436,825
9	Transportation	20	2.8 %	5,507,331
10	Educational services	14	1.9 %	5,320,415
11	Other services except public admin.	13	1.8 %	4,039,820
12	Construction	11	1.5 %	637,167
12	Real estate/rental/leasing	11	1.5 %	17,249,626
14	Management of companies/enterprises	6	0.8 %	2,500,000
15	Arts/entertainment/recreation	5	0.7 %	110,541
15	Mining	5	0.7 %	1,480,000
17	Administrative and waste services	4	0.5 %	600,000
18	Government	3	0.4 %	919,000
19	Utilities	2	0.3 %	330,000
	Overall totals	**724**	**100 %**	**$214,746,457**

Data Source: The Department of the Auditor General developed this chart based on data provided by the Department of Community and Economic Development. See footnote 61 for further detail.

Appendix C –

Response from the Department of Community and Economic Development, with introductory comments from the Department of the Auditor General

Introductory Comments from the Department of the Auditor General:

The Department of Community and Economic Development's verbatim response to our findings and recommendations is presented in the following pages of Appendix C.

It is important for us to put the Department's response into the proper context by noting here that the response includes claims of program success based on job creation and retention data that we did not audit because it fell outside the scope of our audit. In addition, as we have explained in the report, the Department bases its claims of success on data that is self-reported by grantees but is not otherwise corroborated.

The Department's response also discusses billions of dollars in private investments resulting from the Opportunity Grant Program, but the investment numbers are self-reported and therefore uncorroborated as well.

Finally, the Department alternates its presentation of success rates between two time periods (the period of the current administration and the entire period of the program's existence), and we caution readers that the higher success rates cited for the current administration comprise only the results of a small number of grantees who have thus far reported their results.

Overall, it is critical for readers to understand that, even if we could corroborate the claims cited by the Department in its response, these claims do not change the programmatic deficiencies that we found in our audit work. Nor do these claims lessen the critical need for the Department to improve its programmatic administration and oversight as it has committed to do as the result of our audit.

Response from the Department of Community and Economic Development

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT
HARRISBURG, PA 17120

OFFICE OF SECRETARY

October 1, 2007

The Honorable Jack Wagner
Auditor General
Department of the Auditor General
229 Finance Building
Harrisburg, PA 17120-0018

Re: Opportunity Grant Program Audit

Dear Auditor General Wagner,

Thank you for the opportunity to respond to the performance audit report issued by your office for the Opportunity Grant Program.

DCED takes its responsibilities to the citizens of the Commonwealth seriously and is always receptive to new methods of increasing the effectiveness and efficiency of the programs we administer. While we are not in complete accord with all of the report's findings, we appreciate the time and effort of your staff in preparing both the report and in making recommendations to enhance the Program.

As our full response indicates we recognize the value of the Report and its recommendations and are already instituting a number of them. We are giving serious consideration to the remaining recommendations as well as other ideas we have on ways to continue to improve the Program.

In closing, DCED appreciates the collaborative approach adopted by your office in completing the audit and looks forward to working with you in making further enhancements to this vital job-creating program.

Sincerely,

Dennis Yablonsky

Dennis Yablonsky
Secretary

Response from the Department of Community and Economic Development

Since 1996, the Opportunity Grant Program (OGP) has invested $388 million in Pennsylvania's economy, creating and retaining 303,047* jobs. The program has generated $12.5 billion in private investment in the Commonwealth. This private sector investment has far exceeded OGP requirements of four dollars of private investment for each dollar of OGP funds.

The current Administration has improved accountability while using the grant program to maintain existing jobs, create new jobs and grow the economy. Since 2003-04, the Department of Community and Economic Development (DCED) has focused on investing in projects most likely to succeed and ensuring that businesses live up to grant contract job retention and creation commitments.

DCED has monitored $270 million in completed Opportunity Grant projects. Based on the number of jobs retained and created by these projects, the one-time per-job cost has been $891. Using the per capita state median income of $36,680 and the state's personal income (PIT) tax rate of 3.07 percent, a newly hired worker pays $1,126 a year in PIT. When combined with sales taxes generated by the projects, the Commonwealth recovers its total investment within a few months.

In addition to job creation and retention benefits, OGP projects create significant related benefits including job training, new construction and rehabilitation of buildings and infrastructure, elimination of blight, and remediation of environmental hazards. Further, the program has a significant ripple effect in the service and supply chain of the state's economy, producing even greater economic benefits for the region and the Commonwealth. A prime example of this ripple effect is the $1.2 million grant awarded to Spanish wind-energy manufacturer Gamesa. This investment has generated more than $110 million in private investment and has already created approximately 1,000 new jobs in Pennsylvania. As a direct result of the Gamesa project's success, Spanish company

---

* *Note from the Department of the Auditor General: Although the Department of Community and Economic Development's response is dated October 1, 2007, certain numbers were updated as of October 29, 2007, based on adjustments made by the Department of Community and Economic Development to address data discrepancies identified by the Department of the Auditor General.*

SEM has committed to establishing a substantial supply operation near the Gamesa facility in Bucks County.

In evaluating the success of the OGP, it is important to understand how the grant timeline works:

- When a grant is awarded, the business agrees to invest a certain amount of private funding and to retain and/or create a specific number of jobs in Pennsylvania.
- The company typically has three years to demonstrate results.
- At the end of the 3-year grant period, the company certifies the number of jobs created and retained.

In response to the recent audit report of the OGP by the Auditor General's (AG) Office, DCED appreciates the audit's recognition of the significant improvement in accountability and performance made during this Administration and values the audit's recommendations as a means to further enhance the program's effectiveness and efficiency.

<u>DCED Response to AG Recommendations</u>

1. The Department of Community and Economic Development should develop a process for a more accurate and effective evaluation of program performance. The process should, at a minimum, be able to provide success and failure statistics on a grant-by-grant basis.

   Target date: Begin planning immediately;
   Implement this recommendation in full by December 31, 2007.

   DCED believes that aggregate data is the most accurate measure of the success of the OGP. Such data clearly demonstrate the total number of jobs created or retained and the total private sector investment leveraged by the Program. By this measurement, the program has a 98 percent job creation and retention success rate under the current Administration.

   Opportunity Grants that have been awarded since January 20, 2003 with completed activity periods have resulted in:

- **14,792 new jobs (97 percent of the total number of jobs that were projected at the time of grant award), and**
- **33,877 retained jobs (98 percent of the total number of jobs that were projected to be retained at the time of grant award).**
- **Capital investment of $2.1 billion (115 percent of projected leveraged capital investment.)**

The current Administration's success rate is notably higher than in past Administrations. Prior to this Administration, businesses created only 74 percent of projected new jobs and 92 percent of projected job retention.

The Opportunity Grant Program is now creating more jobs for each taxpayer dollar invested. For grants awarded and completed during this Administration, the cost per job retained and created has been reduced from $919 per job to $744 per job, a reduction of 19 percent in per job cost.

In addition, projects awarded and completed under the current Administration have created or retained an average of 383 jobs per project; 7 percent more than in the prior Administration.

The Department recognizes the need to review individual project information and generates individual project reports as well. These reports are analyzed to measure program effectiveness.

It is important to note that the OGP audit categorizes companies that did not meet 100 percent of job requirements – even if they fell short by only a few jobs – as failures. DCED believes that such a characterization creates an inaccurate picture of the program's success. DCED considers the amount of private investment in projects as an important element in evaluating the program's success.

It should also be noted that the rate of job retention and creation has improved significantly under the current Administration:

- **During the prior Administration, 43 percent of projects met or exceeded job targets and 53 percent met at least 80 percent of job targets.**
- **During this Administration, 51 percent of projects met or exceeded job targets and 64 percent met at least 80 percent of job targets.**

2. The Department of Community and Economic Development should, at a minimum, adhere to its Operating Procedures Manual and not accept any other method of reporting job and investment data except the Project Update Report, signed/certified by the company's highest ranking official and by the company's chief financial official. The Project Update Report should also be amended to include a standard notification informing the signatories that misrepresentations of requested information are punishable under the law. Furthermore, in Recommendation 6 of Finding Two, we recommend that these updates be required annually.

    The grant contract and all reports from OGP recipients (including Project Update Reports) will include language advising grant recipients that misrepresentation of information is punishable by law.

    Annual project reports will be required. Signatures of the highest ranking executive and CFO or comparable officials at the project site will be required on all reports.

    A Project Update Report is used to monitor OGP projects. DCED will attach this report form to all other employment verification documentation, ensuring that consistent performance documentation exists for each project.

3. The Department of Community and Economic Development should implement procedures that would validate or verify the job and investment numbers reported on the Project Update Reports. These procedures should include:

    – Obtaining, on at least a sample basis, company payroll records to support the job numbers reported to the Department.

The OGP contract will require that payroll records be made available to the Department.

– Using employment data from the Department of Labor and Industry to confirm the self-reported data submitted by companies receiving Opportunity Grants.

The Department will work with the Department of Labor and Industry to obtain updated employment data.

– Performing on a sample basis, periodic site visits to confirm the existence of employees.

Site visits will be made during the contract period.

Target date: Begin planning immediately;
Implement this recommendation in full by December 31, 2007.

4. The Department of Community and Economic Development should develop and implement additional monitoring procedures that would include performing periodic site visits by Department staff throughout the project period, beginning within the first year of the initial disbursement, as a condition of the grant agreement. The visits should also involve a review of project expenditures and employee payroll records.

Target date: Begin planning immediately;
Implement recommendation in full by March 31, 2008.

All OGP contracts will require that payroll records be made available for review.

5. The Department of Community and Economic Development should maintain regular communications with companies between the time that the Department announces the grant award and the date that the Department begins to monitor the

---

project. The regular communications could include the exchange of electronic mail between the Department and company officials.

Target date: Begin planning immediately;
Implement recommendation in full by December 31, 2007.

The Department acknowledges the necessity for early and regular contact with companies and will institute the recommendation.

6. The Department of Community and Economic Development should consider pursuing legislation that would require companies to submit Project Update Reports at least <u>annually</u>. Furthermore as noted in Finding Three, Recommendation #11, the Department should require grantees to report <u>immediately</u> any changes or potential changes in operating status, such as a merger or closure, before that change actually occurs. These reports should include language that subjects the highest-ranking company officials to penalties for unsworn falsification to authorities.

   Target date: Begin immediately.

   Legislation is not necessary. Contracts will require the grant recipient to notify the Department when any significant adverse change in status of the grantee or the project occurs. All reports will be executed by the highest ranking executive and the CFO or comparable officers at the project site.

7. The Department of Community and Economic Development should develop standard procedures so that grant applications are evaluated consistently.

   Target date: Begin planning immediately;

   Standardized criteria will continue to be used in the Department's evaluation of a project's total economic impact.

---

8. The Department of Community and Economic Development should require two signatures on every grant application, letter of intent, and contract, including the signature of the applicant company's highest ranking official as well as the company's chief financial officer.

   Target date: Immediately

   All grant documents and required reports will be executed by the highest ranking executive and the CFO or comparable officers at the project site.

9. The Department of Community and Economic Development should develop Guidelines setting a maximum grant amount as required in the law establishing the Opportunity Grant Program.

   Target date: Immediately

   The Department will establish a maximum grant amount for OGP projects.

10. The Department of Community and Economic Development should not agree to any grant conditions that are not directly and precisely tied to job creation/retention. For example, the Department should not agree to conditions or contingencies that are far outside the control of either the grantee or the Department, and for which Opportunity Grant funds will not be used.

    Target date: Immediately

    This is the current policy of the OGP as stated in Section III B of the Guidelines.

11. The Department of Community and Economic Development should increase the number of grants for which the full amount of funding is not disbursed until certain job and investment goals have been achieved. Therefore, if the company

is not on track to meet its job and investment goals, the Department can amend the grant award accordingly.

Target date: Begin immediately.

The Department has significantly increased the number of performance-based awards and will continue to do so.

12. The Department of Community and Economic Development should implement additional procedures to improve its timeliness of actions in the collection of penalties/repayments, such as a clause in the contract that requires a company considering closure or any other changes in operating status to notify the Department immediately. Failure to notify the Department should result in additional penalties, which the Department should impose and enforce.

    Target date: Immediately.

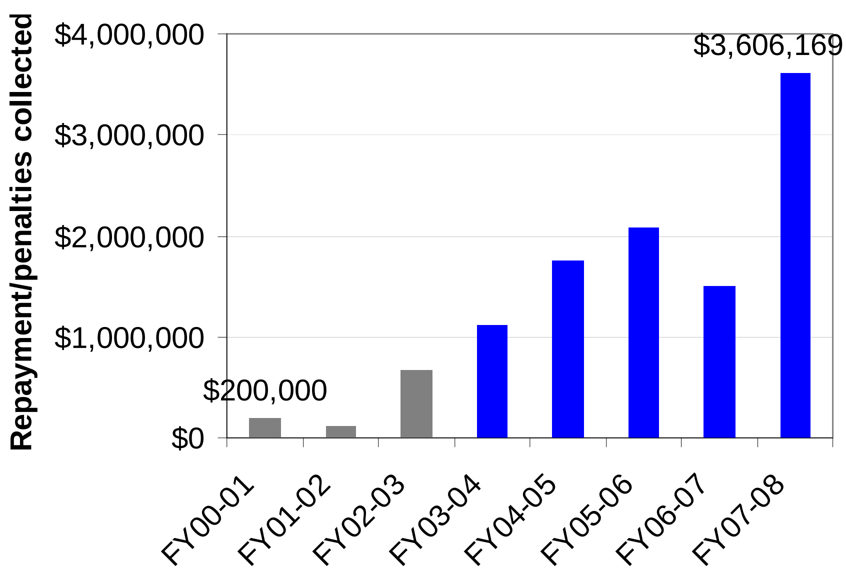
    The Department will modify OGP grant commitment letters and contracts to require the company to notify DCED prior to a closure or upon any substantial adverse change in the company or project.

13. The Department of Community and Economic Development should more frequently exercise its authority to impose a collateral requirement on grantees, particularly for grantees who request higher grants/or who are more at risk for not meeting job creation and retention requirements. In its contracts with grantees, the Department should incorporate language about the collateral and penalty provisions; the Department should then enforce these provisions. Furthermore, the Department should consider contracting out its collection services if it is unable to collect penalties effectively on its own, particularly in extreme cases.

    Target date: Begin planning immediately;
    Implement recommendation in full by December 31, 2007.

    This Administration has placed an emphasis on enforcement and has collected $10.5 million from companies that failed to meet

performance targets. An additional $3.7 million in repayments has been committed but not yet received. DCED has collected more from companies failing to meet job targets each year during the current Administration than during the combined three years under the previous Administration.



The Department remains committed to improving the program's compliance and recovery efforts and will give serious consideration to the audit's specific recommendations.

14. The Department of Community and Economic Development should develop procedures that would enable the Department to track the name of the company owners and other principals receiving grants in addition to the name of the company when noncompliance with grant requirements occurs. The Department should be wary of awarding grants to companies whose employees/officials were associated with failed companies that received previous grants.

Target date: Begin planning immediately;
Implement recommendation in full by December 31, 2007.

The Department currently tracks companies failing to meet grant obligations and considers such information in making future program decisions.

15. The Department of Community and Economic Development should develop standard procedures to direct the waiver determination process. Furthermore, the Department should consider pursuing legislation that would mandate standard waiver procedures that, at minimum, address the following:

    – A standard penalty formula calculated on the number of jobs the company failed to retain or create.

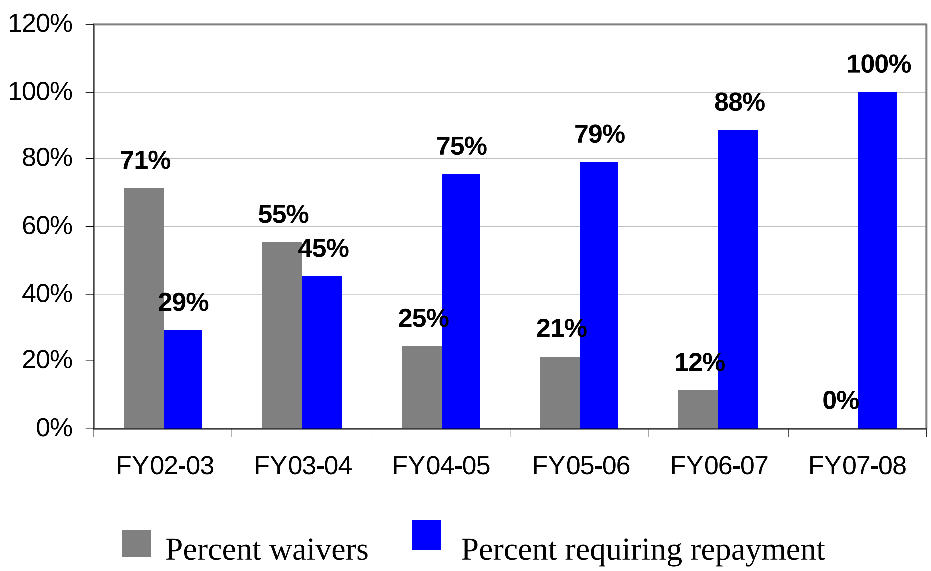
    – Requirements for the specific documentation and data that should be included with the justification letters submitted by the company requesting the waiver.

    – Methods for validating information contained in the company justification letter.

    – Documentation of the Department's waiver decision and the factors upon which the Department personnel based the waiver.

The Department employs an equitable evaluation methodology, considering all elements of a grantee's OGP commitments in determining penalties.

This Administration has made businesses that fail to create and retain required jobs more accountable, as demonstrated by the sharp decline in the number of waivers granted. The previous Administration granted waivers to 44 percent of the projects not meeting job creation and retention commitments. This Administration has reduced this percentage to 22 percent, thereby substantially increasing the number and amount of required repayments.



DCED will continue to ensure that its waiver and penalty processes are accountable to taxpayers while recognizing that in some cases businesses fail to meet the job creation and retention targets through no fault of their own (as the General Assembly recognized by creating the waiver in the Opportunity Grant Program enabling legislation). The Department will give serious consideration to the audit's specific recommendations not already in place. Legislation will not be required to implement these or other improvements that may be accomplished via modifications to OGP grant contracts.

16. The Department should conduct a comprehensive review of all similar grant programs in other states to identify best practices to aid in determining how best to standardize the waiver process in Pennsylvania.

Target date: Immediately.

DCED has begun implementation of this recommendation and plans to adopt best practices where applicable.

---

17. In the Annual Financing Strategy mandated by law, the Department of Community and Economic Development should outline specific program goals and performance measures for the Opportunity Grant Program. The Department should then develop procedures to evaluate the program using these measures. These goals and measurements will also allow interested stakeholders to evaluate the present and past performance of the program.

    Target date: Immediately
    Implement in full for the 2008-09 fiscal year.

    DCED is implementing these recommendations.

Audit Report Distribution List

This report was distributed to the following individuals upon its release:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

The Honorable Robin L. Wiessmann
State Treasurer
Commonwealth of Pennsylvania

The Honorable Dwight E. Evans
Chair
Appropriations Committee
Pennsylvania House of Representatives

The Honorable Gibson E. Armstrong
Chair
Appropriations Committee
Senate of Pennsylvania

The Honorable Mario J. Civera, Jr.
Republican Chair
Appropriations Committee
Pennsylvania House of Representatives

The Honorable Gerald J. LaValle
Acting Democratic Chair
Appropriations Committee
Democratic Chair
Community, Economic, and Recreational
Development Committee
Senate of Pennsylvania

The Honorable Peter J. Daley
Chair
Commerce Committee
Pennsylvania House of Representatives

The Honorable Jane M. Earll
Chair
Community, Economic, and Recreational
Development Committee
Senate of Pennsylvania

The Honorable Dick L. Hess
Republican Chair
Commerce Committee
Pennsylvania House of Representatives

Pennsylvania Department of Community and Economic Development:

The Honorable Dennis Yablonsky
Secretary

John Blake
Executive Deputy Secretary

Dorothy Kaplan
Deputy Secretary for Business Assistance

Scott Dunkelberger, Chief Operating Officer
Center for Business Financing

Michael Rossman, Director
Governor's Action Team

This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, 318 Finance Building, Harrisburg, Pennsylvania 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our Web site at www.auditorgen.state.pa.us or by calling 717-787-1381.