

**OFFICE OF THE CITY CONTROLLER**



**MAYOR'S OFFICE OF ECONOMIC DEVELOPMENT  
CHAPTER 380 PROGRAM  
PERFORMANCE/COMPLIANCE AUDIT**

**Chris B. Brown, City Controller**

**Courtney E. Smith, City Auditor**



**OFFICE OF THE CITY CONTROLLER  
CITY OF HOUSTON  
TEXAS**

**CHRIS B. BROWN**

March 21, 2018

The Honorable Sylvester Turner, Mayor  
City of Houston, Texas

**SUBJECT: REPORT #2018-08  
MAYOR'S OFFICE OF ECONOMIC DEVELOPMENT CHAPTER 380 PROGRAM  
PERFORMANCE/COMPLIANCE AUDIT**

Mayor Turner:

The Office of the City Controller's Audit Division has completed a performance/compliance audit of the City of Houston (the City) Chapter 380 program. The Texas State Legislature passed Chapter 380 of the Texas Local Government Code in 1989, which authorizes municipalities to establish economic development programs. The City's Chapter 380 Program was established in 1999 and is currently administered by the Mayor's Office of Economic Development.

As of June 30, 2017, there were twenty-four (24) Economic Development Division (EDD) administered Chapter 380 projects in progress and approved. In addition, more than \$55 million in reimbursements have been made under the City's Chapter 380 Program.

Our refined audit objectives were to consider the processes and internal controls related to whether:

- The Chapter 380 Program is being administered according to guidelines established and approved from the Texas Local Government Code, Chapter 380 and the City of Houston Ordinance No. 1999-674;
- Applicants met the qualifications/criteria of the Program;
- The terms of Agreements met established criteria of the State Statute and City Ordinance with valid approval;
- Conditions/Commitments negotiated and agreed to in the Agreements were met prior to receiving reimbursements;
- Transactions for Project(s) reimbursements were accurate and adequately supported; and
- Close out of completed Projects were appropriate and adequately documented.

The engagement scope period included Projects approved from July 1999 (the effective date of the City of Houston Ordinance No. 1999-674) through December 31, 2015.

During the audit, we noted that 1) Applicants in the program met the established program qualifications, 2) Project reimbursements were recorded accurately, and properly supported according to the agreements reviewed, and 3) projects were closed properly and close-out documentation was adequate.



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We also documented several exceptions including:

- No formal approved Chapter 380 procedures;
- Inadequate or nonexistent documentation in the application, evaluation and project management areas of the Program;
- Lack of adequate monitoring to ensure conditions/commitments are being met; and
- Some projects were not in compliance with the terms or the conditions/commitment contained in the agreement.

We would like to express our appreciation to the management and staff of the Mayor's Office of Economic Development for their time and effort, responsiveness, and cooperation during this audit.

Respectfully submitted,

Chris B. Brown  
City Controller

xc: Andy Icken, Chief Development Officer, Mayor's Office of Economic Development  
City Council Members  
Marvalette Hunter, Chief of Staff, Mayor's Office  
Tantri Emo, Interim Director, Finance Department, Mayor's Office  
Harry Hayes, Chief Operations Officer, Mayor's Office  
Gwendolyn Tillotson, Deputy Director, Mayor's Office of Economic Development  
Shannan Nobles, Chief Deputy City Controller, Office of the City Controller  
Courtney Smith, City Auditor, Office of the City Controller

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### *EXECUTIVE SUMMARY*

#### *INTRODUCTION*

The Audit Division (AD) of the City Controller's Office has completed a Performance/Compliance Audit of the Chapter 380 Program (the Program), which is administered by the Economic Development Division (EDD) of the Mayor's Office. The audit considered compliance with Local Government Code, Chapter 380, *Miscellaneous Provisions Relating to Municipal Planning and Development* and subsequent passage of the City of Houston (COH), Texas Ordinance No. 1999-674 establishing an Economic Development Program.

The audit was included in the City Controller's Fiscal Year (FY) 2016 Audit Plan as a result of our Enterprise Risk Assessment process.

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#### *BACKGROUND*

The Texas State legislature passed *Texas Local Government Code*, Title 12, *Planning and Development*, Subtitle A., *Municipal Planning and Development*, Chapter 380., *Miscellaneous Provisions Relating to Municipal Planning and Development*, Sections 380.001 through 380.003 in 1989, commonly referred to as Chapter 380. The statute states that "the governing body of a municipality may establish and provide for the administration of one or more programs, including programs for making loans and grants of public money . . . , to promote state or local economic development and to stimulate business and commercial activity in the municipality".

The City of Houston passed Ordinance No. 1999-674 (the Ordinance), effective July 1999, establishing an Economic Development Program (the Program) pursuant to Chapter 380 of the Texas Local Government Code. The Ordinance, which includes Exhibit "A", *Criteria For Chapter 380 Assistance* (Exhibit "A") establishes guidelines for Chapter 380 assistance eligibility and designated the Director of the Planning and Development Department (P&D) to administer the Program.

The responsibilities of administering the Program were moved twice, first to the Finance Department in 2006 and finally to the Mayor's Office in the EDD in Fiscal Year (FY) 2012. In conjunction with the move of responsibilities to EDD, the Chief Development Officer was named as the Director overseeing the administration of the Program. The Program's intent is to benefit the City by stimulating business and commercial activity in Houston. EDD's mission under the direction of the Mayor's Office was to "Implement and manage citywide policy and procedure for economic development programs. In addition to the Chapter 380 Program, the EDD use other innovative incentive programs to market Houston as the place to grow or relocate a targeted business".

Currently, EDD requires prospective businesses to submit an Application for Chapter 380 Program Form, which includes but is not limited to information regarding the company, business structure, potential development, expected timetable for the project, employment and cost value. Once the information disclosed in the form is reviewed, it is used to complete EDD's *Scoring Matrix* (the Matrix), a scoring method developed by EDD used to document the evaluation of potential projects. Criteria



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such as Investment, Community Benefits, Current Policy Priority and Quality of Life are scored and must meet a minimum score threshold that has been determined by EDD. If the project does not meet the minimum score threshold, the company representative is contacted for further clarification or a letter is sent denying the incentive. For projects that meet the minimum score threshold, a meeting is set up with representative(s) of the company and the EDD Task Force, to continue the due diligence and evaluation process for the project.

The total population of Agreements/Projects considered for testing was twenty-seven (27), which represented projects in-progress and completed projects (Agreements/Projects with a TIRZ component and any revisions/amendments to an original Agreement were excluded). **(See Table 1)**. As of June 30, 2017, the total number of in-progress (active) and approved Chapter 380 Agreements/Projects was twenty-four (24) and reimbursements made for those projects totaled \$55,061,214.

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<b>TABLE 1 COH CHAPTER 380 PROGRAM AGREEMENTS/PROJECTS AS OF 12/31/2015</b>	
<b>AGREEMENTS/PROJECTS</b>	<b>TOTAL AGREEMENTS</b>
TOTAL AGREEMENTS <sup>1</sup>	32
<b>(LESS):</b>	
TIRZ COMPONENT	2
REVISIONS/AMENDMENTS	3
SUB-TOTAL	<b>(5)</b>
<b>TOTAL AGREEMENTS/PROJECTS</b>	<b>27</b>

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<sup>1</sup> The Total Agreements represent the total population of Chapter 380 Program Agreements since the effective date of City of Houston Ordinance No. 1999-674 through December 31, 2015. The listing was obtained from the Legal Department and verified by the Deputy Director of Economic Development Division (EDD). The total population (Agreements) less other agreements that were not considered to be specifically Chapter 380 (TIRZ) revisions, and amendments) to an original Agreement was used for the sample selection.

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**AUDIT SCOPE AND OBJECTIVES**

Our original objectives were to consider the internal controls related to: 1) Compliance with applicable State and City guidelines and regulations; 2) Establishment of the Chapter 380 Program; and 3) Contractual Agreements. After conducting our initial research on economic development information, related State Statutes, City Ordinance(s), policies, operating procedures, and interviews with key personnel to gain an understanding of the functions performed by the Economic Development Division (EDD), we refined the audit objectives to consider the processes and internal controls related to whether:

1. The Chapter 380 Program is being administered according to guidelines established and approved from the Texas Local Government Code, Chapter 380 and the City of Houston Ordinance No. 1999-674;
2. Applicants met the qualifications/criteria of the Program;
3. The terms of Agreements met established criteria of the State Statute and City Ordinance with valid approval;
4. Conditions/Commitments negotiated and agreed to in the Agreements were met prior to receiving reimbursements;
5. Transactions for Project(s) reimbursements were accurate and adequately supported; and
6. Close out of completed Projects were appropriate and adequately documented.

The engagement scope period included various types of Projects approved from the effective date, July 1999 of the City of Houston Ordinance No. 1999-674 through December 31, 2015. **(See Table 2).**

<b>TABLE 2 TYPE OF PROJECTS/SAMPLE SELECTION</b>		
<b>TYPE OF CHAPTER 380 PROJECTS</b>	<b>TOTAL TYPE OF PROJECTS</b>	<b>NUMBER OF PROJECTS INCLUDED IN SAMPLE</b>
DEVELOPER/COMPANY	14	4
BUSINESS/COMPANY	2	0
DEVELOPER/GROCER	3	1
MANAGEMENT DISTRICT	2	1
NON-PROFIT	5	3
TECHNOLOGY	1	1
<b>TOTAL SAMPLE SELECTION</b>		<b>10</b>
<b>TOTAL PROJECTS</b>	<b>27</b>	



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**PROCEDURES PERFORMED**

In order to obtain sufficient evidence to achieve engagement objectives and support our conclusions, we performed the following:

- Obtained and reviewed the applicable Texas Local Government Code, Chapter 380, *Miscellaneous Provisions Relating To Municipal Planning And Development*, Sections 380.001 through 380.003 and the City of Houston, Texas Ordinance No. 1999-674, (which includes Exhibit “A” *Criteria For Chapter 380 Assistance*) that established the Economic Development Program;
- Obtained and reviewed EDD’s processes and procedures as presented to the Audit team by the Deputy Director of EDD;
- Interviewed EDD personnel;
- Selected ten (10) Projects (eight outstanding and two completed) and reviewed the applicable Agreement(s) and other documentation;
- Verified the total population (Agreements/Projects) since the effective date, July 1999 of City Ordinance No. 1999-674 through December 31, 2015;
- Obtained and examined documents maintained for each Project;
- Reviewed selected sample of negotiated Conditions/Commitments agreed to and verified whether they were met prior to reimbursement;
- Verified selected tax payments from taxing authorities were adequate; and
- Judgmentally selected five (5) Projects, which represented 76% of reimbursements paid as of December 2015 from the sample of ten (10) and verified the reimbursements amount(s) were according to the Agreement and were properly recorded in the general ledger (SAP). (See Table 3).

<b>TABLE 3 REIMBURSEMENTS SAMPLE</b>		
<b>TYPE OF PROJECT</b>	<b>STATUS OF PROJECT</b>	<b>TOTAL REIMBURSEMENTS AS OF 12/31/2015</b>
DEVELOPER/COMPANY	CLOSED/COMPLETED	\$6,712,823
NON-PROFIT	OPEN/OUTSTANDING	5,484,000
MANAGEMENT DISTR.	OPEN/OUTSTANDING	8,824,775
RETAIL/GROCER	OPEN/OUTSTANDING	724,838
TECHNOLOGY	OPEN/OUTSTANDING	120,302
<b>TOTAL SAMPLE<sup>2</sup> REIMBURSEMENTS</b>		<b>\$21,866,738</b>

<sup>2</sup> Sample Size of five (5) Projects was judgmentally selected for testing of Reimbursements and Conditions/Commitments taken from the Total Sample size (See Table 2).



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## ***AUDIT METHODOLOGY***

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards and in conformance with the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The scope of our work did not constitute an evaluation of the overall internal control structure of EDD. Management is responsible for establishing and maintaining a system of internal controls to ensure that City assets are safeguarded; financial activity is accurately reported and reliable; and management and employees are in compliance with laws, regulations, and policies and procedures. The objectives are to provide management with reasonable, but not absolute assurance that the controls are in place and effective.

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## ***CONCLUSIONS AND SIGNIFICANT ISSUES***

We believe that we have obtained sufficient and appropriate evidence to adequately support the conclusions provided below as required by professional auditing standards. Each Conclusion is aligned with the related Audit Objective for consistency and reference. For details, see the “*Detailed Findings, Recommendations, Management Responses, and Assessment of Responses*” section of this report.

### **CONCLUSION 1 – (AUDIT OBJECTIVE #1)**

Based on the results of the work performed, overall the selected sample of Projects reviewed, indicated that EDD is administering the Chapter 380 Program according to guidelines from the Texas Local Government Code, and the City of Houston Ordinance No. 1999-674. However, there were deficiencies noted. **(See Findings, #1, #2, and #4)**

### **CONCLUSION 2 – (AUDIT OBJECTIVE #2)**

Based on results of the work performed as it relates specifically to the Application and Evaluation/Approval Processes for selected sample Projects, applicants in the Application process met the qualifications established according to the Texas Local Government Code, Chapter 380, City Ordinance No. 1999-674 and EDD procedures. Selected Projects for review in the Approval process were approved accordingly. However, there were exceptions noted. **(See Findings #2 and #4)**

### **CONCLUSION 3 – (AUDIT OBJECTIVE #3)**

After reviewing the files for the selected sample of Projects, we concluded that documentation was inadequate or non-existent for criteria that was to be submitted by an applicant in order to be considered for the Chapter 380 Program. However, through interviews with EDD’s Deputy Director,

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we determined that some of the projects in our selected sample were approved prior to procedures established by EDD. Noted exception included:

Documentation submitted to meet the criteria established for consideration was inadequate, for example community impact proposed. **(See Finding #2)**

**CONCLUSION 4 – (AUDIT OBJECTIVE #4)**

As part of the Agreement the City makes with businesses/developers and/or organizations seeking assistance under the Chapter 380 Program, there are Conditions/Commitments negotiated and agreed to that must occur prior to the business or organization being reimbursed. In reviewing the Agreements of the five (5) selected sample of Projects and documentation to support the Conditions/Commitments agreed exceptions were noted. **(See Finding #3)**

**CONCLUSION 5 – (AUDIT OBJECTIVE #5)**

The Projects' reimbursements reviewed, were recorded accurately, adequately and were properly supported according to the Agreements.

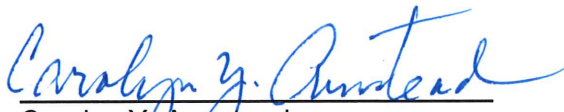
**CONCLUSION 6 – (AUDIT OBJECTIVE #6)**

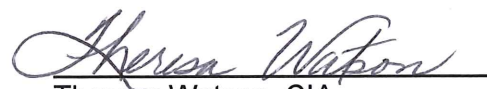
In reviewing selected Projects that were completed and closed out within the scope period, documentation was adequate and was appropriately closed.


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**ACKNOWLEDGEMENT AND SIGNATURES**

The Audit Team would like to thank the Mayor's Office, Economic Development Division's management and staff for their responsiveness, cooperation, time and efforts, throughout the course of the engagement.

  
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Lead Auditor

  
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### ***DETAILED FINDINGS, RECOMMENDATIONS, MANAGEMENT RESPONSES, AND ASSESSMENT OF RESPONSES***

#### **FINDING # 1 – NO FORMAL APPROVED DIVISION PROCEDURES (RISK RATING = HIGH)**

##### **BACKGROUND:**

The Texas State legislature passed *Texas Local Government Code*, Title 12, *Planning and Development*, Subtitle A., *Municipal Planning And Development*, Chapter 380 *Miscellaneous Provisions Relating To Municipal Planning And Development*, Sections 380.001 through 380.003 in 1989 most often referred to as Chapter 380. In 1999, the City of Houston Ordinance No. 1999-674 (Ordinance No. 1999-674) established an economic development program focused on the need for economic development in various under developed neighborhoods and/or needed infrastructures throughout the City. Although, the program was established in 1999, the City's first Chapter 380 Agreement on record was in March 2001.

When the Mayor and City Council originally approved Ordinance No. 1999-674, "...establishing an Economic Development Program pursuant to Chapter 380 of the *Local Government Code*...", the Planning and Development Department was named as the Department that would administer the program. Those responsibilities were moved twice, first to the Finance Department in 2006 and finally to the Mayor's Office in the Economic Development Division (EDD) in Fiscal Year (FY) 2012.

Prior to City Council's consideration and approval of Chapter 380 Projects, the Ordinance states, "...qualified applicants which are recommended by the Director may be presented to the appropriate Council committee...", which currently is the Economic Development Committee.

EDD follows a checklist of procedures that were developed during the audit that are based on guidance from "City of Houston Financial Policies" (Financial Policies). These Financial Policies were most recently amended and restated on December 3, 2014 by Ordinance No. 2014-1078. Section L of the Financial Policies specifically addresses policies related to Economic Development activities.

##### **FINDING:**

EDD provided the Audit Team with written procedures that were prepared during the audit for their 380 Process to include *Application, Approval, and Reimbursement*. The



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procedures did not show evidence of formal approval or an effective date. A lack of formal approved procedures led to the following:

- Inconsistencies and in some instances a lack of documentation to determine eligibility;
- Lack of documentation on EDD's evaluation of potential Projects; and
- Insufficient documentation contained in the project files provided and reviewed. For example, some projects only had handwritten notes as documentation, which at times were illegible.

### **RECOMMENDATION:**

We acknowledge that EDD uses the Financial Policies for guidance, however we recommend EDD management formally approve the Division's procedures documenting the processes of the Chapter 380 Program starting with inquiries for Chapter 380 assistance through the closing of completed Projects. The Division should ensure their procedures are in compliance with established criteria including the State Statute, City Ordinance, and any applicable amendments. The approved procedures should also include documentation requirements for Program compliance, which should be updated as needed. Formal written and approved procedures will facilitate the stewardship of public funds administered through the Chapter 380 Program.

### **EDD'S MANAGEMENT**

#### **RESPONSE:**

We agree to continue to evaluate and amend as needed the procedures relating to the Chapter 380 program. In 2016, the Office of Economic Development presented the primary application and evaluation formats to be used to request information from businesses and assess related projects for incentive consideration. The Application and Evaluation Scoring Matrix allows for consistent information to be collected relating to the Chapter 380 Program.

Our office has developed procedures relating to the Chapter 380 Program information flow from inquiries to council approval in both a narrative format and flow diagram. We agree that formalizing the procedures to include an annual review against the City Ordinance will ensure that critical knowledge will transfer with future administrations and staff.

### **RESPONSIBLE PARTY:**

The Office of Economic Development will work with the Finance and Legal Departments to continue to assess and improve procedures, protocol and standardization where possible.



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**ESTIMATED DATE OF COMPLETION:**

June 30, 2018 and annual review

**ASSESSMENT OF RESPONSE:**

Management response as presented sufficiently addresses issues identified and corrective actions are appropriate.

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**FINDING #2 – INADEQUATE DOCUMENTATION FOR CHAPTER 380 PROGRAM PROJECTS  
(RISK RATING = HIGH)**

**BACKGROUND:**

The City of Houston had twenty-seven (27) approved and executed Chapter 380 projects/agreements from inception (1999) to December 31, 2015. The Economic Development Division (EDD) has administered the Chapter 380 Program since Fiscal Year (FY) 2012.

EDD has identified three main processes for the Chapter 380 Program to include the following:

- 1) Application Process;
- 2) Evaluation and Approval Process; and
- 3) Reimbursement Process.

City Ordinance No. 1999-674, Exhibit “A”, paragraph 5, item #7 states in part,” ... *Applicants for assistance shall initiate consideration by submitting the following items: ...Nonrefundable application fee of \$500...to process and review the application. The Director may waive this fee for applicants which are non-profit entities...*”.

Additionally, the Ordinance states, “... applications for assistance will be reviewed for qualification and feasibility by City Staff...”.

**FINDING:**

We judgmentally selected a sample of ten (10) of the twenty-seven (27) Chapter 380 Projects/Agreements within the scope period from the effective date of City Ordinance No. 1999-674 through December 31, 2015 for review. In reviewing files of the selected sample for documentation of compliance with the Chapter 380 State statute, City Ordinance, corresponding agreements, and EDD’s process procedures, the following were noted:

- One of the ten (10) projects reviewed did not have documentation in the project files of the initial applicants’ application/letter applying for assistance in the Chapter 380 program;
- Eight (8) of the ten (10) projects had inadequate (partial) documentation for one or more criteria tested according to the Ordinance and/or the Application Process procedures developed by EDD;
- Six (6) of the ten (10) projects did not have documentation that the applicant paid the required application fee or that the EDD Director waived the fee if the



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entity was a non-profit, as stated in City Ordinance No. 1999-674, Exhibit "A". Three (3) of the ten (10) companies (applicants) reviewed were non-profit entities;

- Nine (9) of the ten (10) projects had inadequate (partial) documentation for one or more criteria tested per the Ordinance and/or the Evaluation Process procedures developed by EDD; and
- There was no documentation in the files examined as evidence that any of the ten (10) projects included in the sample selection (excluding any construction projects of infrastructure) were being monitored by the EDD throughout the various project stages to ensure compliance with terms of the agreement. Two (2) of the ten (10) projects were completed projects that were monitored and inspected by the Public Works & Engineering Department (PW&E) in order to issue a "Certificate of Final Completion" as required by the City.

### **RECOMMENDATION:**

We recommend that EDD ensure approved written procedures are followed to facilitate compliance and transparency in the administration of the Program.

### **EDD's MANAGEMENT**

#### **RESPONSE:**

The files for each project contain varied documentation, including supplemental documentation but disagree with the general finding of inadequate documentation with the exception that the file for one of the projects did not contain the record of the application fee and the authorizing ordinance for the project did not include a provision that waives any requirements. The files for the remaining eight (8) projects contained the documents necessary to recommend projects for incentive consideration. The authorizing ordinances for six (6) of the projects include a provision that waives any requirements of Ord. No. 99-674 with which the company has not complied. A separate economic development program created under a separate ordinance was established for (2) of the projects and therefore Ord. No. 99-674 is not applicable.

We agree with the recommendation to formalize processes that will facilitate program compliance. The Office of Economic Development has developed and will continue to review and modify as needed a "pre-council" 380 checklist as a tool to confirm all required and supplemental documentation as requested by the office and/or recommended in the ordinance. The checklist will be routed to the Deputy Director and approved with signature prior to the agreement council date.



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Our office will consider the audit recommendation to develop monitoring protocol to track the development status on an annual basis and document the development status

**RESPONSIBLE PARTY:**

The Office of Economic Development

**ESTIMATED DATE OF COMPLETION:**

June 30, 2018

**ASSESSMENT OF RESPONSE:**

The Audit Division disagrees with EDD's Management Response regarding, "The authorizing ordinances for six (6) of the projects include a provision that waives any requirements of Ord. No. 99-674 with which the company has not complied. A separate economic development program created under a separate ordinance was established for (2) of the projects and therefore Ord. No. 99-674 is not applicable." The first step in applying for Chapter 380 Assistance is the Application Process, which is guided by the State Statute and City Ordinance No. 1999-674 (including Exhibit "A"). City Ordinance No. 1999-674 continues to be the governing guidance until the project is presented to City Council for approval. Any waiver(s) granted by EDD should be documented and included in the project file(s).

The Audit Division acknowledges the two projects referenced as separate economic development programs. However, as stated above, adequate documentation to demonstrate compliance starting with the Application Process is guided by the State Statute and City Ordinance No. 1999-674, which is prior to City Council's approval of the project, therefore, Ordinance No. 1999-674 does apply.

The Audit Division agrees and acknowledges EDD's development and use of their "pre-council" 380 checklist as a tool to confirm all required and supplemental documentation as requested by the office and/or recommended in the ordinance. We believe a "post-Council" or Agreement checklist in each Project file would also be beneficial for monitoring by EDD.





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### **FINDING #3 – CHAPTER 380 PROJECT CONDITIONS/COMMITMENTS WERE NOT MET PRIOR TO REIMBURSEMENTS (RISK RATING = HIGH)**

#### **BACKGROUND:**

When the terms of an Economic Development Agreement are negotiated under Chapter 380, the company (Applicant/Tenant) agrees to comply with certain conditions/commitments, which "...must be fulfilled in order to receive the Reimbursement Amount... ". In the projects reviewed, examples of agreement conditions/commitments were: job creation, operational condition, building of infrastructure, maintenance of records, MWBE component, etc.,. The City of Houston requires that Chapter 380 contracts are approved by City Council, signed by other applicable parties, and is countersigned and dated by the City Controller for it to be legally binding and effective.

The Economic Development Agreement may also include language that states "...to ensure that the benefits the City provides under this Agreement are utilized in a manner consistent with Chapter 380 and other law, Tenant agrees to comply with certain conditions for receiving those benefits...".

In addition, language included in four of the five Agreements reviewed for compliance of conditions/commitments stated in part: "...corporate officer of the Tenant...shall provide a sworn statement that Tenant is and has been in compliance.... The sworn statement shall constitute the sole information upon which the City may rely to determine Tenant's compliance".

#### **FINDING:**

We judgmentally selected and reviewed five (5) of the ten (10) projects/agreements that were included in our original sample. Various conditions/commitments agreed to by the Companies were required for reimbursement by the City. The following exceptions were noted:

- Four (4) of the five (5) companies selected did not meet their agreed conditions/commitments either partially or fully prior to receiving reimbursements from the City. In one instance, the company sent documentation to support compliance with their agreed to condition(s), however, further review revealed the documents sent for compliance did not meet the conditions outlined in the agreement. One of those conditions was "Job Creation", which is a crucial component to economic development and the terms agreed upon for reimbursement;



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- The Economic Development Division (EDD) was not adequately monitoring the Chapter 380 agreements to ensure compliance with agreed conditions/commitments for each project prior to paying reimbursements to those companies, as required by the agreements;
  - We found one Company/Tenant where sworn statements of compliance were submitted as required attesting to compliance of agreed conditions/commitments. However, one Compliance Statement was missing for the calendar year 2012 (i.e., there should have been a Compliance Statement each year since 2011). Also, one of the four Compliance Statements submitted was late. According to the agreement, a Compliance Statement should have been submitted "..., On or before January 1 of each year...", but it was submitted February 19th. In addition, another Company that was selected for review, submitted both of their Compliance Statements after the date required per the agreement; and
  - Although, language in four of the five agreements reviewed, stated that the City may rely solely on the sworn Compliance Statement to determine the Company's compliance with agreed conditions/commitments, one of the five agreements did not have that language. There was no documentation that EDD verified the conditions/commitments agreed to were met for the one Company or that the company was contacted for failure to comply prior to reimbursement, as stated in the agreement.
  - During our review of agreements for selected projects, we noted one agreement was never executed. However, the Legal Department was made aware of this issue, and it was properly executed with the City Controller's countersignature and date.

### **RECOMMENDATION:**

Although the state statute and City Ordinance(s) are silent on monitoring, we believe monitoring is a valuable management best practice, that will help the EDD be able to determine whether projects (excluding construction of infrastructure projects) approved with Chapter 380 funds are operating as intended. We recommend EDD include and implement in their formal approved procedures processes to monitor and verify, where applicable, conditions/commitments agreed to by the Company have been fulfilled prior to disbursing any reimbursements. That verification should be documented and included in the project files.

We also recommend that EDD review the language regarding "sworn statements of compliance" as being the only documentation required to be submitted by the company and as the "sole information" the City may rely on and that all conditions/commitments

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have been met prior to any reimbursements. The current language precludes EDD from verifying whether the company is in compliance and eligible to receive reimbursement(s). Review of the contract/agreement language should be prior to approval of all agreement(s).

In addition, we recommend that EDD verifies that each final and approved Chapter 380 Agreement has been properly executed.

### **EDD's MANAGEMENT**

#### **RESPONSE:**

There is a distinction between a review oversight and administrative negligence or “non-compliance”. The companies referenced in the findings have all complied with the reporting terms of their respective agreements related to the reimbursement conditions. Comments to the audit findings are noted:

With regards to the findings, we agree that a payment was made later than the date referenced in the agreement for one company due to the amount of time required to complete the internal review of more than a thousand pages of documents submitted by the company pursuant to the agreement. Additionally, regarding the job creation reconciliation finding with the second company, we have recalculated the reimbursement, requested and received a refund, which has been deposited. No further action is required. Finally, regarding the compliance statement finding with the third company, the company submitted two sworn statements on December 21, 2012. The first statement stated compliance for calendar year 2011 and the second statement stated compliance for the preceding year. The company submitted the second statement intending to demonstrate 2012 compliance. However, because the statement was submitted in December 2012 instead of January 2013, for the “preceding year”, it implies compliance for 2011. The 2012 compliance statement should have been submitted in January 2013 for the preceding year, 2012.

We support the Auditor's position that a sworn statement of compliance without verifiable documentation should not be the sole support documentation for reimbursement and subsequent agreements did require a higher level of documentation; however, the company did comply fully with the stated terms of the agreement by submitting the sworn statement. The referenced agreement that allows for the sworn statements only is an earlier agreement approved in 2011. The Office of Economic Development has developed and implemented a “380 Audit Checklist” as an enhanced internal control to ensure that each construction, development, and



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reimbursement requirement has been met prior to making a reimbursement payment. The checklist is submitted to the Deputy Director for review and signature approval.

**RESPONSIBLE PARTY:**

Office of Economic Development

**ESTIMATED DATE OF COMPLETION:**

Process was implemented in 2017; No further action is required.

**ASSESSMENT OF RESPONSE:**

The Audit Division acknowledges the corrective action taken by the EDD, as well as the implementation of the “380 Audit Checklist” as a monitoring tool for the projects. We agree that the use of the “380 Audit Checklist” will facilitate the monitoring of the Chapter 380 Projects ensuring that conditions/commitments are met prior to reimbursing the companies.

The management of EDD should also ensure that all final and approved Chapter 380 Agreements are properly executed.



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### **FINDING #4 – CITY OF HOUSTON, ORDINANCE NO. 1999-674 GOVERNING THE CHAPTER 380 PROGRAM IS OUTDATED (RISK RATING = MEDIUM)**

#### **BACKGROUND:**

In July 1999, City Council adopted and passed the City of Houston, Texas Ordinance No. 1999-674, including Exhibit “A” *Criteria For Chapter 380 Assistance (Exhibit “A”)*, which established an economic development program, pursuant to State Statute Chapter 380 of the *Local Government Code*. Exhibit “A” of the Ordinance, paragraph five (5), item no. 7 states, “...Applicants for assistance shall initiate consideration by submitting the following items...Nonrefundable application fee of \$500...The Director may waive this fee for applicants which are non-profit entities”.

*Exhibit “A”* of City Ordinance No. 1999-674, also states, “Assistance packages shall have a maximum term of ten years.”

City of Houston Ordinance No. 2014-1078, an Ordinance amending and restating the City’s Financial Policies was adopted and passed by City Council, which included Exhibit A, Section L, *Local Economic Development Policies*. The economic development policies include defined scope of economic development emphasis; project eligibility and standardization of application, presentation and evaluation formats for economic development projects.

#### **FINDING:**

In the 18 years since passage of City Ordinance No. 1999-674, there have been procedural changes implemented by various City of Houston Mayors during their administrations, and the language in some sections of the original City Ordinance has become outdated and/or is no longer applicable. Examples include but may not be limited to:

- Ordinance No. 1999-674 limits assistance package duration to a maximum of 10 years, however two (2) projects have terms beyond 10 years;
- The original \$500 application fee, authorized in the Ordinance has not been reviewed or evaluated since its passage; and
- The Mayor’s Office has administered the Chapter 380 Program since Fiscal Year (FY) 2012, rather than the Planning Division as authorized in the Ordinance.

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**RECOMMENDATION:**

We recommend that the Director of EDD with the approval of the Mayor, make a formal written request to the Legal Department to review the existing Ordinance and draft an amendment to address any outdated sections including those that may be restrictive and/or no longer practiced to ensure the Chapter 380 Program's purpose is maintained, reflects the current economic climate, and enhances the City's ability to stimulate economic development.

Best practice indicates there should not be any conflicting language between Ordinance No. 1999-674 and the amended/restated Financial Policies of Ordinance No. 2014-1078, which includes Section L. *Local Economic Development Policies*. Also, language in Ordinance No. 1999-674 should depict the language and any amendments from applicable State statute(s), and the Texas Local Government Code (Chapter 380). EDD should ensure if there are any changes/amendments to the State statute, City financial policies, and/or procedural changes from administrations that affect the Program, the City Ordinance is updated accordingly to reflect those changes.

In addition, EDD should determine and evaluate whether the \$500 nonrefundable application fee is sufficient and in line with other City fee structures and if not, update the fee and Ordinance and document in the EDD files.

**EDD'S MANAGEMENT**

**RESPONSE:**

After a review of the 1999 statute of Chapter 380 of the Texas Local Government Code and subsequent amendments in coordination with City Legal, neither our office nor City Legal agrees that an amendment to Ordinance No. 99-674 is necessary to reflect statutory changes.

Since 1999, the State Legislature has amended Chapter 380 of the Texas Local Government Code four times (76R SB 681; 77R HB 782; 79R HB 918; and 80R HB 2278); however, the Legal Department has confirmed that these amendments did not impact the City or necessitate a change to Ordinance No. 99-674. While the ordinance is legally and statutorily sound, we will consider amending the ordinance to reflect outdated fees and other practical considerations or develop internal policies and procedures to meet the same objective.

Currently, the nonrefundable application fee is set at \$500. We will review the cost associated with the application review process to determine if it accurately reflects the amount of time and resources required to process the application.



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### **RESPONSIBLE PARTY:**

The Office of Economic Development, Legal Department and Finance Department, and the mayor's senior staff

**ESTIMATED DATE OF COMPLETION:** June 30, 2018

### **ASSESSMENT OF RESPONSE:**

The Audit Division appreciates and acknowledges the EDD collaboration with the City's Legal Department to ensure compliance with the Chapter 380 Program. We also acknowledge EDD's consideration to amend the Ordinance to reflect outdated fees and other considerations. However, we disagree that there is not a need to amend Ordinance No. 1999-674 for any future statutory changes that affect Chapter 380. In addition, some current sections as noted in the findings are restrictive and/or no longer practiced, for example, the term limit maximum of 10 years, as stated in Exhibit "A", is just one of the restrictions, which ensures the Chapter 380 Program's purpose is maintained, reflects the current economic climate, and enhances the City's ability to stimulate economic development.

Although the \$500 non-refundable fee is set, it has not been assessed or reviewed since 1999, over 18 years ago. Audit agrees that EDD should review the cost associated with the Application Process. However, an assessment should be performed soon to ensure that the amount is still sufficient and in line with other City fee structures.



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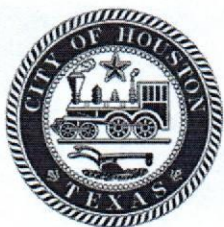
Audit Division

## **EXHIBIT 1**

# **ACKNOWLEDGEMENT STATEMENT**

**MAYOR'S OFFICE, ECONOMIC DEVELOPMENT DIVISION**





CITY OF HOUSTON

Sylvester Turner

Mayor

Andrew F. Icken  
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## Acknowledgement Statement

Date: February 15, 2018

Chris B. Brown  
City Controller  
Office of the City Controller

**SUBJECT: CHAPTER 380 PROGRAM PERFORMANCE/COMPLIANCE AUDIT  
ACKNOWLEDGEMENT OF MANAGEMENT RESPONSES**

I acknowledge that the management responses contained in the above referenced report are those of the Chief Development Officer of the Economic Development Division (EDD). I further acknowledge confirmation from the Controller's Office, that our responses to the Audit Findings are satisfactory in addressing and resolving the issues presented. I also understand that this document will become a part of the final audit report that will be posted on the Controller's Office website.

Sincerely,

Andrew F. Icken  
Chief Development Officer  
Mayor's Office

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