



An Audit Report on

Selected Major Agreements Under the Texas Economic Development Act

July 2019
Report No. 19-046



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Overall Conclusion

Under the Texas Economic Development Act (Texas Tax Code, Chapter 313), independent school districts (ISDs) have entered into agreements with businesses for limitations on the appraised value for property (agreements), and those agreements have enabled capital investments and job creation benefiting the local and state economy.

The State Auditor's Office selected and audited four agreements at three ISDs and determined the following:

- Applications, Agreements, and Conflicts of Interest. The ISDs processed applications, executed agreements, and disclosed conflicts of interests as required. However, the Office of the Comptroller of Public Accounts (**Comptroller's Office**) should specify the appropriate actions that ISDs should take to correct an issue identified in the agreements. In addition, two of the three audited ISDs should ensure that they calculate all payments under the agreements according to requirements.
- Reinvestment zone noncompliance. A clause requiring qualified property to be located in a reinvestment zone for the life of the agreement created noncompliance for 3 agreements and, potentially, 38 others because of the expiration of the reinvestment zones in which those properties were located. A reinvestment zone is an area designated by a local government or school district that is likely to contribute to increased employment opportunities and attract major investment. Because the ISDs were required to use the **agreement form produced by the Comptroller's Office**, **the Comptroller's Office should** establish guidance on this clause to avoid noncompliance with agreement terms.
- Supplemental payments. Floydada ISD and Calhoun County ISD did not follow Texas Education Code, Section 42.005, for computing average daily attendance when calculating supplemental payments, as required by Texas Tax Code, Section 313.027(i). Those payments are made by businesses under the agreements to the ISDs to offset administrative costs.

Background

The Texas Economic Development Act authorizes independent school districts (ISDs) to enter into agreements for limitations on appraised values of qualifying property (agreements). That property valuation limitation allows businesses under those agreements to pay a reduced amount of taxes to the ISD in return for creating jobs and capital improvements that enhance the local and state economy.

As of December 31, 2018, there were 383 agreements with 180 ISDs. The ISDs audited were:

- Barbers Hill ISD.
- Calhoun County ISD.
- Floydada ISD.

See Appendix 3 for more background on the Texas Economic Development Act.

Sources: The Texas Tax Code, Chapter 313, and the Office of the Comptroller of Public Accounts.

This audit was conducted in accordance with Texas Tax Code, Section 313.010.

For more information regarding this report, please contact Becky Beachy, Audit Manager, or Lisa Collier, First Assistant State Auditor, at (512) 936-9500.

- Compliance Monitoring and Reporting. All three ISDs performed required monitoring and submitted all required monitoring reports to the **Comptroller’s Office**. However, **the Comptroller’s Office does not provide** guidance to the ISDs to address issues resulting from business eligibility reports prior to submitting monitoring reports. As a result, Floydada ISD submitted a report for the 2015 tax year with an incomplete response **regarding South Plains Wind Energy II’s franchise tax** status, and it did not take corrective action.

Table 1 presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 1

Summary of Chapters/Subchapters and Related Issue Ratings		
Chapter/ Subchapter	Title	Issue Rating ^a
1	Summary of the Agreements Audited	Not Rated
2-A	Processing Applications for Agreements and Developing Agreements	Low
2-B	Reinvestment Zone Noncompliance	Medium
2-C	Payments to ISDs Under Agreements	Medium
2-D	Conflict of Interest Disclosures	Low
3	Compliance Monitoring and Reporting	Medium

^a A chapter is rated Priority if the issues identified present risks or effects that if not addressed could critically affect the audited entity’s ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.

A chapter is rated High if the issues identified present risks or effects that if not addressed could substantially affect the audited entity’s ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.

A chapter is rated Medium if the issues identified present risks or effects that if not addressed could moderately affect the audited entity’s ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

A chapter is rated Low if the audit identified strengths that support the audited entity’s ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity’s ability to effectively administer the program(s)/function(s) audited.

Auditors communicated other, less significant issues separately in writing to the **Comptroller’s Office**.

Summary of Management's Response

At the end of certain chapters in this report, auditors made recommendations to address the issues identified during this audit. **The Comptroller's Office and the ISDs** agreed with the findings and the recommendations in this report.

Audit Objectives and Scope

The objectives of this audit were to:

- Determine whether selected major agreements under the Texas Economic Development Act:
 - ◆ Accomplish the purposes of Texas Tax Code, Section 313.003.
 - ◆ Comply with the intent of the Legislature in enacting Texas Tax Code, Section 313.004.
 - ◆ Were executed in compliance with the provisions of Texas Tax Code, Chapter 313.
- Determine whether there are ways to increase the efficiency and effectiveness of the administration of the Texas Economic Development Act.

The scope of the audit covered selected applications and agreements processed from January 1, 2014, through December 31, 2018.

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Detailed Results

Chapter 1

Summary of the Agreements Audited

The four agreements for limitations on appraised value of property (agreements) audited included:

- Barbers Hill Independent School District’s (ISD) agreements with Lone Star NGL Asset Holding II LLC (Application No. 1016 and Application No. 1034).
- Calhoun County ISD’s agreement with Formosa Plastics Corporation, Texas (Application No. 1048).
- Floydada ISD’s agreement with South Plains Wind Energy LLC and South Plains Wind Energy II LLC (Application No. 1004).

Each ISD hired a consultant to assist in the administration of the agreements selected, including (1) addressing reporting requirements and (2) performing annual calculations of revenue protection payments and supplemental payments.

Table 2 summarizes key information from the agreements audited.

Table 2

Summary of Agreements Audited				
ISD Name	Barbers Hill	Barbers Hill	Calhoun County	Floydada
Agreement Number	1016	1034	1048	1004
Agreement Holder	Lone Star NGL Asset Holdings II LLC	Lone Star NGL Asset Holdings II, LLC	Formosa Plastics Corporation, Texas	South Plains Wind Energy LLC; South Plains Wind Energy II LLC
Eligibility Category	Manufacturing	Manufacturing	Manufacturing	Renewable [Wind] Energy Electric Generation
County	Chambers	Chambers	Calhoun	Floyd
Estimated Investment Amount (in millions) ^a	\$300.0	\$285.0	\$600.0	\$243.4
Jobs Created ^b	4 ^c	10	66	8 ^c

Summary of Agreements Audited				
ISD Name	Barbers Hill	Barbers Hill	Calhoun County	Floydada
Estimated Appraised Value as of December 31, 2018 (in millions) ^a	\$267.7	\$274.0	\$570.5	\$178.5
Limitation per Agreement (in millions)	\$30.0	\$30.0	\$30.0	\$20.0
Agreement Date	December 15, 2014	March 23, 2015	November 9, 2015	December 8, 2014
Limitation Period Start Date	January 1, 2017	January 1, 2017	January 1, 2018	January 1, 2016
Limitation Period End Date	December 31, 2026	December 31, 2026	December 31, 2027	December 31, 2025
Final Termination Date	December 31, 2031	December 31, 2031	December 31, 2032	December 31, 2030
Projected Total Taxes for Agreement Period (in millions) ^a	\$38.2	\$45.5	\$81.1	\$28.7
Tax to Be Paid (Estimated in millions) ^a	\$18.1	\$22.8	\$36.6	\$14.2
Lifetime Tax Savings (Estimated in millions) ^a	\$20.0	\$22.7	\$44.5	\$14.5
Revenue Protection Payments Received Through December 31, 2018	\$2,254,922	\$2,259,255	\$1,615,228	\$981,069
Supplemental Payments Received Through December 31, 2018	\$1,887,600	\$1,415,700	\$1,339,666	\$287,200

^a Certain information presented in this table is based on estimates from information self-reported by the businesses and was not verified by auditors.

^b Texas Tax Code, Section 313.025(f-1), allows ISDs to waive the jobs requirement if the governing body determines that the requirement exceeds the industry standard to operate a facility described in the application.

^c Agreements 1004 and 1016 received waivers for the qualifying jobs requirement **from the Comptroller's Office**.

Source: The **Office of the Comptroller of Public Accounts'** Web site information on Texas Tax Code, Section 313, Barbers Hill ISD, Calhoun County ISD, the Calhoun County Appraisal District, and Floydada ISD.

Table 3 provides information on the appraised value and the appraisal limitation value of the properties in the selected agreements through tax year 2018. The information in Table 3 provides additional background information on the audited agreements for the subsequent chapters in this report.

Table 3

Property Appraisal Values Compared to Appraisal Limitation Values for Agreements Audited January 2014 through December 2018												
Agreement Year	Barbers Hill ISD Agreement No. 1016 ^a			Barbers Hill ISD Agreement No. 1034 ^a			Calhoun County ISD Agreement No. 1048 ^a			Floydada ISD Agreement No. 1004 ^a		
	Tax Year	Appraised Value	Appraisal Limitation Value	Tax Year	Appraised Value	Appraisal Limitation Value	Tax Year	Appraised Value	Appraisal Limitation Value	Tax Year	Appraised Value	Appraisal Limitation Value
1	2014	\$0	No limitation	2015	\$0	No limitation	2015	\$1,145,880	No limitation	2014	\$0	No limitation
2	2015	\$0	No limitation	2016	\$20,000,000	No limitation	2016	\$28,454,050	No limitation	2015	\$0	No limitation
3	2016	\$285,101,681	No limitation	2017	\$282,492,000	\$30,000,000	2017	\$112,078,520	No limitation	2016	\$141,534,990	\$20,000,000
4	2017	\$284,833,811	\$30,000,000	2018	\$289,883,167	\$30,000,000	2018	\$213,340,990	\$30,000,000	2017	\$224,728,785	\$20,000,000
5	2018	\$289,258,769	\$30,000,000							2018	\$178,483,080	\$20,000,000

^a All agreements have a stipulated qualifying time period to make the qualified investment. The qualifying time period begins on the date the application is approved by the ISD and ends on the last day of the second complete tax year following the agreement start date.

Sources: Barbers Hill ISD, Calhoun County ISD, Calhoun County Appraisal District, and Floydada ISD.

Applications, Agreements, and Conflicts of Interest

All three ISDs had processes in place, and those processes were operating effectively for (1) processing applications, (2) executing agreements, and (3) disclosing conflicts of interest.

However, the Office of the Comptroller of Public Accounts (Comptroller’s Office) should develop guidance for the ISDs on how to resolve an issue created by a reinvestment zone clause in several agreements.

In addition, Floydada ISD and Calhoun County ISD did not calculate certain payments they received from businesses under the agreements in accordance with agreement terms.

Chapter 2-A
Rating:
Low ¹

Chapter 2-A Processing Applications for Agreements and Developing Agreements

Table 4 summarizes the results of testing of the applications that the businesses submitted and the agreements entered into by the three ISDs. Based on those testing results, the ISDs both processed the applications and developed agreements appropriately (see Appendix 3 for further information on how agreements are formed, including the application process).

Table 4

Testing Results - Applications for Agreements and Developing Agreements				
Attribute	Barbers Hill ISD (1016)	Barbers Hill ISD (1034)	Calhoun County ISD (1048)	Floydada ISD (1004)
Did the submitted application contain sufficient information to indicate that the qualifying property met the applicable criteria established by Texas Tax Code, Section 313.021(2), and was the applicable application fee included?	Yes	Yes	Yes	Yes
Before approving the application, did the ISD properly verify the accuracy and completeness of information in the application; evaluate the application to ensure that the business project met the eligibility requirements; and determine that granting the application was in the best interest of the ISD and the State?	Yes	Yes	Yes	Yes
Did the agreement between the ISD and the business contain all provisions required by statute at the time of the agreement?	Yes	Yes	Yes	Yes

¹ The risk related to the issues discussed in Chapter 2-A is rated as Low because the audit identified strengths that support the audited entity’s ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity’s ability to effectively administer the program(s)/function(s) audited.

Reinvestment Zone Noncompliance**Chapter 2-B
Rating:**Medium²

Forty-one current agreements executed between January 1, 2014, and January 24, 2016, contain a clause requiring qualified property to be located in a reinvestment zone until the final termination date of the agreement (see text box for information on reinvestment zones). All 41 agreements containing this clause have durations of 15 to 19 years. However, the Comptroller's Office has asserted that, according to Texas Tax Code, Chapter 312, a reinvestment zone can last only up to 10 years. As a result, for 3 of the 4 agreements audited, the properties are located in areas where the reinvestment zone designation had expired. Additionally, for the remaining 38 agreements that include the clause, the reinvestment zones will also expire before the agreements end.

The agreements formed since January 2016 no longer contain the language causing the reinvestment zone issue. The Comptroller's Office updated the reinvestment zone clause in its agreement template to state that a reinvestment zone has to be in place when an application to form an agreement is approved by the ISD board.

Reinvestment Zones

The Texas Economic Development Act (Texas Tax Code, Chapter 313) requires that property considered for the value limitation (qualified property) be located in a reinvestment zone as defined in the Texas Tax Code, Chapters 311 or 312.

Under the statute, ISDs or counties may designate an area as a reinvestment zone to promote development by private industry. This is an area that is likely to contribute to increased employment opportunities and major investment to benefit the local government or ISD and the state.

Reinvestment zones are established for a limited period of five years with an option for a five-year renewal.

Source: Texas Tax Code, Chapters 311-313.

Recommendation

The Comptroller's Office should provide guidance to the ISDs with the 41 affected agreements on how to resolve the issue created by the reinvestment zone clause.

Management's Response

The Comptroller's office agrees with the recommendation and will send additional guidance to the ISDs with the 41 affected agreements.

Responsible Party: Data Analysis and Transparency Division

Implementation Date: 12/31/2019

² The risk related to the issues discussed in Chapter 2-B is rated as Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

Chapter 2-C
Rating:
Medium ³

Chapter 2-C
Payments to ISDs Under Agreements

While Barbers Hill ISD, Floydada ISD, and Calhoun County ISD complied with requirements for calculating revenue protection payments, two (Floydada ISD and Calhoun County ISD) of the four agreements were not in compliance with the Texas Education Code in calculating a component used to determine supplemental payments from businesses (see text box for more information on selected payments ISDs can receive under the agreements).

Specifically, for their agreements, Floydada ISD and Calhoun County ISD did not calculate average daily attendance (ADA), which is used in determining supplemental payments, according to the methodologies in Texas Education Code, Section 42.005. Both the Comptroller’s Office’s agreement template and Texas Tax Code, Section 313.027(i), require the ISDs to follow those methodologies.

Selected Payment Types Under the Audited Agreements

- Revenue protection payment—The payment from the business to protect an ISD against losses in maintenance and operations revenue throughout the duration of the agreement.
- Supplemental payment—An amount paid to an ISD for the execution of an agreement. The annual supplemental payment amount is the greater of either \$50,000 or \$100 per student per year multiplied by average daily attendance (ADA).

Source: The Comptroller’s Office.

Table 5 summarizes the results of auditors’ testing of payments received by the ISDs.

Table 5

Testing Results - Payments Received by the ISDs				
Attribute	Barbers Hill ISD (1016)	Barbers Hill ISD (1034)	Calhoun County ISD (1048)	Floydada ISD (1004)
Were the revenue protection payments and supplemental payments (payment in lieu of taxes) paid by the applicant?	Yes	Yes	Yes	Yes
Were the calculations of the revenue protection payment and supplemental payment (payment in lieu of taxes) amounts performed correctly/accurately and in accordance with the agreement?	Yes	Yes	No ^a	No ^a
^a In their calculations of supplemental payment amounts, Floydada ISD and Calhoun County ISD used an average daily attendance amount that did not comply with statutory requirements.				

³ The risk related to the issues discussed in Chapter 2-C is rated as Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity’s ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

When an ISD forms an agreement with a business, it agrees to receive revenue protection payments to offset the resulting reduction in state funding, and it may receive a supplemental payment as part of the agreement. To calculate both payments, the ISD must determine an ADA amount to use in accordance with the methodologies in Texas Education Code, Section 42.005 (see textbox for more information on ADA). For supplemental payments, the ADA amount is stated in the agreements.

Average Daily Attendance
Average Daily Attendance (ADA) is the quotient of the sum of attendance for each day of the minimum days of instruction divided by the minimum days of instruction.
Source: The Texas Education Code, Section 42.0005.

To calculate supplemental payments for its two agreements, Barbers Hill ISD used the ADA amount that it had previously calculated and reported to the Texas Education Agency (TEA), and that number complied with Texas Education Code, Section 42.005. However, Floydada ISD and Calhoun County ISD used estimated ADA computations that were not in compliance with Texas Education Code and had not previously been reported to and published by the TEA. While there is no statutory requirement for the ISDs to use the published ADA amount, those two ISDs could not support that the ADA amounts they had used in their calculations complied with the methodology in Texas Education Code, Section 42.005. When compared to the TEA’s published ADA amount, the calculations resulted in potential overpayment of supplemental payments from the businesses of \$6,600 to Floydada ISD and \$19,800 to Calhoun County ISD annually until the third year after the end of the limitation period.

Recommendation

For future agreements, Floydada ISD and Calhoun County ISD should ensure that their ADA calculations are supported and are performed in accordance with Texas Education Code, Section 42.005⁴.

Management’s Response

Floydada ISD

The District acknowledges that it estimated the ADA in establishing the limit for supplemental payments under section 6.2.C of the Agreement, but offers the following explanation.

At the time the Summary of the District’s Financial Impact report was prepared and the Agreement was submitted to the Comptroller for approval,

⁴ Effective September 1, 2019, House Bill 3 (86th Legislature) transfers the requirements of Texas Education Code, Section 42.005, to Texas Education Code, Section 48.005.

the data to calculate the ADA under Texas Education Code section 42.005 for the 2013-2014 school year was unavailable. Therefore, to stay below the statutory limit and comply with the Comptroller's form Agreement, the District projected a 1% decline in ADA from the most recent ADA available under section 42.005 to set the limit of supplemental payments in accordance with section 6.2.C of the Agreement. This was done because the Comptroller did not allow the ADA to fluctuate in 2014. See 2014 Form 50-286. The proposed agreement, with the projected ADA, was submitted to the Comptroller's office, which concluded the Agreement complied with Chapter 313 and the Comptroller's rules.

Thereafter, when updating the Form in 2016, the Comptroller's 2016 Adopted Rules for the Comptroller allowed a change in the 2016 Form Agreement (Form No. 50-826), noting:

"[T]he comptroller agrees that the decision regarding whether to lock in the ADA at the time of agreement or allow the ADA to float during the length of the agreement is a decision best made between the school district and the applicant. The comptroller adopts optional language in §6.2.D that will allow the parties to choose between the school district's ADA at the time of agreement or the school district's ADA for the previous school year."

Note that the subject Agreement requires a static ADA in Section 6.2.C. as required in 2014:

"C. For purposes of this Agreement, the amount of the Annual Limit shall be Seventy-One Thousand Eight Hundred Dollars (\$71,800.00) based upon the District's 2014-15 Average Daily Attendance of 718, rounded to the whole number."

District's third-party consultant prepared the Summary of the District's Financial Impact report for the project in 2014 and projected future ADA in order to estimate future state funding figures for the District. Floydada ISD had an ADA of 725 for the school year of 2012-13, however, enrollment was on the decline. When an actual ADA count was unavailable, the third-party consultant estimated the 2013-14 ADA at 718, which the District used in section 6.2.C of the Agreement for the 2014-2015 school, the year in which the Agreement was finally approved. The District was concerned that using the 725 ADA would violate Texas Tax Code § 313.027(i) and, therefore, used the more conservative estimate of 718 ADA. As noted in the report, there is no statutory requirement that Floydada ISD use the TEA published ADA.

Based upon the 2016 Form Agreement (Form No. 50-826) and the Comptroller's change in position, the foregoing has not created issues with

subsequent agreements. Additionally and as part of its Economic Impact Analysis of applications pursuant Texas Tax Code 313.026, the Comptroller now provides school districts an ADA for the preceding school year. To comply with the requirements of Texas Tax Code section 313.027(i) since this Agreement, the District does not use an estimated ADA for purposes of establishing the limit on supplemental payments. It has already implemented a practice to calculate such limitation on supplemental payments based on the ADA amount provided by the Comptroller or uses the most current available data to calculate its ADA according to Texas Education Code section 48.005 (formally codified at section 42.005 prior to the effective date of H.B. 3 of the Regular Session of the 86th Texas Legislature).

Calhoun County ISD

District leadership has changed since the District considered the final agreement reviewed during the SAO Audit. Current District staff was able to recreate the information used to determine the average daily attendance (“ADA”) number set forth in the Agreement; however, we were unable to locate official documentation that confirmed the numbers.

The District has implemented new procedures for agreements going forward to ensure that the ADA number accurately reflects the District’s ADA calculated under Texas Education Code Section 48.005 (formerly section 42.005). The current Administration has ensured that the ADA figure amount exactly matches the information publicly available on the Texas Education Agency website. A copy of that information is saved and will be maintained through the life of any future agreement. The District has already begun to implement this practice for the application currently under review.

Chapter 2-D
Rating:
Low ⁵

Chapter 2-D Conflict of Interest Disclosures

All three ISDs had effective processes for disclosing conflicts of interest. Specifically, all three ISDs complied with Texas Local Government Code, Chapters 171 and 176, which requires board members to disclose conflicts of interest.

⁵ The risk related to the issues discussed in Chapter 2-D is rated as Low because the audit identified strengths that support the audited entity’s ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity’s ability to effectively administer the program(s)/function(s) audited.

Compliance Monitoring and Reporting

Chapter 3
Rating:
Medium ⁶

All three ISDs submitted all required monitoring reports (see text box for required monitoring reports). However, for one of the four agreements audited, Floydada ISD submitted to the Comptroller’s Office an incomplete report noting that the business was not current with its Texas franchise tax requirements. While the Comptroller’s Office has included in its agreement template some procedures to address certain noncompliance issues, it has not provided guidance on how to handle situations in which incomplete monitoring reports are submitted.

Table 6 summarizes the results of auditors’ testing of compliance and reporting requirements.

Required Monitoring (Eligibility and Progress) Reports

The ISDs are required to submit monitoring reports for their agreements to the Comptroller’s Office. Specifically:

- Annual Eligibility Report (Form 50-772A) - The form filled out annually by businesses in agreements and submitted to the ISDs by June 15 to report continued eligibility under Texas Tax Code, Chapter 313. The ISDs must submit the form to the Comptroller’s Office by August 15.
- Biennial Progress Report (Forms 50-773A and 50-773B) - The form filled out by businesses in agreements and submitted to the ISDs by June 15 of every even-numbered year to report business project status. The ISDs must submit the form to the Comptroller’s Office by August 15.
- Biennial School District Cost Data Request (Forms 50-827A and 50-827B) - The form completed by the ISDs and submitted to the Comptroller’s Office by August 15 of each even-numbered year to report payment activity and projected costs over the life of the agreement.

Source: The Comptroller’s Office’s Web site.

Table 6

Testing Results - Compliance Reporting				
Requirement Tested	Barbers Hill ISD (1016)	Barbers Hill ISD (1034)	Calhoun County ISD (1048)	Floydada ISD (1004)
Did the ISD monitor the business’ compliance with the limitation agreement, including submitting the required monitoring reports showing that capital investments and job creation were performed as agreed?	Yes	Yes	Yes	Yes
Did the ISD’s Web site contain a link to the Comptroller’s Office-maintained Web page with all Chapter 313 limitation agreement information?	Yes	Yes	Yes	Yes

⁶ The risk related to the issues discussed in Chapter 2 is rated as Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity’s ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

Floydada ISD did not ensure that its monitoring report was complete prior to **submitting that report to the Comptroller's Office.**

In its 2015 Annual Eligibility Report to Floydada ISD, SouthPlains Wind Energy II, LLC submitted an incomplete response to a question about its franchise tax status.

However, Floydada ISD's consultant asserted that the 2015 report was submitted to the Comptroller's Office without comment on that issue to meet the filing deadline, and the Comptroller's Office published that report without requiring the ISD to take any action. The report indicated that SouthPlains Wind Energy II, LLC's franchise tax status was forfeit during the time period covered in that report. In the next reporting period, the business' franchise tax status had been restored to active. Not ensuring that identified eligibility issues are addressed increases the risk that (1) the interests of the ISDs and the State may not be protected and (2) businesses could receive incentives under these agreements while not meeting their obligation to file and pay state taxes.

The Comptroller's Office has not provided guidance on how to address an incomplete monitoring report.

The Comptroller's Office asserted that its role related to the Annual Eligibility Reports is to make them publicly available on its Web site. But to help ensure that the State's interests are protected, the Comptroller's Office should provide guidance on what to do when an issue is identified in required reporting. The Comptroller's Office requires the submitted reports to be accurate "to the Comptroller's satisfaction." However, there is no guidance as to what "the Comptroller's satisfaction" means for accuracy or completion, or on how to resolve any issues identified through that report, such as when a business is no longer current with the Texas franchise tax requirements.

Because the Comptroller's Office relies on the businesses and the ISDs to monitor eligibility for these agreements, it is important that the guidance to those entities be clear on how to accurately complete the reports and resolve any identified issues.

Recommendations

Floydada ISD should ensure that it takes action on any issues identified in monitoring reports to ensure that businesses are eligible for incentives under the agreement prior to submission of required eligibility reports.

The Comptroller's Office should provide guidance to the ISDs on how to address issues identified in the Annual Eligibility Reports prior to submission.

Management's Response

Floydada ISD

South Plains Wind Energy II discovered the oversight regarding its franchise tax status and immediately self-corrected its status. The District has instituted a process for the annual review of an applicant's franchise tax status and will notify the applicant to take corrective action, if necessary, to confirm the applicant's eligibility to continue to receive the benefits of the Limitation Agreement.

Comptroller's Office

The Comptroller's office agrees with the recommendation and will provide additional guidance to the ISDs on how to address incomplete Annual Eligibility Reports prior to submission.

Responsible Party: Data Analysis and Transparency Division

Implementation Date: 12/31/2019

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

The objectives of this audit were to:

- Determine whether selected major agreements under the Texas Economic Development Act:
 - ♦ Accomplish the purposes of Texas Tax Code, Section 313.003.
 - ♦ Comply with the intent of the Legislature in enacting Texas Tax Code, Section 313.004.
 - ♦ Were executed in compliance with the provisions of Texas Tax Code, Chapter 313.
- Determine whether there are ways to increase the efficiency and effectiveness of the administration of the Texas Economic Development Act.

Scope

The scope of the audit covered selected applications and appraisal valuation limitation agreements (agreements) under the Texas Economic Development Act processed from January 1, 2014, through December 31, 2018.

Methodology

The audit methodology included selecting agreements from the Comptroller's Office's listing of agreements to audit at the following three independent school districts (ISDs):

- Barbers Hill ISD (Chambers County).
- Calhoun County ISD (Calhoun County).
- Floydada ISD (Floyd County).

Auditors selected the agreements using information that the businesses reported, including total gross savings for the businesses as a result of the appraisal limitation, the qualified investment, and supplemental payments.

The four agreements selected from the three ISDs were:

- An agreement between Barbers Hill ISD and Lone Star NGL Asset Holdings II, LLC for property used in manufacturing (Application No. 1016).
- An agreement between Barbers Hill ISD and Lone Star NGL Asset Holdings II, LLC for property used in manufacturing (Application No. 1034).
- An agreement between Calhoun County ISD and Formosa Plastics Corporation, Texas for property used in manufacturing (Application No. 1048).
- An agreement between Floydada ISD and South Plains Wind Energy, LLC and South Plains Wind Energy II, LLC for property used in renewable energy electric generation (Application No. 1004).

The audit methodology also included (1) testing applications, agreements, conflict of interest policies and procedures, and required annual and biennial reports and (2) conducting interviews with ISD staff and consultants, county appraisal district staff, and management and staff at the Comptroller's Office.

Information collected included the following:

- Agreements between the ISDs and businesses.
- Application documentation, including certificates for limitations on appraised value and economic impact analyses issued by the Comptroller's Office; financial impact evaluations from the Texas Education Agency; ISDs' financial projections; school board application review results; and correspondence from the Comptroller's Office to the ISDs.
- Minutes from school board meetings.
- Eligibility and compliance monitoring reports including Annual Eligibility Reports; Biennial Progress Reports; Biennial School District Cost Data Requests; and Reports on Value Lost Because of Value Limitations Under Tax Code Chapter 313.
- Summary of Finance reports from the Texas Education Agency.
- ISD policies and procedures.
- Conflict of interest statements signed by selected ISD school board members and management.

- Supporting documentation for calculations and receipts of revenue protection and supplemental payments.
- Agreement data used to develop the Comptroller's Office's *Report of the Texas Economic Development Act*, January 2019.

Procedures and tests conducted included the following:

- Interviewed ISD school board members, management, staff, and consultants; county appraisal district staff; and Comptroller's Office staff.
- Reviewed ISD and Comptroller policies and procedures.
- Reviewed school board meeting minutes.
- Reviewed application and supporting documentation for the selected agreements.
- Reviewed conflict of interest questionnaires and disclosure statements prepared by members of school boards and management.
- Reviewed Annual Eligibility Reports, Biennial Progress Reports, and Biennial School District Cost Data Requests for selected agreements.
- Reviewed supporting documentation for calculations and receipts for revenue protection and supplemental payments.

Criteria used included the following:

- Texas Tax Code, Chapters 312 and 313.
- Texas Local Government Code, Chapters 171 and 176.
- Title 34, Texas Administrative Code, Chapter 9.
- Texas Education Code, Chapter 42.
- ISD policies and procedures.
- Agreements between the ISDs and the businesses.

Project Information

Audit fieldwork was conducted from February 2019 through July 2019. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions 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 following members of the State Auditor's staff performed the audit:

- Jules Hunter, CPA, CIA (Project Manager)
- Shaun Alvis, JD (Assistant Project Manager)
- Brandy Corbin
- Douglas Jarnagan, MAcc
- Jenna Perez, MAcy
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Becky Beachy, CIA, CGAP (Audit Manager)

Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; noncompliance with state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 7 provides a description of the issue ratings presented in this report.

Table 7

Summary of Issue Ratings	
Issue Rating	Description of Rating
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

Background Information on the Texas Economic Development Act

In 2001, the 77th Legislature enacted the Texas Economic Development Act, Texas Tax Code, Chapter 313 (Act), which permitted independent school districts (ISDs) to offer eight-year limitations on the appraised value of a property for the maintenance and operations portion of the ISDs' property taxes. Under the Act, ISDs also were entitled to receive additional state aid each tax year from the Texas Education Agency for tax credits that are associated with the agreements for limitations on the appraised value of property (agreements).

The purpose of the Act was to enhance economic development in Texas by permitting independent school districts (ISDs) to offer incentives to attract large capital investments and new jobs. Additionally, the Act sought to attract new businesses or production to improve the Texas economy and expand the property tax base.

In 2013, the 83rd Legislature passed House Bill 3390 (HB 3390), which both reauthorized the program for 10 years and made several substantive changes. Those changes included: repealing the tax credit provisions; adjusting the definitions of qualified jobs, properties, and investments; requiring that all agreements use a form developed by the Comptroller's Office; and requiring that the State Auditor's Office conduct a yearly audit of selected agreements under the Act.

In addition, the Legislature expressed in HB 3390 its intent that economic development decisions involving ISD property taxes should occur locally with oversight by the State and should be consistent with identifiable statewide economic development goals. Under the Act, Texas ISDs are authorized to offer tax incentives to applicants that invest in the local community. The Act offers applicants a 10-year limitation on appraised value for a portion of the ISD property tax (ad valorem tax). In exchange for that limitation, the applicants agree to invest in new property, create jobs in the ISD, and maintain a presence in the community for a specified number of years. Local tax revenues that the ISDs forego during the limitation period are replaced with state funding, plus direct incentives from the applicant based on tax savings and school attendance as described in individual agreements developed after the applicant is approved by the ISD and the Comptroller's Office.

Further, the Act describes situations in which property owners may not receive ad valorem tax benefits under the code, including prohibiting property owners from pooling investments to qualify for ad valorem tax benefits and prohibiting benefits to entities that are not subject to Texas

franchise tax. The code also does not allow an applicant to assert that jobs will be eliminated if certain investments are not made, if that assertion is not true.

The Act also includes specific guidance to the ISDs and the Comptroller's Office. The ISDs are directed to approve only applications for agreements that enhance the local community, improve the local public education system, and create high-paying jobs. The Comptroller's Office is directed to certify limitations on appraised values only for applications for agreements that create high-paying jobs and provide a net long-term benefit to the State. Both the ISDs and the Comptroller's Office are directed to strictly interpret the criteria and selection guidelines of the Act and to select and certify only applications that advance the economic development goals of the State.

Related State Auditor's Office Work

Related State Auditor's Office Work		
Number	Product Name	Release Date
18-037	An Audit Report on Selected Major Agreements Under the Texas Economic Development Act	July 2018
17-043	An Audit Report on Selected Major Agreements Under the Texas Economic Development Act	July 2017
17-009	An Audit Report on Selected Major Agreements Under the Texas Economic Development Act	October 2016
16-021	A Report on the Implementation Status of Prior State Auditor's Office Recommendations	April 2016
15-042	An Audit Report on Selected Major Agreements Under the Texas Economic Development Act	August 2015
15-009	An Audit Report on Selected Major Agreements Under the Texas Economic Development Act	November 2014

Copies of this report have been distributed to the following:

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The Honorable Dan Patrick, Lieutenant Governor, Joint Chair
The Honorable Dennis Bonnen, Speaker of the House, Joint Chair
The Honorable Jane Nelson, Senate Finance Committee
The Honorable Robert Nichols, Member, Texas Senate
The Honorable John Zerwas, House Appropriations Committee
The Honorable Dustin Burrows, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

Office of the Comptroller of Public Accounts

The Honorable Glenn Hegar, Comptroller of Public Accounts

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