Dave Heineman
Governor

STATE OF NEBRASKA
DEPARTMENT OF REVENUE
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December 31, 2014

Hon. Dave Heineman, Governor
Senator John Wightman, Chairperson, Executive Board
Patrick J. O'Donnell, Clerk of the Legislature

Gentlemen:

The attached audit report has been prepared by the Nebraska Department of Revenue (Department) in compliance with the provisions of Neb. Rev. Stat. § 77-5544, which requires an audit of the Invest Nebraska Act every five years by January 1. The audit is required to be completed by a qualified independent accounting firm. The Department used the normal bid process. However, no qualifying firms responded. As a result, this audit was conducted by the Department as allowed by statute.

As required in Neb. Rev. Stat. § 77-5544(3), I have reviewed this audit and verified that this report does not reveal any confidential information that allows identification of any company involved.

If you have any questions regarding this report, please contact me.

Sincerely,

Kim Conroy

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Tax Commissioner

Neb. Rev. Stat. § 77-5544 (1) requires an audit of the Invest Nebraska Act be conducted every five years. The last audit report was issued in December 2004. An audit was not conducted in 2009 because the findings would have released confidential information. This audit covers activity from the date the records were examined during the last audit on November 22, 2004 through November 3, 2014, the start date of the current audit. Applicable records were obtained from the Nebraska Department of Revenue (Department) and examined on-site.

**Applications**

The approval process of four applications was examined. The examination consisted of the following areas:

- Completeness of applications in compliance with the statutory requirements;
- Actions of the Department within the sixty-day time frame established by statute; and
- Transactions in the Invest Nebraska Fund in relationship to the application fee.

The applications, Department correspondence, and Invest Nebraska Board meeting minutes were examined to determine whether the requirements in Neb. Rev. Stat. § 77-5534 (2) were met. No discrepancies were found. All applications were filed prior to the June 1, 2005 deadline imposed by Neb. Rev. Stat. § 77-5543 (1) and processed within the appropriate timeframes. The application fees were properly deposited in the Invest Nebraska Fund. The statutory requirements governing the applications were met in all areas.

**Department's Verification of Credits**

Neb. Rev. Stat. § 77-5544 (2) requires the examination of the information collected by the Department in the areas below.

*(a) The extent the data collected from the companies receiving benefits is verified.*

Fourteen entities signed agreements to participate in the Invest Nebraska program (program). It is the Department's practice to send notices to companies that failed to file the necessary forms during the attainment period. If a company provided documentation, it was reviewed by the Department to determine qualification under the program.

Qualification audits were conducted, or are in process, for seven entities. The Department conducted additional maintenance audits on three of these entities. We reviewed the audit work completed for all audits final as of November 3, 2014. As of the date of this audit, seven entities have been terminated from the program. The termination resulted from either requested information not being provided by the company or the company not meeting the qualification requirements.

*(b) The extent to which the projects receiving benefits from the act are in compliance with the act initially and throughout the entitlement period.*

Qualifying companies are required to report their investment, employment, and gross sales throughout the entitlement period. The Department evaluates the information reported and selects companies for maintenance audits to verify ongoing compliance. If a company fails to file the data or if the audit determines that a company did not maintain required levels of investment or employment, the company is considered to be in recapture.

*(c) Whether the requirements of the act regarding the investment threshold have been attained and maintained by the companies.*

Investment information provided by participating entities was examined by the Department during audits or reviews of this and other incentive programs. This audit was limited to Department audits conducted specifically for this program and did not include information obtained through other incentive programs.

Two discrepancies regarding lease calculations were found in one of the Department audits for this program. These discrepancies would have impacted the total investment by an immaterial amount. Based upon the examination of the information available, all qualified entities exceeded their investment thresholds.

*(d) Whether and to what extent new employees are added by the companies to their workforce and employed at the project locations.*

In the 2013 Annual Report to the Nebraska Legislature, the Department reported full time equivalent employees for the program to be 1,482. We verified this number to be materially accurate per the records that were examined.

*(e) Whether and to what extent the new jobs created meet the minimum compensation requirements of the act.*

All finalized qualification and maintenance audits were examined on a test basis to determine whether new employees met the minimum compensation requirements of the program. Per Neb. Rev. Stat. § 77-5512, "compensation means the wages and other payments subject to withholding for federal income tax purposes." Per Neb. Rev. Stat. § 77-5536 (5)(b), "…compensation paid by the company to such employee for the year shall be the amount paid for the entire year for regular hours worked, not including overtime, bonuses, or any other irregular payments…"

1. The methods used by the Department to determine whether employees met the minimum compensation requirements varied from audit to audit. One method included regular compensation plus holiday, vacation, and other types of leave adjusted for nontaxable deductions. This method appears to meet the statutory requirements.

Another method calculated compensation by allocating the nontaxable deductions between regular compensation and other types of pay. The qualification compensation was based on regular pay less a portion of the nontaxable deductions. This method excluded holiday, vacation, and other types of paid leave from regular wages.

Still another method based qualification on regular compensation, which was not adjusted for nontaxable deductions. This method ignored pay for holiday, vacation, and other types of leave. This is contrary to Neb. Rev. Stat. § 77-5512, which requires pay to be based on taxable compensation.

It appears the Department's use of different methods did not affect which companies qualified for the program. However, total compensation of qualified employees is used to determine a company's wage benefit credits. The credits earned by qualified companies may have been affected by the method used.

2. Inconsistencies were noted in the Department calculations of annual wages for partial-year employees. In some instances, the number of days worked by partial-year employees was calculated incorrectly, ignoring either the first or last day of employment, or using incorrect employment date ranges. For a small number of employees, this could impact whether an individual employee was considered to be receiving the minimum required compensation.

   In one audit, annualized wages were not calculated for two partial-year employees. Using the Department's method to calculate annual wages, one of these employees would have been earning the minimum required taxable compensation, impacting the wage benefit credit.

   It appears that the Department's methods to annualize the wages of partial-year employees did not affect which companies qualified for the program. However, total compensation of qualified employees is used to determine a company's wage benefit credits. The credits earned by qualified companies may have been affected by the calculations used for partial-year employees. Overall, this impact is likely immaterial in relationship to the total benefits earned under the program.

It is recommended that the Department develop and utilize a consistent method for calculating employee compensation used to determine whether employees met the minimum annual qualified compensation.

<u>Department Response:</u> *The Nebraska Department of Revenue has taken steps in response to your recommendations on the required minimum compensation per Neb. Rev. Stat. § 77-5544 (2) (e) to clarify its calculation methods to ensure consistent application as well as compliance with statutory requirements.*

*(f) The industry or industries in which the new jobs are created, by North American Industry Classification System Code.*

To maintain confidentially this information was not included in the report.

(g) *The extent to which the minimum new job threshold of the act has been attained and maintained by the companies.*

Of the finalized qualification audits, four companies were determined to have met the minimum new employee threshold. Through finalized maintenance audits or Department reviews, these companies were determined to have maintained the minimum number of new jobs for the years examined.

(h) *By category of spending, what is purchased by the companies that is claimed as qualified investments.*

In the 2013 Annual Report to the Nebraska Legislature, the Department reported cumulative investment for the program to be $605,658,880. We verified this number to be materially accurate per the records that were examined. Data was not available to allocate investments to specific categories.

(i) *Gross sales from output of the project if reasonably determinable.*

Gross sales are not required to be provided for qualification or to receive benefits under the program. The Department did not verify any gross sale figures submitted by companies in the program. Therefore, gross sales data is not included in this report.

**Conclusion**

Although this audit discovered some irregularities as previously mentioned, these were not material and did not have a detrimental impact on the Invest Nebraska program as a whole. It was determined that the Nebraska Department of Revenue is materially in compliance with the Invest Nebraska Act.