A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit and Sunset Review

Arizona Commerce Authority

Authority Can More Clearly Report Its Economic Development Impact and Enhance Its Processes for Awarding and Monitoring Grants

September • 2015
Report No. 15-112

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

Debra K. Davenport
Auditor General

The **Auditor General** is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits of school districts, state agencies, and the programs they administer.

The Joint Legislative Audit Committee

Senator **Judy Burges**, Chair

Senator **Nancy Barto**
Senator **Lupe Contreras**
Senator **David Farnsworth**
Senator **Lynne Pancrazi**
Senator **Andy Biggs** (*ex officio*)

Representative **John Allen,** Vice Chair

Representative **Regina Cobb**
Representative **Debbie McCune Davis**
Representative **Rebecca Rios**
Representative **Kelly Townsend**
Representative **David Gowan** (*ex officio*)

Audit Staff

Dale Chapman, Director

Dot Reinhard, Manager and Contact Person
Cheya Wilson, Team Leader
Emmie Contreras
Marcia Schweers

The Auditor General's reports are available at:
www.azauditor.gov

Printed copies of our reports may be requested by contacting us at:
Office of the Auditor General
2910 N. 44th Street, Suite 410 • Phoenix, AZ 85018 • (602) 553-0333

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

September 24, 2015

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor
Arizona Commerce Authority Board of Directors Chairman

Ms. Sandra Watson, President/CEO
Arizona Commerce Authority

Transmitted herewith is a report of the Auditor General, *A Performance Audit and Sunset Review of the Arizona Commerce Authority*. This report is in response to an October 3, 2013, resolution of the Joint Legislative Audit Committee and was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Arizona Commerce Authority agrees with all of the findings and plans to implement all of the recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

Debbie Davenport
Auditor General

Attachment

Cc: Arizona Commerce Authority Board of Directors

2910 NORTH 44th STREET • SUITE 410 • PHOENIX, ARIZONA 85018 • (602) 553-0333 • FAX (602) 553-0051

STATE OF ARIZONA
OFFICE OF THE
AUDITOR
GENERAL

Arizona Commerce Authority

REPORT HIGHLIGHTS
PERFORMANCE AUDIT

Our Conclusion

The Arizona Commerce Authority (Authority) focuses on growing and diversifying Arizona's economy and marketing Arizona to attract, expand, and retain businesses, and create jobs. The Authority is authorized to use various financial incentives, such as tax credits, grants, and loans, to encourage economic growth in the State. Although the Authority reports on its activities and goals, it should make the summary report on its progress toward its goals more readily available to the public; more clearly indicate in its reports whether the jobs, wages, and capital investment information is based on the commitments companies announce or the actual jobs created and capital investment made; and provide information about the State's actual financial contributions toward economic development compared to the actual economic benefits it receives. Finally, the Authority should continue with its efforts to formalize its grant-awarding processes, better document its compliance with these processes, and strengthen its grant-monitoring processes.

2015

September • Report No. 15-112

Authority can more clearly present its impact on Arizona's economic development

Authority focuses on economic growth—One of the ways the Authority promotes economic growth is to offer grants to attract or retain companies that may relocate to or expand within Arizona and that will provide benefits to the State such as high-quality jobs and/or increases in capital investment. In fiscal year 2014, the Authority reported that it awarded $4.3 million in deal-closing grants to four companies. These companies committed to create a total of 2,217 jobs in Arizona with an average wage of more than $67,000. The grant money is paid when grant recipients meet specified milestones. The Authority also awards grants to start-up and early-stage companies seeking to commercialize innovative technologies, and to rural communities to develop their infrastructure to help strengthen their competitiveness for economic growth.

Authority should enhance its reporting—The Authority reports on its progress toward achieving its 5-year goals, which are to create 75,000 higher-wage jobs, increase average wages of jobs created, and increase capital investment by $6 billion between fiscal years 2013 and 2017. The Authority developed a summary document that reports this progress, but this document is not broadly distributed to the public. In addition, its reports generally provide information based on commitments companies announce rather than the actual jobs created or capital investment made. The Authority should clearly indicate in its reports whether the information presented for jobs, wages, and capital investment represents actual results or commitments. In addition, the Authority has not developed a consolidated report that summarizes the amount of financial incentives Arizona provided compared to the actual economic benefits the State has received.

Authority should include additional statutorily required information in the annual report for the Arizona Competes Fund (Competes Fund)—The Competes Fund provides monies for deal-closing grants, innovation grants for start-ups and early-stage companies, and rural infrastructure project grants. As required by statute, the Authority reports specific information for each deal-closing grant recipient, including the number of jobs each recipient committed to create, the jobs actually created, and the amount of capital investment each company committed to and actually made in the State. However, for the innovation and rural grants, the Authority presents the combined information from all grant recipients rather than for each recipient individually as statute requires. Additionally, although statute requires the Authority to report median wages, it reports average wages.

Recommendations

The Authority should enhance its reporting by:

- Posting its summary report that shows its cumulative progress toward its goals on its Web site;
- Clarifying in its various reports whether the information reported represents companies' announced commitments or actual results;
- Developing a summary report that compares the cost of the financial incentives Arizona provided to the actual economic benefits the State has received; and
- Ensuring that its annual Competes Fund report includes the statutorily required information.

Competes Fund grant-selection processes generally align with statutes and best practices, but should be formalized and monitoring processes can be improved

Authority has adequate grant-selection processes but should formalize and better document compliance with them—The Authority has established various processes to help ensure it meets statutory requirements for awarding Competes Fund grants. Each of the three grant types has its own process for selecting eligible recipients. For example, for the deal-closing grants, the Authority reviews the entity's financial statements and/or credit reports and independently prepared economic impact statements. For the innovation grants, a panel of judges evaluates and scores the applications as part of a competitive process. For the rural grants, the Authority has developed a checklist to ensure that applicants meet established eligibility requirements. All grant agreements must include performance targets that recipients must meet in order to receive grant payments.

Although these processes are consistent with statutes and/or best practices, the Authority should continue with its efforts to formalize them by developing and implementing comprehensive, written procedures and better document its compliance with the grant-selection processes.

Authority should strengthen its grant-monitoring processes—Although the Authority monitors grant recipients, it has not done so in a consistent manner, lacks uniform monitoring processes, and inconsistently documents its verification efforts. For example, for its deal-closing grants, the Authority reported that it typically spot-checks the grant recipients' self-reported outcomes and verifies them by comparing the outcomes with recipient-supplied employee lists, wage reports, and invoices. However, until June 2015, the Authority did not have a written procedure for verifying reported information for deal-closing grants and lacked documentation that it consistently performed these steps. For innovation grants, the Authority lacks a formal process for verifying self-reported milestone and outcome information. For rural grants, the Authority verifies that milestones are met by checking the submitted receipts or invoices for infrastructure project costs, but does not verify outcomes, such as the number of jobs created or capital investment that resulted from these infrastructure improvements.

Finally, the Authority has not developed guidance for how it will address recipient noncompliance or partial compliance with the grant agreement. For example, for three of eight innovation grants we reviewed, the Authority reduced the amount of the grant payments when milestones were changed to better meet opportunities presented to the companies, but the corresponding grant files did not indicate how the modified payment amounts were decided. In addition, the Authority does not always document its decisions to not enforce reporting requirements for companies that take longer to meet outcomes or milestones. For example, one-deal closing grant recipient did not submit required quarterly progress reports. When asked, the Authority could provide only limited documentation regarding the recipient's failure to file quarterly reports.

Recommendations

The Authority should either develop and implement, or continue with its efforts to develop and implement:

- Comprehensive written procedures for all of its Competes Fund grants;
- Written grant-monitoring policies and procedures; and
- Policies and procedures for making changes to grant agreements and documenting reporting requirement exceptions.

TABLE OF CONTENTS

TABLE OF CONTENTS

INTRODUCTION
Scope and Objectives

The Office of the Auditor General has conducted a performance audit and sunset review of the Arizona Commerce Authority (Authority) pursuant to an October 3, 2013, resolution of the Joint Legislative Audit Committee. This performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq.

This audit assesses whether the Authority's economic development efforts are consistent with statute and best practice in the following areas:

- Reporting information about the results of its programs; and
- Awarding grants and monitoring grant recipients.

The report also includes responses to the statutory sunset factors.

Authority designed to grow Arizona's economy and market the State

Authority mission

The Authority was established in 2011 to replace Arizona's previous economic development agency, the Arizona Department of Commerce (Department), and to provide a more specific focus: to grow and diversify Arizona's economy, and to market Arizona for the purpose of attracting, expanding, and retaining businesses and creating jobs. To fulfill its mission (see textbox), the Authority recruits out-of-state companies to expand in or relocate their operations to Arizona, works with existing Arizona companies to grow their businesses in Arizona, and partners with entrepreneurs and investors to help create new businesses. The Authority focuses its efforts on targeted industries such as aerospace and defense, semiconductors, and renewable energy. To guide its state-wide economic development efforts between fiscal years 2013 through 2017, the Authority has set the following three goals:

Authority's mission

To grow and strengthen Arizona's economy and facilitate the creation of quality jobs for its citizens by supporting and attracting businesses in targeted, high-value base sectors throughout the State.

Source: The Authority's business plan.

- Create 75,000 higher-wage jobs;
- Increase the average wages of jobs created; and
- Increase capital investment by $6 billion.[1]

According to the Authority, it promotes business attraction, business expansion, and business creation through various activities. For example, to recruit new businesses to the State, the Authority markets and communicates Arizona's value as a business location, establishes relationships with site selectors to identify companies considering relocation, and provides information about the Authority's and the State's available resources and incentives that may influence the decision to relocate. The Authority also works with the Governor's Office and the Legislature to establish a tax and regulatory environment in Arizona that is attractive to businesses. To help existing Arizona companies expand and retain their businesses in Arizona, the Authority builds relationships with local and regional businesses to better understand their needs and helps meet these needs by collaborating with industry groups, proposing legislation, and serving as a liaison between businesses and public

[1] Capital investment refers to the amount of money the company spent on physical assets that will enable the company to operate and produce income such as land, buildings, machinery, and fixtures, as well as costs associated with obtaining the asset, such as construction costs.

or private groups that can assist these businesses. To promote business creation, the Authority works directly with investors and entrepreneurs and offers programs that help create a favorable innovation and entrepreneurship ecosystem in Arizona. Finally, the Authority supports business attraction, expansion, and creation through programs that help ensure companies in Arizona have adequate skilled workers to meet employment demand by coordinating job services and training programs and offering assistance to match companies and individuals for employment opportunities.

Authority history

The Authority is different from its predecessor and other state agencies. Prior to 2011, Arizona's economic development was the responsibility of the Department, a state agency that was established in 1985 to promote and enhance economic growth in Arizona. However, in 2010, a Governor's Commerce Advisory Council report recommended changes to the structure of the State's economic development efforts to strengthen Arizona's competitiveness and narrow the agency's focus to growing Arizona businesses and attracting new companies to the State.[1] Soon after, Executive Order 2010-12 established the Arizona Commerce Authority Board of Directors (Board) and priorities for the existing Department, including job creation and expansion of capital investment through business attraction, expansion, and retention. Subsequently, Laws 2011, 2nd S.S., Ch. 1, §29, eliminated the Department, established the Authority, and further defined the Authority and its responsibilities. The newly established Authority differs from the former Department in the following ways:

- **Focused responsibilities—**The Authority's responsibilities are prioritized to focus more narrowly on economic development, such as job creation and expansion of capital investment. For example, session law repealed some of the former Department's existing programs, such as the Hydrogen Grant program, and transferred other programs and powers from the Department to the Governor's Energy Office, such as the Arizona Biofuels Conversion program.[2]

- **Governed by a board—**The Authority is governed by the Board, which is statutorily required to be chaired by the Governor and includes the Authority's board-appointed Chief Executive Officer/President (CEO) and 17 private sector leaders (see textbox, page 3). Nine of the private sector leaders are to be appointed by the Governor, 4 by the President of the Senate, and 4 by the Speaker of the House of Representatives.[3] Statute also specifies a group of 12 ex officio members without power to vote and eight state agency directors/commissioners who serve as technical advisors to the Board. Previously, statute had established various groups to advise the Department's director, such as an advisory board and an interagency coordinating council.

[1] Governor's Commerce Advisory Council. (2010). *Governor's Commerce Advisory Council report*. Phoenix, AZ: Office of the Arizona Governor.

[2] A.R.S. §41-1515 established the Hydrogen Grant program in 2005 to encourage the use of hydrogen in projects that benefit the public. A.R.S. §41-1515.01 established the Arizona Biofuels Conversion program in 2011 to encourage the use of biofuels by granting awards to provide for the conversion of existing and installation of new storage and dispensing equipment for biofuels.

[3] Laws 2011, 2nd S.S., Ch. 1, §132, initially allowed the Governor to select all 17 board members, but as the staggered terms expired through January 19, 2015, the Governor, President of the Senate, and Speaker of the House of Representatives should appoint all board members in the proportions specified in A.R.S. §41-1502(B).

Arizona Commerce Authority Board of Directors

Voting members

- Governor (Chair)
- Authority CEO/President
- 17 private sector leaders appointed as follows: 9 by the Governor, 4 by the President of the Senate, and 4 by the Speaker of the House of Representatives

Nonvoting members

- Speaker of the House of Representatives
- President of the Senate
- President of the Arizona Board of Regents
- President of each state university
- President of one community college
- Chairperson of the Governor's Council on Small Business
- Chairperson of the Governor's Council on Workforce Policy
- One member of the Rural Business Development Advisory Council
- President of the state-wide organization of incorporated cities and towns
- President of a state-wide organization of county boards of supervisors

Technical advisors to the Board

- Arizona Department of Environmental Quality Director
- Arizona State Land Commissioner
- Arizona Department of Revenue Director
- Arizona Department of Transportation Director
- Arizona Office of Tourism Director
- Arizona Water Resources Director
- Arizona Department of Financial Institutions Director
- Arizona-Mexico Commission Director

Source: Auditor General staff analysis of A.R.S. §41-1502.

- **Received exemptions and provisions that differ from other state agencies—**The Authority's enabling legislation sets it apart from other state agencies by exempting it from some laws that other state agencies must follow, such as the State's rule-making process and state general accounting practices (see Appendix A, pages a-1 through a-2, for a list of exemptions and authorizations). Some of these exemptions, such as its exemption from the state procurement process and state personnel system regulation, were recommended in the Governor's Commerce Advisory Council (Council) report. This Council analyzed economic development agencies in other states and noted in its report that the Virginia Economic Development Partnership had greater flexibility as a quasi-public state authority than a state agency. Specifically, the report noted that the Virginia Economic Development Partnership was not required to operate under the state procurement process or participate in its state retirement system, and that its director was hired under a long-term contract. Similarly, the Authority has established its own procurement policy and participates in a retirement plan other than the state retirement plan.

Authority manages financial incentives to encourage economic growth

The Authority is authorized to use various financial incentives, such as grants and tax credits, to encourage economic growth in Arizona (see Appendix B, Table 2, pages b-1 through b-3, for all incentives administered in fiscal year 2014). Specifically, the financial incentives include:

> **Tax credits**—An amount subtracted from the total a taxpayer owes the State.
>
> **Tax incentives**—Exemptions, deductions, or exclusions from paying tax liability such as transaction privilege tax (TPT), which is commonly referred to as sales tax, or reclassification of property for tax purposes.

- **Tax credits and incentives—**The Authority reported that in fiscal year 2014, it approved more than $11 million for 190 companies to receive statutorily established tax credits and incentives that are provided through the Arizona Department of Revenue (see textbox).[1] For the various tax credits and incentives, the Authority is responsible for reviewing applications, assessing whether the applicants meet eligibility requirements, and approving applicants, but the Arizona Department of Revenue is responsible for providing the actual tax credit or incentive. For example, as part of its Angel Investment Income Tax Credit program, the Authority reported that in fiscal year 2014, it reviewed and approved applications from 91 unique investors to receive tax credits totaling more than $2 million. According to A.R.S. §41-1518, this program provides tax credits to investors who invest in a small business that meets various statutory qualifications, such as employing at least two full-time employees, owning less than $10 million in total assets, and not engaging in human cloning or embryonic stem cell research. Similarly, as part of its Military Reuse Zone program, which was established to lessen the impact of military base closures, the Authority reported that in fiscal year 2014, it approved more than $1.2 million in income tax credits, tax exemptions, and property tax reclassification for four companies. According to A.R.S. §41-1532, various individuals may qualify for a Military Reuse Zone tax incentive such as a taxpayer who owns or leases income-producing property located in a closed military facility.

- **Grants—**The Authority reported that in fiscal year 2014, it entered into grant agreements totaling nearly $25 million to be paid over multiple years to companies and local governments as they meet specific requirements in the grant agreements (see Appendix B, Table 2, page b-1, for a listing of all grants administered in fiscal year 2014). These monies were awarded through six types of grants that the Authority administers (see textbox on page 5). For

[1] This amount includes tax credits, property tax reductions, and sales and use tax exemptions approved through the use of nine tax incentives (see Appendix B, Table 2, pages b-1 through b-3, for a description of each incentive). Amounts are estimates based on approvals and do not reflect amounts actually claimed or programs no longer open to new applicants.

example, the Authority awarded a total of more than $14.2 million in grants to 52 companies from its Job Training Fund during fiscal year 2014. The Job Training Fund grant program was statutorily established to provide employee training for new and expanding businesses undergoing economic conversion.[1]

Grant monies awarded in fiscal year 2014

Job Training Fund—$14.2 million

Arizona Competes Fund:

- Deal-closing—$4.3 million
- Arizona Innovation Challenge—$3 million
- Rural Economic Development—$2.73 million

Arizona Federal and State Technology (AZ FAST)—More than $300,000

Arizona Furnace Technology Transfer Accelerator—Nearly $80,000

Source: Auditor General staff analysis of the Authority's annual reports and agency-provided information (see Appendix B, Table 2, page b-1, for more information on the grants).

In addition, in fiscal year 2014, the Authority awarded more than $10 million in grant commitments through three different types of grants paid from the Arizona Competes Fund (Competes Fund).[2] The Competes Fund was established in 2011 by A.R.S. §41-1545 et seq. to (1) attract, expand, or retain Arizona basic enterprises and (2) support and advance programs and projects for rural businesses, small businesses, and business development that enhance economic development.[3] These grants include the following:

- **Deal-closing grants (*Authority CEO awards grant and determines grant amount)*—** The Authority offers deal-closing grants to attract or retain companies that may relocate to or expand within Arizona and that provide benefits to the State such as tax revenue that exceeds the cost of the grant, and also provides numerous high-quality jobs and/or capital investment (see textbox). This grant is not awarded through an application or board-approval process. Rather, statute provides the CEO with sole discretion to offer these grants, and the CEO works with the Authority's executive staff to make these decisions. Statute does not specify a limit on the amount that one company may receive, nor does it require that all the monies allocated to Competes Fund grants be expended annually.

Example of a deal-closing grant

In fiscal year 2014, the Authority awarded $1.3 million in Competes Fund monies to General Motors, LLC, which proposed to develop and operate a software development facility in Chandler, AZ. The company committed to create 738 jobs with an average annual wage of more than $71,000 and invest nearly $18 million in capital investment over 3 years.

Source: Auditor General staff analysis of the Authority's 2014 *Arizona Competes Fund Annual Report* and deal-closing grant award files.

Authority officials reported that the Authority takes a conservative approach in awarding these monies and uses the grant to help close a deal only when the company would not otherwise move or expand and if an independent economic analysis shows that the tax

1 Laws 2015, Ch. 10, repealed the funding for the Job Training Fund program effective January 1, 2016. The program is closed to new applicants effective January 1, 2017.

2 The primary revenue source for the Competes Fund is income tax withholding. See Table 1, footnote 1, page 9, for more information on Competes Fund revenue sources. See Appendix C, Table 3, pages c-1 through c-2, for all Competes Fund grants awarded in fiscal years 2012 through 2014.

3 A.R.S. §41-1545 defines Arizona basic enterprises as any enterprise that is located or principally based in Arizona and that can provide demonstrable evidence that it meets one or more of the following: it is primarily engaged in one or more of the Arizona basic industries defined in statute such as certain manufacturing industries or the development of new technologies; is the national or regional corporate headquarters of an Arizona basic industry or the corporate or regional headquarters of a multistate enterprise that is primarily engaged in out-of-state industrial activities; or is primarily engaged in developing or producing goods or providing services for out-of-state sale.

revenues generated as a result of the agreement over time will exceed the cost of the grant. The Authority reported that in fiscal year 2014, it awarded a total of $4.3 million in Competes Fund monies for deal-closing grants to four companies. These companies committed to create a total of 2,217 jobs in the State with an average wage of more than $67,000. The Authority issues monies to grant recipients in installments that are paid when the company demonstrates it has met milestones specified in the grant agreement, such as creating a specific number of jobs with a set average wage.

- **Arizona Innovation Challenge grants** (*$3 million annually; up to $250,000 each*)—The Arizona Innovation Challenge is a biannual business plan competition available to start-up and early-stage companies seeking to commercialize innovative technologies for the purpose of growing and diversifying Arizona's economy (see textbox). To qualify, applicants must have between 2 and 30 employees, have less than $10 million in net assets, and present a technology or scientific solution in a specific industry such as information technology software or aerospace and defense. Applicants are selected after participating in three elimination rounds, two of which involve a panel of volunteer expert judges who rate the company's business plan, and a third that is a "pitch" round where contestants present to a panel of judges and authority management.

Example of an Arizona Innovation Challenge grant

In fiscal year 2014, the Authority awarded $250,000 to World View Enterprises, Inc., a small company located in Tucson, AZ. The company's proposed innovation involved building high-altitude balloon technology that will provide suborbital spaceflight for tourism and research.

Source: Auditor General staff analysis of the Authority's Arizona Innovation Challenge grant files and World View Enterprises Web site.

Authority management reported that the Arizona Innovation Challenge grants attract approximately 130 to 300 applicants semiannually. Further, they reported that although these grants generally produce far fewer jobs and less capital investment than deal-closing grants, the Arizona Innovation Challenge Grant program promotes a business-friendly, entrepreneurial environment in Arizona and provides companies with useful feedback on their business plans as well as exposure to investors, mentors, and stakeholders who can help them succeed. The Authority reported that in fiscal year 2014, it awarded a total of $3 million in Competes Fund monies for Arizona Innovation Challenge grants to 12 companies. The Authority issues monies to award recipients in installments that are paid when the company reports that it has met milestones specified in the grant agreement.

- **Rural Economic Development grants** (*approximately $2 million awarded annually*)—This grant is designed to help rural Arizona communities develop infrastructure that strengthens their capacity and competitiveness for economic growth (see textbox). To be eligible for a Rural Economic Development grant,

Example of a Rural Economic Development grant

In fiscal year 2014, the Authority awarded more than $369,000 to the City of Coolidge, AZ, to modify an existing unpaved road into a three-lane paved road to allow easier access to businesses. According to the Authority's 2014 annual report, a major local employer was contemplating expansion or relocation to a different area, and this award kept the employer in Coolidge, saving 120 jobs and potentially creating 20 to 30 new jobs.

Source: Auditor General staff analysis of the Authority's Rural Economic Development grant files and the Authority's 2014 annual report.

an applicant must be an incorporated city or town with a population of less than 150,000, a county with a population of less than 750,000, or a federally recognized tribe in Arizona. The applicant must also be able to provide at least 10 percent of the project's total costs. The Authority reported that in fiscal year 2014, it awarded a total of $2.73 million in Competes Fund monies for Rural Economic Development grants to six rural communities. The Authority issues monies to award recipients as reimbursements for costs included in the project agreement.

- **Loans**—To stimulate financing of small businesses and foster job creation and business expansion, the Authority manages a loan participation program. The loan amount may be provided by investors and the Authority, or it may be a loan from the Authority that matches a private investor's purchase of equity in the business. The Authority reported that as of fiscal year 2014, it had either loaned or arranged loans totaling approximately $9.5 million for 26 companies since fiscal year 2012. Specifically, the Authority manages the Arizona Innovation Accelerator Fund, a loan participation program funded through the U.S. Department of Treasury's State Small Business Credit Initiative. Through this program, the Authority has received a total of $18.2 million. Using these federal monies, the Authority offers loans ranging from $50,000 to $2 million that support up to one-half of the overall financing package a company obtains from the Authority and a private lender or investor. For example, the Authority reported that in 2014, it provided $249,000 of a total $499,000 loan to a company specializing in the design and manufacture of optical systems for the intelligence, surveillance, and reconnaissance markets.

The Authority also administers a variety of other programs that do not provide financial incentives to businesses, but provide other types of assistance, such as training or helping businesses identify sources for finding skilled workers. To help support the costs of these programs, the Authority uses both federal grants and/or state monies. For example, in fiscal year 2014, the Authority received $2 million in federal grants to help pay for the costs of administering various programs and grants that assist Arizona businesses or businesses moving to Arizona (see textbox).

Other authority programs

Advanced Manufacturing Jobs and Innovation Accelerator Challenge Grant—Intended to support and grow southern and central Arizona's Aerospace and Defense industry and its supply chain.

Office of Economic Adjustment Planning Grant—Arizona Diversification Initiative—Established to offer assistance to small- and medium-sized manufacturing and high-tech companies in Arizona that are affected by federal budget cuts and defense downsizing.

Rev AZ (Manufacturing Extension Partnership)—Designed to provide products and services that match the needs of manufacturing companies in Arizona and provide focused, concrete advice, training, and hands-on assistance in growing businesses and improving profitability.

Workforce Investment Act Administration Fund—The Authority uses monies from this fund for the operations of its Workforce Department, which assists companies that are moving to or expanding in Arizona by providing a variety of services to help meet their workforce needs.

Source: Auditor General staff analysis of the Authority's 2014 annual report, the Authority's Web site, and other authority-provided information.

Budget

The Authority receives revenue from various sources including state, federal, and private sources as well as from fees assessed for some of its programs and interest on investments. This revenue includes monies for the Authority's operations and monies allocated to several funds that the Authority administers. As shown in Table 1 (see page 9), the Authority received or is estimated to receive between approximately $53 and $63 million annually in revenues between fiscal years 2013 and 2015. The largest source of these revenues is income tax withholdings, which the Authority receives through a State General Fund appropriation. These revenues have totaled $31.5 million annually in fiscal years 2013 through 2015. Of that amount, $10 million was deposited in the Arizona Commerce Authority Fund for operating expenses, and $21.5 million was deposited in the Competes Fund to be used for grants to attract, expand, and retain businesses in Arizona. In addition, a nonappropriated amount of $3.5 million in lottery revenues and a portion of state revenues from fees associated with the sales of certain securities are deposited in the Competes Fund.

However, recent legislative changes have impacted the Authority's budget. For example, for fiscal years 2013 through 2015, the Authority received $25 million annually for the Competes Fund. However Laws 2015, Ch. 12, reduced future State General Fund allocations to the Competes Fund to $16.5 million annually, which, combined with the unchanged $3.5 million allocation from lottery revenues, totals $20 million annually beginning in fiscal year 2016. In addition, as of fiscal year 2014, the Authority had accumulated a Competes Fund balance of more than $68 million primarily because, as authority officials reported, the Authority had conservatively awarded and distributed grant monies from the Competes Fund. However, Laws 2015, Ch. 8, transferred $75 million from the Competes Fund to the State General Fund in fiscal year 2016.

In addition, the Arizona Job Training Fund, which the Authority had used to attract companies to Arizona and reimburse them for specific employee-training opportunities, provided between approximately $13 million and more than an estimated $14.2 million in revenues to the Authority annually in fiscal years 2013 through 2015. Monies in the Arizona Job Training Fund primarily consisted of a 0.1 percent job training employer tax up to $7 per employee, per year. However Laws 2015, Ch. 8, transferred $25 million from the Arizona Job Training Fund to the State General Fund in fiscal year 2016. In addition, Laws 2015, Ch. 10, repealed the job training employer tax effective January 1, 2016. Further, this session law also repealed the Arizona Job Training Fund effective January 1, 2016, and this program is closed to new applicants effective January 1, 2017. Additionally, effective January 1, 2017, all unexpended or unencumbered employer tax monies will revert to the unemployment compensation fund, and any monies not attributable to the employer tax, such as gifts or grants, will revert to the State General Fund.

As also shown in Table 1, the Authority's actual or estimated expenditures ranged from between more than $27 million to more than $30 million annually in fiscal years 2013 through 2015. In fiscal year 2015, the Authority's estimated expenditures included more than $10 million for Authority-distributed grants, approximately $7 million for personnel, and approximately $4.3 million for the Authority's other operating expenses.

Table 1: Schedule of revenues, expenditures, and changes in fund balance Fiscal years 2013 through 2015 (In thousands) (Unaudited)

	2013 (Actual)	2014 (Actual)	2015 (Estimate)
Revenues			
Arizona Competes Fund[1]	$ 26,986	$ 27,377	$ 27,746
Arizona Job Training Fund[2]	13,966	13,036	14,249
Arizona Commerce Authority Fund[3]	10,000	10,000	10,000
Arizona Innovation Accelerator Fund[4]	78	6,319	6,714
Federal[5]	1,421	2,000	3,341
Other	585	704	1,228
Total revenues	53,036	59,436	63,278
Expenditures			
Personal services and related benefits	5,714	6,458	7,006
Professional and outside services	4,326	4,056	4,745
Travel	234	256	302
Aid to organizations[6]	13,041	9,655	10,762
Other operating	6,706	8,207	4,360
Total expenditures	30,021	28,632	27,175
Net change in fund balance	23,015	30,804	36,103
Fund balance, beginning of year	79,637	102,652	133,456
Fund balance, end of year	$ 102,652	$ 133,456	$ 169,559

1 Amount includes $21.5 million in income tax withholdings received from the State General Fund and $3.5 million from lottery revenues. In addition, amount includes a portion of state revenues from fees associated with the sales of certain securities in the State and interest earned on investments.

2 Amounts are primarily received from a 0.1 percent job training employer tax, up to $7 per employee, per year. Laws 2015, Ch. 10, repealed this employer tax effective January 1, 2016, and the Arizona Job Training Fund program is closed to new applicants effective January 1, 2017.

3 Amounts are income tax withholdings received from the State General Fund and are used to pay for the Authority's operating expenditures.

4 Amounts are primarily received from the U.S. Department of Treasury through its State Small Business Credit Initiative that increases the amount of capital made available by private lenders to small businesses.

5 Amounts are received from various federal sources for grants and for programs that the Authority operates.

6 Aid to organizations consists of grants issued by the Authority.

Source: Auditor General staff analysis of the Authority's fiscal years 2013 through 2014 general ledgers, financial statements audited by an independent certified public accounting firm, and authority-prepared information for fiscal year 2015.

Authority organization and staffing

In addition to being governed by its Board, the Authority is led by an executive management team. Specifically, the Board governs the Authority's activities; approves policies such as a conflict-of-interest policy and a general procurement and grant policy; and provides expertise, business experience, and overall direction to the Authority. The executive management team consists of eight executives, including the CEO, who is responsible for managing and supervising the Authority, and who can negotiate contracts with businesses and enter into agreements with grant recipients for job creation and other economic development outcomes. The executive management team also includes the Authority's chief financial officer and senior vice presidents of business attraction and business development, who manage and supervise one or more departments or programs at the Authority.

As of February 2015, the Authority reported it had 75 full-time equivalent (FTE) positions, of which 67 were filled and 8 were vacant, and had organized its employees to perform the following functions related to business attraction and development: (1) establishing relationships with business site selectors to identify companies considering relocation, (2) pursuing and closing deals using the Authority's resources and/or financial incentives, and (3) performing outreach efforts by contacting clients through phone and e-mail and attending trade show events. The Authority also partners with entrepreneurs and investors to help create new businesses and oversees Arizona's Mexico City Trade Office (see textbox). In addition, staff engage with rural communities in Arizona to understand and assist with their specific needs and assist companies that are moving to or expanding in Arizona to identify the workforce talent they need and connect them to the Authority's local workforce partners throughout the State.

Mexico City Trade Office—In fiscal year 2015, the Authority joined with four other entities to help provide monies for a trade office in Mexico City dedicated to promoting Arizona trade and investment in Mexico. Mexico was Arizona's largest export market in 2014, according to the U.S. Department of Commerce International Trade Administration. In both fiscal years 2015 and 2016, the Authority was appropriated $300,000 from the State General Fund for the Mexico City Trade Office. As of March 2015, the Authority had used more than $173,000 of these monies for costs such as rent and supplies, and payments to a consulting firm that operates the trade office. This firm is contracted to promote trade and foreign investment in Arizona by operating the Mexico City Trade Office. Its activities include providing trade consultation and technical assistance to Arizona companies seeking to export to Mexico and marketing to attract foreign company relocations or expansions that create high-wage jobs in Arizona.

Source: Auditor General staff analysis of the Authority's Mexico City Trade Center contract, financial detail, related statutes, and the April 2015 U.S. Department of Commerce's International Trade Office's Arizona report.

FINDING 1

Authority can more clearly present its impact on Arizona's economic development

Although the Arizona Commerce Authority (Authority) reports on its activities and some outcomes, it should enhance this reporting. Specifically, the Authority should post on its Web site a summary report of the cumulative progress made toward its goals for job creation, capital investment, and higher average wages. In addition, the Authority should better clarify in its publicly available annual report and other reports whether the information included in these reports represents actual results or commitments companies have made. Further, the Authority should develop a report that better illustrates the State's actual economic development investment costs compared to the benefits achieved. Finally, the Authority can better comply with two Arizona Competes Fund (Competes Fund) statutory reporting requirements—presenting information for each Arizona Innovation Challenge (innovation) and Rural Economic Development (rural) grant recipient, and the median wage associated with jobs created.

Authority should enhance reporting regarding its goals and outcomes

Although the Authority reports information about its activities and some outcomes, it should take steps to more clearly demonstrate the impact of its work. The Authority has established 5-year goals focused on strengthening Arizona's economy by creating jobs and increasing capital investment in the State (see textbox). It reports to the public on its progress toward these goals primarily through its annual report, which the Authority posts on its Web site, and according to authority officials, these goals are measured by the job creation and capital investment commitments that companies announce rather than the actual jobs created or capital investment made. According to the Authority, its goals focus on commitments rather than actual results for a variety of reasons, including that the announced commitments more promptly and directly measure the Authority's work to add jobs and investment in Arizona. The National State Auditors Association (NSAA) has developed a set of best practices for carrying out state economic development efforts that indicate that an agency should report relevant information to the public and policymakers summarizing the results of its economic development program.[1]

Authority's 5-year goals are to obtain commitments from companies to:

- Create 75,000 higher-wage jobs;
- Increase average wages of jobs created; and
- Increase capital investment by $6 billion.

Source: The Authority's 5-year business plan and explanation from authority officials.

To help ensure legislators and the public can clearly understand the Authority's economic development efforts and results, the Authority should enhance its reporting in the following three ways:

- **Publicly report the cumulative progress made toward its 5-year goals**—Although the Authority reports many types of information regarding its activities, it should publicly report the cumulative progress made toward its 5-year goals. Annually, the Authority reports on the total number of jobs and the amount of capital investment that the companies

[1] National State Auditors Association. (2004). *Best practices in carrying out state economic development efforts: A National State Auditors Association best practice document.* Lexington, KY. The NSAA is an organization that assists state auditors by providing opportunities to exchange information at the state and federal government levels. The NSAA states that although this document addresses many of the best practices that could apply in these situations, it should not be considered exhaustive.

it worked with during the fiscal year committed to create. However, the Authority does not publicly report on the cumulative progress it has made toward its goals. Specifically, the Authority's annual report does not include cumulative progress made from previous years. Although the Authority developed summary documents for fiscal years 2013 and 2014, and the 2014 summary document shows 2 years of progress toward its goals, according to authority officials, this summary document is distributed internally within the Authority, to the Board of Directors (Board), and occasionally to other stakeholders. According to authority management, this report is not a confidential document; however, it is not broadly distributed to the public. However, according to NSAA best practices, an economic development agency should periodically report to the public and policymakers on the extent to which it has achieved its goals. Therefore, the Authority should ensure that it publicly reports the cumulative progress it makes toward its three 5-year goals. For example, it could consider making its summary report that shows the cumulative progress on its goals more readily available to the public by posting it on its Web site.

- **Clearly state whether reported outcomes are actual or commitments announced by companies—**The Authority's annual report generally provides information based on the commitments that the companies that it works with announce, but it does not always clearly state that this information is based on these commitments and not the actual jobs created and capital investment made. For example, the Authority's 2014 annual report lists the total jobs created for each quarter during the fiscal year, but these numbers are not clearly identified as jobs companies have committed to create. Although an earlier page in the annual report mentioned that these outcomes are committed numbers, without stating this explicitly throughout the report, those reading the report may not understand that the jobs presented have not yet been created. NSAA best practices state that when reporting to the public and policymakers on the agency's activities, an economic development agency should acknowledge any data limitations, such as clearly identifying the number of jobs created as planned, projected, or actual. Clear information can help the Authority's management and state leaders better assess the effectiveness of the Authority and its economic development efforts. Therefore, the Authority should clarify in its annual report and other reports it produces whether the information presented on jobs created, wages, and capital investment represents committed or actual outcomes. Similarly, when reporting outcome information to other entities, such as the Governor's Office of Strategic Planning and Budgeting, the Authority should be clear whether the information presented for jobs created, wages, and capital investment is actual or committed.

- **Present more information on costs of and benefits from the Authority's activities—**The Authority has not developed a consolidated report that summarizes all financial incentives given on a company-by-company basis compared to the actual economic development outcomes produced. Although the Authority presents a variety of information in its annual and other reports separately, these reports lack a consolidated comparison of the incentives given to the benefits received. Without having a complete comparison reflected in one report, it is more difficult to readily obtain an overall picture of Arizona's return on investment or the benefits the State has received in return for its economic development investment costs. NSAA best practices suggest that economic development agencies should compare the amount an agency spends on economic development activities with the benefits attributable to those activities when feasible. Without clear information about the State's return on investment, it may be difficult for decision makers to make informed decisions about Arizona's economic development activities.

Auditors identified an economic development agency in one other state that reports on the financial incentive amounts the state provided compared to the benefits the state received. Specifically, the Utah Governor's Office of Economic Development's 2014 annual report presented outcomes resulting from its economic development activities for each year between fiscal years 2006 and 2014. This report shows, by company, Utah's projected costs—the amount the state committed in financial incentives—and the projected state benefits, such as projected new jobs and capital investment. In addition, for fiscal years 2006 through 2012, this report compares the overall projected performance to the actual performance to date. This comparison is done for three areas: the state's incentive costs, jobs created, and new tax revenue.

To strengthen its reporting of comparative information, the Authority should take steps to provide information about the State's actual financial contributions toward economic development compared to the actual economic benefits it receives. According to the Authority, it had not reported the total amount of grant and tax incentive amounts given on a company-by-company basis because the Authority had not been asked to report this information, and some of the individual company tax incentive information is confidential. Statutes establishing each of the tax incentive programs vary in how much information can be reported. However, to help further demonstrate its economic impact, the Authority should develop a report or add information that it can legally report to its existing reports or Web site that better summarizes Arizona's total economic development investment costs and the benefits that the State received as a result of these expenditures. Similar to Utah's report, the Authority's report could show by fiscal year the financial incentives Arizona committed to provide to each company along with each company's announced job creation and capital investment commitments. This report should also compare actual job creation and capital investment outcomes to those announced and update this comparison each year to show progress over time. For information that cannot be disclosed on a company-by-company basis, this comparison could be presented in aggregate by combining the information for all the companies to avoid any confidentiality issues.[1]

Authority should include additional information required by statute in its Competes Fund annual report

Although the Authority reports on most elements required by statute for its Competes Fund grants, it should better comply with two statutory requirements. Specifically, A.R.S. §41-1545.04 requires the Authority to annually report to the Legislature on the grants made from the Competes Fund along with specific information for each grant recipient, including the number of jobs each recipient committed to create, the number of jobs actually created, and the amount of capital investment each recipient committed to and actually spent in the State (see Finding 2, page 18, for additional information about

[1] According to Arizona Revised Statutes (A.R.S.) §42-2001, taxpayer liabilities are considered confidential, and the Authority would not be able to legally report tax revenues by company. In addition, some statutes prohibit reporting certain information to the public, such as A.R.S. §41-15012, which makes information that is gathered from a business applying for a qualified income tax credit confidential.

the Competes Fund grant types). Consistent with statute, the Authority's Competes Fund annual reports for 2013 and 2014 have included this information for deal-closing grants.

However, for two other grant types—innovation and rural grants—the Authority presented combined information for all grant recipients rather than for each recipient individually as statute requires. For example, in its fiscal year 2014 report, the Authority reported that companies receiving its innovation grants created a total of nine jobs at an average wage of $91,733 and made capital investments of more than $2 million. Although this report listed the names of each innovation grant recipient, it did not provide the information statute requires for each individual company. Similarly, in the same report, the Authority reported that its fiscal year 2013 rural grant recipients created a total of 879 jobs at an average wage of $46,945 and made capital investments of more than $97 million, but did not provide the specific information required by statute for each recipient. According to authority management, this information was summarized because the Authority had not interpreted this statute to require reporting on individual recipients of the innovation and rural grants. To ensure it complies with statutory reporting requirements, the Authority should report the required information for each grant recipient for the innovation and rural grants in addition to its deal-closing grants.

The Authority should also better comply with the statutory requirement for reporting median wages of the jobs Competes Fund grant recipients create. According to A.R.S. §41-1545.04, the Authority is required to report on the median wage of the jobs each Competes Fund grant recipient created. Although the Authority's Competes Fund annual report includes a similar measure—the average annual wages of the jobs created for each of its deal-closing grant recipients—it does not include the median wage. According to authority management, it has not reported the median wage for several reasons, including that average wages are easier to verify and that the Authority's goals are based on average wages rather than median wages. However, the average wage may not always provide the best illustration of the wages being paid. For example, if an entity creates mostly low-wage jobs and one high-paying Chief Executive Officer (CEO) position, the median wage of all jobs would be lower, which better reflects the majority of jobs created, while the average wage of all jobs would be higher because it is influenced by the CEO position's wage. Therefore, the Authority should report the median wage of the jobs each Competes Fund grant recipient created.

Recommendations:

1.1. To help ensure the Legislature and the public can clearly understand the Authority's economic development efforts and results, the Authority should enhance its reporting in the following three ways:

   a. Ensure that it reports the cumulative progress it makes toward its three 5-year goals. For example, it could consider making its summary report that shows the cumulative progress made more readily available to the public by posting it on its Web site.

b. Clarify in its annual report and other reports it produces whether the information presented on jobs created, wages, and capital investment represents actual activity or commitments.

c. Develop a report or add information that it can legally report to its existing reports or Web site that better summarizes Arizona's total economic development investment costs and the benefits that the State received as a result of these expenditures. For example, the Authority's report could show by fiscal year the financial incentives Arizona committed to provide on a company-by-company basis along with each company's announced job creation and capital investment commitments. This report should also compare actual job creation and capital investment outcomes to those announced and update this comparison each year to show progress over time. For information that cannot be disclosed on a company-by-company basis, this comparison could be presented in aggregate by combining the information for all the companies to avoid any confidentiality issues.

1.2. To ensure compliance with statutory reporting requirements, the Authority should include in its annual Competes Fund report:

a. Required information, such as jobs committed and created, for each grant recipient for the innovation and rural grants; and

b. The median wage of the jobs each Competes Fund grant recipient created.

FINDING 2

Competes Fund grant-selection processes generally align with statutes and best practices, but should be formalized and monitoring processes can be improved

Although the Arizona Commerce Authority (Authority) has some processes for awarding and monitoring Arizona Competes Fund (Competes Fund) grants, it can enhance these processes. The Authority's processes for awarding Competes Fund grants are consistent with statutes and many best practice suggestions. However, the Authority should develop and implement comprehensive written grant-selection procedures and better demonstrate that it consistently follows these procedures by improving its grant-selection documentation. In addition, the Authority has developed processes for monitoring some of its grants, but should formalize its monitoring processes and document its verification efforts to help ensure that the outcomes reported by grant recipients are accurate.

Authority has adequate grant-selection processes, but should formalize and better document its compliance with them

Although the Authority has developed adequate processes for awarding Competes Fund grants, it has not developed comprehensive written procedures for these processes or maintained evidence it follows them. The Authority's processes for awarding Competes Fund grants include several steps that are consistent with statutes and best practices, such as steps to help ensure that companies receiving awards are likely to provide the intended benefits to the State prior to awarding the grant. However, not all of the Authority's processes are supported by written procedures to help ensure consistency, and the Authority has not consistently documented that it has followed its processes.

Authority's grant-selection processes include several steps that align with statutes and best practices—The Authority has established various processes to help it award Competes Fund grants in compliance with statutory requirements. The Authority awards three types of Competes Fund grants: deal-closing, Arizona Innovation Challenge (innovation), and Rural Economic Development (rural) (see textbox, page 18) and statute establishes specific requirements governing the awarding of each grant. For example, to receive a deal-closing grant, statute requires companies to pay compensation that exceeds the median wage by county, pay at least 65 percent of the health insurance premium for employees, and qualify as an Arizona basic industry.[1] To comply with statute, prior to awarding deal-closing grants, authority staff perform a due diligence review that gathers information about the potential recipient, including the basic industry it falls into, the wages it anticipates paying, and the percentage of health insurance premiums it will pay for employees. In addition, statute requires that for all Competes Fund grants, applicants must sign agreements with the Authority that include performance targets and consequences for failing to meet these

[1] As defined by Arizona Revised Statutes (A.R.S.) §41-1545(2), an Arizona basic industry means any of the following: manufacturing industries identified by North American industry classification system code sectors 31, 32, and 33; producing goods or services that derive at least 65 percent of revenue from out-of-state sales; research and development of new products, processes, or technologies; national or regional headquarters or back-office operations supporting a national or regional company; or warehouse distribution operations identified by North American industry classification system code sector 42 if 65 percent of inventory is shipped out of State.

Competes Fund grants

- **Deal-closing grants**—A grant used to attract companies that may relocate to Arizona or expand within Arizona in exchange for the recipient's commitment to bring quality jobs and high capital investment. These grants frequently total $1 million or more and are negotiated as part of a business attraction process rather than a competitive process.
- **Arizona Innovation Challenge (innovation grant)**—A competitive grant used to assist start-up, and early-stage businesses commercialize their innovative technology. In 2014, these grants were for $250,000 each and awarded biannually to the winners of a three-round business plan competition.
- **Rural Economic Development grants (rural grant)**—A grant used to improve infrastructure in rural communities that strengthens their capacity and competitiveness for economic growth. As of fiscal year 2015, these grants were for approximately $250,000 each and awarded through a competitive application process.

Source: Auditor General staff analysis of the Authority's Web site information and grant-related documents.

targets, such as not receiving grant monies or repaying grant monies already awarded. To help ensure this requirement is met, the Authority has designed grant agreements that include these provisions for each grant award.

Additionally, the Authority's grant processes help guide its selection of Competes Fund grant recipients (grant recipients) in a manner consistent with best practices. According to the National State Auditors Association (NSAA) best practices, having a well-designed economic development program increases the likelihood that intended outcomes of the program can be achieved.[1] As part of a well-designed economic development program, states should develop a systematic process for selecting who receives assistance and should follow a systematic, objective, and independent process for monitoring performance to ensure that grant recipients are complying with all program requirements. Consistent with these best practices, the Authority has developed three unique processes for awarding Competes Fund monies. Each grant-award-selection process includes procedures and requirements to help ensure that the Authority selects eligible applicants consistent with statute and/or best practices and that those applicants have a reasonable likelihood of achieving specified results. Specifically:

- **Deal-closing grant process considers potential economic benefit to the State**—To identify potential recipients and award deal-closing grants, the Authority developed a noncompetitive process that focuses on companies that may only move to Arizona or expand in Arizona with financial assistance. Authority staff identify potential candidates for the award based on criteria such as being in a statutorily defined targeted industry and having the potential to create higher-paying jobs and the potential for substantial capital expenditures. Authority staff also review a company's compliance with statutory eligibility requirements, including that it owes no Arizona taxes and that it is in good standing under the laws of the state in which it was formed or organized.

[1] National State Auditors Association. (2004). *Best practices in carrying out state economic development efforts: A National State Auditors Association best practice document.* Lexington, KY. The NSAA is an organization that assists state auditors by providing opportunities to exchange information at the state and federal government levels. The NSAA states that although this document addresses many of the best practices that could apply in these situations, it should not be considered exhaustive.

The Authority's executive management team (see Introduction, page 10) assesses companies for a potential deal-closing grant. For example, this team reviews information, such as the entity's financial statements and/or credit report, which may be used to assess the financial likelihood that a company can meet its stated goals. The team also considers Arizona's competitiveness by reviewing a comparison of the cost of the company doing business in competing states compared to the cost of doing business in Arizona when including the incentives that Arizona can offer. In addition, the Authority contracts with a third party to obtain an independent economic impact analysis that uses the number of jobs and capital investment the company plans to create in Arizona and the amount of Arizona taxes that it would likely pay to analyze whether the economic benefit to the State outweighs the award amount that may be offered to the company. Finally, if the team decides that a deal-closing grant should be offered, the team negotiates the grant and prepares a written statement of the Authority's assessment that the direct economic impact of the grant is clearly in the State's best interest and then the Authority's Chief Executive Officer/President (CEO) signs the statement and the Authority executes the grant.

- **Innovation grants awarded through a competitive process**—To select recipients for innovation grants, the Authority has established a three-round business plan competition to review applicants. Both authority staff and management and expert judges are involved in narrowing the pool of applicants through this competition. According to the Authority, approximately 130 to 300 applicants are narrowed to 6 recipients semiannually. Prior to the first round, authority staff screen applicants for eligibility based on authority-identified qualifications, such as the company being located in Arizona or willing to move to Arizona and having between 2 and 30 employees. Next, the first and second rounds of this process are judged by a panel of professionals who have experience in start-up and early-stage businesses. These judges are trained by the Authority on how to score the applications and how to recuse themselves if they identify a company with which they have a potential or real conflict of interest. The judges review and score the applications using a detailed rubric with evaluation criteria, including evidence of intellectual property protection, such as patents or exclusive licenses. Judges then submit their scores into an online evaluation software system that statistically analyzes the scores and assigns an overall score to each applicant.

  Based on the applicants' scores and ranks, authority management and judges identify ten semifinalists to proceed to a third round. In the third round, the semifinalists give a presentation about their business to a panel of judges and authority management. The panel determines which applicants will be recommended for the awards based on the oral presentation, the company's detailed business plan, and scores from previous rounds. The Authority's CEO approves six grant recipients based on the recommendations from authority management and the judges.

- **Rural grants awarded through an evaluation process**—To select recipients for the rural grants, authority staff have developed a checklist to help ensure applicants meet authority-established eligibility requirements. These requirements include that the applicant be a rural community such as an Arizona incorporated city, town, or county with a certain population or a federally recognized Arizona Indian tribe.[1] In addition, these communities must provide

[1] Rural communities are Arizona incorporated cities and towns with populations of less than 150,000 (based on U.S. Census Bureau 2010 population) not contiguous with or situated within a metropolitan area, or Arizona counties with populations of less than 750,000 (based on U.S. Census Bureau 2010 population data), or federally recognized Indian tribes situated in Arizona.

matching funds for the project, and the project must involve the construction of public infrastructure. Eligible projects are then evaluated by a group of members from the Rural Business Development Advisory Council using a detailed scoring matrix, which includes considerations such as how well the project demonstrates anticipated return on investment and the amount of the cash match the applicant will provide for the project.[1] These members recommend the highest-scoring projects to the Authority's CEO, who reviews and approves grant awards.

Finally, the Authority has included requirements in its grant agreements as required by statute and also recommended by NSAA best practices. For example, the Authority's grant agreements include milestone or performance targets specific to each project that the grant recipient must show progress toward meeting, such as high-paying jobs created, prior to receiving grant payments. In addition, agreements include consequences for not achieving milestones or performance targets, including "clawback" provisions. These provisions allow the Authority to recover grant monies already disbursed if the award recipient does not continue to meet specific requirements, such as maintaining a specified number of jobs during a specified time frame or keeping the company in Arizona during the agreement period. In addition, the Authority's grant agreements provide the Authority with the right to audit or verify the information reported.

Authority should develop comprehensive written grant-selection procedures and better document grant-selection information—

The Authority has established several effective grant-awarding processes, and the Authority should continue with its efforts to formalize these processes by developing and implementing written procedures. For example, the innovation grant process was described in application documents and judge guidelines, but a complete description of the internal procedures authority staff should follow to evaluate grant applications was not documented. In June 2015, the Authority began drafting a comprehensive procedure or "playbook" for the innovation grant, beginning with eligibility determination and extending through the final selection of its competition winners. According to the Authority, its processes were developed at the program's inception and continually updated over subsequent years, but they were not compiled into a comprehensive program policies and procedures manual until during the audit process. In addition, the Authority has not developed comprehensive written procedures for the rural grants, although some of this process was captured in other documents, such as its online requests for proposal and proposal guidelines. Because written, comprehensive procedures help ensure all grant award steps are completed, and completed consistently during each grant cycle, the Authority should develop or continue with its efforts to develop and implement written procedures for all of its Competes Fund grants. Once these are developed, it should train staff on these written procedures and ensure that staff follow them.

Additionally, the Authority does not always adequately document grant application, review, and award information to demonstrate compliance with these processes. According to NSAA best practices, economic development agencies should maintain a record of all applications and supporting documents while also documenting the screening process followed and the award decisions made. To determine whether the Authority followed its processes, auditors reviewed 18 Competes Fund grants the Authority awarded between fiscal years 2013 and

[1] The Rural Business Development Advisory Council was established by A.R.S. §41-1505 to advise the Authority's Board of Directors regarding rural business development strategies, including creating jobs, diversifying economies, and attracting new investment.

2014, which included 6 deal-closing grants, 8 innovation grants, and 4 rural grants.[1] Auditors' review of the deal-closing grants found that most of the grant files contained evidence that the Authority consistently reviewed company information for grant criteria during the selection process, but in a few instances the files lacked some documentation. For example, one deal-closing grant lacked a comparison of the cost of doing business in Arizona compared to the cost of doing business in other states. According to authority management, this comparison was done, but it could not locate the documentation. In addition, all of the innovation grants auditors reviewed lacked documentation explaining the final award decision. Therefore, to better demonstrate compliance with its grant-selection processes, the Authority should develop procedures detailing what documentation it should maintain in its grant files and a final verification process to ensure that all required documentation has been retained. For example, it could develop a checklist of the documents that should be retained in the file and require supervisory review and sign-off that all documents have been placed in the file.

Authority should strengthen its grant-monitoring processes

To better ensure that Competes Fund grants benefit the State, the Authority should improve its monitoring of grant recipients. According to NSAA best practices, economic development agencies should help ensure that state dollars are being spent wisely and are achieving the desired results by developing and following systematic processes for determining whether recipients are complying with all grant requirements. Although the Authority takes steps to monitor grant recipients, such as receiving progress reports from grant recipients and verifying some reported outcomes, it has not monitored grant recipients in a consistent manner, lacks uniform monitoring processes, and inconsistently documents its verification efforts. In addition, the Authority has not developed written procedures for how it will address noncompliance or partial compliance and how these decisions will be documented. Therefore, the Authority should develop and implement written policies and procedures to enhance its monitoring efforts and address noncompliance with grant agreement terms.

Authority receives progress reports as outlined in its grant agreements—The Authority generally has required grant recipients to report on the outcomes specified in the grant agreements and has taken steps to help ensure it receives progress, quarterly, and/or annually required reports. The Authority's grant agreements require recipients to submit written reports detailing the milestones that have been achieved or annual reports that include outcomes such as those relating to job creation, wages, and capital investments. This reporting requirement is aligned with NSAA best practices, which indicate that grant recipients should provide all required reports and information to help ensure indicated outcomes are achieved. Auditors' review of grant files found that the Authority had received most required reports from grant recipients. However, some of the deal-closing grants auditors reviewed lacked grant recipients' 2012 and/or 2013 annual reports, which the Authority uses to compile a statutorily required annual report. For example, one grant recipient did not file annual reports in fiscal years 2012 and 2013, and two other grant recipients failed to provide annual reports in fiscal year 2013.[2] According to authority

[1] See Appendix D, pages d-1 through d-2, for more information regarding the methods auditors used to select the grants for review.

[2] This does not include one grant recipient who has not met several reporting requirements (see page 24).

management, to prepare its annual report, it instead used the progress reports these grant recipients submitted because these progress reports contained similar information.

Authority verifies some self-reported progress, but lacks written procedures for consistently doing so and documenting its verification efforts—Although the Authority has performed some verification of grant recipients' self-reported milestones and/or outcomes prior to making grant payments, it lacks written policies and procedures for consistently verifying the accuracy of self-reported information. According to NSAA best practices, an effective monitoring process would include reviewing and verifying the milestones and outcomes reported by the grant recipient for accuracy and reliability to help ensure that tax dollars are being spent wisely and the grant recipients are achieving the agreed-upon results. Despite performing some verification steps, the Authority needs to enhance its practices, including developing and implementing written verification policies and procedures for all three Competes Fund grants types and documenting its verification efforts. Specifically:

- **Deal-closing grant outcomes are sometimes verified through independent sources, but verification process was not formalized or documented—**Until June 2015, the Authority lacked a written procedure for verifying the information that deal-closing grant recipients reported, such as jobs created, average wages, and capital investment amounts. For example, the Authority stated that its typical practice for verifying this self-reported information consisted of spot-checking outcomes and using verifications steps such as the following:

    - Comparing grant-recipient-provided employee lists from one quarter to the next to ensure that the company had not reported the same names twice;

    - Comparing the grant-recipient-provided employee list to a grant-recipient-provided copy of a tax form companies use for reporting wages to the Arizona Department of Economic Security;

    - Reviewing the grant-recipient-prepared employee list to ensure that the wages listed were greater than or equal to the agreed-upon wages; and

    - Requesting and reviewing a sample of invoices the grant recipient had paid to verify capital expenditures.

  However, four of the six deal-closing grant files auditors reviewed lacked evidence that these steps were performed consistently for all grants and all reported outcomes, while the other two grant recipients had yet to report any outcomes. For example, only one file included receipts as evidence for capital expenditures, and all four files had some evidence the Authority received payroll information, but the files did not include clear documentation indicating what verification procedures the Authority performed. As of June 2015, the Authority had compiled its typical practices into a written procedure specifying how authority staff should verify self-reported outcomes for its deal-closing grants.

- **Innovation grant milestones and outcomes not verified—**The Authority lacks a formal process for verifying milestone and outcome information reported by innovation grant recipients and has not required these grant recipients to submit evidence that would allow staff to verify this reported information. All eight innovation grant files auditors reviewed lacked evidence that the Authority verified self-reported milestone or outcome information (i.e., jobs created, average wages, or capital investment). According to authority management, it frequently receives some information from innovation grant recipients that provides evidence that milestones are being achieved. For example, a company that received an innovation grant to assist in the manufacturing of a commercial, high-altitude balloon included photos of the balloon fabrication equipment in a quarterly report. However, the Authority had not required grant recipients to submit documentation for this or other milestones in any of the agreements reviewed and received this information only because the recipient provided it. In addition, according to authority officials, verification of grant recipients' progress toward the Authority's goals of job creation and capital investment was not prioritized because innovation grants are not designed to produce a large number of jobs in the early years of the grant and the length of time needed for companies to produce results will frequently exceed the grants' 3- to 5-year time period. Although authority management stated that reported milestones and outcomes are required by the grant agreements to be materially true, correct, and complete, and are self-certified by the company or indirectly verified, it has not established verification procedures and does not require recipients to provide evidence that the milestones or outcomes were achieved.

- **Rural grant project costs verified, but outcomes not verified—**The Authority verifies that rural grant agreement milestones are met by checking submitted receipts or invoices for infrastructure project costs, but it does not verify outcomes. Specifically, prior to paying rural grant recipients, authority staff review receipts or invoices submitted by the grant recipients showing that invoices were paid and to ensure that these project costs were for the same goods and services agreed upon in the grant agreements. For example, for a rural grant that was awarded to build a road in 2014, the Authority paid the grant recipient only after it received and reviewed a paid invoice from an asphalt company that had been included in the project budget. However, in addition to the focus on infrastructure improvement, these projects are intended to support job growth and capital investment, which is required for all Competes Fund grants. Yet, the Authority does not have a process for verifying outcomes reported by rural grant recipients, such as the number of jobs created.

The Authority has not established formal policies and procedures for monitoring all grants, including verifying milestone and/or outcome information reported by grant recipients. Thus, it lacks procedures for documenting the results of its monitoring efforts, and in some cases, has not required grant recipients to submit evidence that would allow staff to verify this reported information. In addition, the Authority's monitoring process did not include a requirement for verifying company-reported information through independent sources, such as employee payroll records or through the records of other state agencies. By not requiring documentation to support reported milestones or outcomes and taking steps to verify this information, the Authority may not know whether the investment of state dollars benefited the State. Therefore, the Authority should develop and implement written policies and procedures for verifying grant-recipient-reported milestones and/or outcomes for all of its Competes Fund grants. These policies and procedures should specify what milestone and/or outcome information grant recipients should report; how to verify submitted information, including the independent sources the Authority should use to verify the reported information; what information to document in the Authority's files; and that grant payments will not be made until the Authority has completed and documented the verification process.

Authority should address any issues with agreement compliance and document decisions made—Although the Competes Fund grant agreements include provisions that allow the Authority to address issues of noncompliance, such as through terminating the agreement or recovering grant monies already paid, the Authority has not developed guidance for how it will address noncompliance or partial compliance and how it will document these decisions. For example, for three of the eight innovation grants auditors reviewed, the Authority had reduced the amount of the grant payments when the agreed-upon milestones were changed to better meet opportunities presented to the company, but corresponding grant files did not indicate how the modified payment amounts were decided. Authority management indicated that it uses professional judgment to address these situations, discusses with the client why they are not meeting the intended goals of the project, and holds internal discussions regarding how much, if any, incentive monies should be paid. However, the Authority should develop and implement policies and procedures for addressing these situations to help ensure that it consistently handles changes to the required outcomes specified in grant agreements, such as changes in milestones or delays in meeting goals within the required time frame. These policies and procedures should also require documenting the discussions, decisions, and any changes to the grant agreement in the grant files.

In addition, the Authority does not always document its decisions to not enforce reporting requirements for companies that take longer to meet outcomes or milestones. For example, one-deal closing grant recipient did not submit required quarterly progress reports. Authority officials indicated that discussions with the company occurred regarding the situation and the lack of reporting on its progress; however, the Authority could only provide limited documentation about the results of these conversations. Further, since no money had been paid to the company and would not be paid until the company met the agreed-upon milestones, the Authority stated that it was not doing anything further at this time. However, to ensure companies report the required information or the Authority documents exceptions to its reporting requirements, the Authority should include steps in its policies and procedures for ensuring that grant recipients report milestone or outcome results or, when such results are not reported, exceptions to the reporting requirements are noted in the Authority's files.

Recommendations:

2.1. The Authority should enhance its Competes Fund grant-awarding practices by:

a. Developing and implementing, or continuing with its efforts to develop and implement, comprehensive written procedures for all of its Competes Fund grants;

b. Training staff on these written procedures and ensuring that staff follow them; and

c. Developing procedures detailing what documentation should be maintained in its files and a final verification process to ensure that all required documentation is in the grant recipient's file.

2.2. The Authority should improve its monitoring of all Competes Fund grants by developing and implementing written policies and procedures for verifying grant-recipient-reported milestones and/or outcomes. These policies and procedures should:

a. Specify what milestone and/or outcome information grant recipients should report;

b. Indicate how the Authority should verify submitted information, including the independent sources the Authority should use to verify the reported information;

c. Identify what information the Authority should document in files; and

d. Specify that grant payments will not be made until the Authority completes and documents the verification process.

2.3. The Authority should develop and implement policies and procedures for making changes to grant agreements to help ensure that it consistently addresses changes to the required outcomes specified in the agreements, such as changes in milestones or delays in meeting goals within the required time. These policies and procedures should include:

a. How it will document the discussions, decisions, and any changes to the grant agreement in the grant files; and

b. Steps for ensuring that grant recipients report milestone or outcome results or, when such results are not reported, exceptions to the reporting requirements are noted in the Authority's file.

SUNSET FACTORS

In accordance with Arizona Revised Statutes (A.R.S.) §41-2954, the Legislature should consider the following 12 factors in determining whether the Arizona Commerce Authority (Authority) should be continued or terminated.

Auditors' analysis of the sunset factors identified a few recommendations for improvement that were not already contained in this report's findings. Specifically, the Authority can take some steps to better manage conflicts of interest (see Sunset Factor 2, pages 31 through 32), continue with its efforts to adopt rules for two of its incentive programs (see Sunset Factor 4, page 33), and comply with the portions of the State's open meeting law that apply to the Authority (see Sunset Factor 5, page 34).

Sunset factor analysis

1. **The objective and purpose in establishing the Authority and the extent to which the objective and purpose are met by private enterprises in other states.**

   The Authority was established in 2011 to replace Arizona's previous economic development agency, the Arizona Department of Commerce (Department), and to provide a more specific focus to grow and diversify Arizona's economy, and to market Arizona for the purpose of attracting, expanding, and retaining businesses and creating jobs. In 2010, a Governor's Commerce Advisory Council report recommended changes to the structure of the State's economic development efforts to strengthen Arizona's competitiveness and narrow the agency's focus.[1] Soon after, Executive Order 2010-12 established the Arizona Commerce Authority Board of Directors (Board) and priorities for the existing Department, including job creation and expansion of capital investment through business attraction, expansion, and retention. Then, Laws 2011, 2nd S.S., Ch. 1, §29, eliminated the Department and further defined the Authority and its responsibilities. For example, this law repealed some of the former Department's existing programs, such as the Hydrogen Grant program, and transferred other programs and powers from the Department to the Governor's Energy Office, such as the Arizona Biofuels Conversion program.[2] In addition, this law established the Arizona Competes Fund (Competes Fund) to be administered by the Authority to provide grants to attract, expand, or retain businesses in Arizona.

   To meet its mission the Authority recruits out-of-state companies to expand in or relocate their operations to Arizona, works with existing Arizona companies to grow their businesses in Arizona, and partners with entrepreneurs and investors to help create new businesses. The Authority focuses its efforts on targeted industries such as aerospace and defense, semiconductors, and renewable energy. The Authority is authorized to use various financial incentives, such as grants and tax incentives/credits, to encourage economic growth in Arizona (see Introduction, pages 4 through 7). In addition, according to the Authority, it markets the benefits of doing business in Arizona and works to improve the economic climate in the State through activities such as conducting trade missions, hosting networking events in other states, and identifying potential statutory changes that may promote business in Arizona. The Authority is governed

[1] Governor's Commerce Advisory Council. (2010). *Governor's Commerce Advisory Council report*. Phoenix, AZ: Office of the Arizona Governor.

[2] A.R.S. §41-1515 established the Hydrogen Grant program in 2005 to encourage the use of hydrogen in projects that benefit the public. A.R.S. §41-1515.01 established the Arizona Biofuels Conversion program in 2011 to encourage the use of biofuels by granting awards to provide for the conversion of existing and installation of new storage and dispensing equipment for biofuels.

by a Board of Directors (Board) that is chaired by the Governor and includes the Authority's board-appointed Chief Executive Officer/President (CEO) and 17 private sector leaders—9 appointed by the Governor, 4 appointed by the President of the Senate, and 4 appointed by the Speaker of the House of Representatives.[1]

Other states' economic development agencies are designed in a variety of ways. In addition, a 2013 National Governor's Association white paper reports that a number of states have started experimenting with new organizational models for economic development agencies, and some have recently reorganized, replaced, or supplemented their agencies, with a public-private partnership.[2] For example:

- **Wisconsin—**In 2011, the Wisconsin Economic Development Corporation (WEDC) was created as a public-private partnership to replace the former Wisconsin Department of Commerce. The responsibilities of WEDC's board of directors are to provide business support, expertise, and financial assistance to companies that are investing and creating jobs in Wisconsin and to support new business start-ups and expansion and growth in Wisconsin. In addition, the WEDC's board of directors may develop and implement any programs related to economic development in Wisconsin.

- **New Jersey—**New Jersey established a new state agency in 2010 that consists of three interconnected organizations, one of which is a public-private partnership that serves as the lead marketing organization for the state and provides recommendations on economic development strategy.

- **Florida—**Florida's lead economic development agency, Enterprise Florida, Inc., was created in 1996 and is a public-private partnership with a mission to expand and diversify Florida's economy through job creation. It exists alongside a second, fully public Department of Economic Opportunity, which administers other economic development programs in Florida.

- **Oregon—**In Oregon, the private sector has become a central actor in the economic development policy process through an independent organization called the Oregon Business Council, which was created in 1985, and is run by a collection of supporting businesses with no organizational ties to state agencies. Its mission is to encourage business leaders in Oregon to contribute to the state's economic prosperity.

To determine how Arizona's economic development structure compares to other states' economic development agencies, auditors also contacted six states that authority officials described as states Arizona frequently competes with for business attraction: Colorado, Florida, Georgia, Nevada, Texas, and Utah. Similar to the states in the National Governor's Association report, these states use various approaches for their economic development efforts. Economic development agencies in four of the six states were administered by one or more state programs, while the other two states used a public-private partnership. For example, Texas uses a public-private partnership between its Governor's Office of

---

[1] Laws 2011, 2nd S.S., Ch. 1, §132, initially allowed the Governor to select all 17 board members, but as the staggered terms expired through January 19, 2015, all board members should be appointed by the Governor, President of the Senate, and Speaker of the House of Representatives in the proportions specified in A.R.S. §41-1502(B).

[2] Sparks, E. & Pappas, L. (2012). *Redesigning state economic development agencies*. Washington, DC: National Governor's Association.

Economic Development and Tourism and a privately funded nonprofit organization called the Texas Economic Development Corporation. In contrast, according to a Utah state agency official, Utah uses a state-based approach. Specifically, the Utah Governor's Office of Economic Development (GOED) is an executive branch agency established in 2006, responsible for enhancing the quality of life by increasing Utah's revenue base and improving employment opportunities.

2. **The extent to which the Authority has met its statutory objective and purpose and the efficiency with which it has operated.**

The Authority has organized its activities to meet many of its statutory objectives and purposes, but should take some steps to strengthen its programs and ensure it operates in line with best practices. Best practices for administering a state economic development program have been developed by the National State Auditors Association (NSAA).[1] These best practices suggest that a well-designed economic development program that includes appropriate planning, monitoring, and reporting can greatly increase the likelihood that its intended outcomes will be achieved.

Auditors compared the processes developed by the Authority for administering its program to those principles and processes suggested by best practices and found that the Authority has established many of these processes. For example, the Authority has developed clear and measurable goals and established processes and/or written guidelines for many of its programs, such as its loan and tax incentive/credit programs. In addition, the Authority has developed procedures for informing interested companies about the type of assistance that is available, what is required to obtain it, and what is expected in return. For example, the Authority publicly announces the availability of its grants in a variety of ways, including on its Web site, which includes links to grant applications, eligibility criteria, and guidelines, and announces grants through social media, press releases, and at economic development networking events. Finally, the Authority has provided services in a timely manner when awarding grants to promote economic development. Specifically, the Authority helps ensure that it processes grant applications quickly by monitoring the time it takes to award grants from the Competes Fund for both (1) Arizona Innovation Challenge (innovation) grants awarded through a business plan competition and (2) Rural Economic Development (rural) grants designed to develop infrastructure in rural communities. For example, in fiscal year 2014, innovation grant award decisions were announced within 114 days of the grant application opening date, and rural grants were awarded within 86 days of the grant application opening date (see Finding 2, page 18, for more information on these two grants).

Further, authority officials stated that they have used a conservative approach to awarding state monies for deal-closing grants, which the Authority offers through the Competes Fund to attract or retain companies that will provide numerous high-quality jobs and/or capital investment in Arizona. For example, in fiscal year 2014, the Authority awarded only $4.3 million in deal-closing grants, although it had received $25 million in Competes Fund monies that year and had a fiscal year 2013 Competes Fund fund balance of nearly $46 million.

[1] National State Auditors Association. (2004). *Best practices in carrying out state economic development efforts: A National State Auditors Association best practice document.* Lexington, KY.

Additionally, as indicated in Finding 2 (see pages 17 through 25), the Authority developed processes for awarding Competes Fund grants that generally align with statutes and best practices. For example, prior to awarding a deal-closing grant, the Authority reviews information such as the entity's financial statement and/or credit report that can be used to assess the financial likelihood that a company can meet its stated goals. The Authority also considers Arizona's competitiveness by reviewing a comparison of the cost of the company doing business in competing states compared to the cost of doing business in Arizona, including the incentives that Arizona can offer. According to authority officials, the Authority awards state monies only when necessary to bring companies to Arizona that would not come otherwise and that would provide a benefit to the State.

However, some of the Authority's reporting (as discussed in Finding 1, pages 11 through 15), grant awarding and monitoring (as discussed in Finding 2, pages 17 through 25), and conflict-of-interest processes should be enhanced. Specifically, the Authority should:

- **More clearly report on its economic development efforts**—Although the Authority has developed reports that present a variety of information about its economic development goals and outcomes, it should enhance this reporting. For example, the Authority should post on its Web site a summary report of the cumulative progress it has made toward its 5-year goals for job creation, high wages, and capital investment (see textbox) and more clearly state when information in its annual and other reports is based on commitments that the companies that it works with announce, rather than actual outcomes (see Finding 1, pages 11 through 15, for more details).

Authority's 5-year goals are to obtain commitments from companies to:

- Create 75,000 higher-wage jobs;
- Increase average wages of jobs created; and
- Increase capital investment by $6 billion.

Source: The Authority's 5-year business plan and explanation from authority officials.

- **Formalize its grant selection processes and document its compliance with them, and strengthen its processes for monitoring grants**—Although the Authority's grant-awarding processes generally align with statute and best practices, it should develop procedures detailing what documentation should be maintained in its grant files and continue with its efforts to develop and implement comprehensive written procedures for all of its Competes Fund grants processes. Further, although the Authority has some processes for determining whether grant recipients are meeting grant agreement outcomes, it has not established formal policies and procedures for monitoring, including verifying reported milestone and/or outcomes information reported by grant recipients. For example, until June 2015, the Authority lacked a written procedure for consistently verifying the information that deal-closing grant recipients reported. In addition, it had not established formal procedures for verifying milestone and outcome information reported by other grant recipients. As a result, the Authority should develop and implement written policies and procedures for monitoring grant recipients and verifying and documenting recipient-reported information for all Competes Fund grants (see Finding 2, pages 17 through 25, for more details).

- **Strengthen conflict-of-interest practices—**Although the Authority has adopted a conflict-of-interest policy to help guide the consideration and reporting of potential conflicts of interest, its implementation of this policy should be improved. In response to A.R.S. §38-503, which requires public officers and state employees to disclose conflicts of interest, the Authority has developed a conflict-of-interest policy. The Authority's policy follows some guidelines for managing conflicts of interest published by the Organization for Economic Cooperation and Development.[1] As suggested by the guidelines, the Authority's policy lists several examples of possible conflicts of interest, such as owning a business that is competing for an authority contract, including grant agreements, or accepting a bribe or kickback from an organization seeking a business relationship with the Authority. In addition, the policy requires stakeholders, including staff, volunteers, and board members, to disclose potential conflicts in writing and sign a conflict-of-interest policy acknowledgment form at least annually.

  Because authority management and staff make decisions regarding publicly funded financial awards, and because board members select and employ the Authority's CEO and are connected to Arizona businesses, it is important for the Authority to be vigilant in matters of conflict of interest and avoid even the appearance of a conflict in its decisions. As such, the Authority should strengthen its conflict-of-interest practices in the following two ways:

  - **Annually update conflict-of-interest policy acknowledgment forms—**The Authority has not consistently required staff, board members, and volunteers to review the Authority's conflict-of-interest policy and sign an acknowledgement of the policy at least annually, as required by its policy. For example, auditors requested conflict-of-interest policy acknowledgement forms for 16 staff and board members and found that as of May 2015, two conflict-of-interest policy acknowledgment forms were not readily available and ten of the policy acknowledgment forms had not been signed in more than 3 years. However, during the course of the audit, the Authority had the board member and staff person who were missing policy acknowledgment forms complete them, and according to authority officials, it will require the other staff/board members with outdated forms to update them in October 2015. In addition, the Authority had obtained several written disclosures of potential conflicts from its board members and staff since its inception, and according to the Authority, it has been vigilant about potential conflicts of interest. Nevertheless, the Authority should continue to ensure that all decision makers at the Authority have considered and disclosed potential conflicts by complying with its requirement that individuals review and sign conflict-of-interest policy acknowledgment forms annually.

  - **Require all grant volunteer judges to sign conflict-of-interest policy acknowledgment forms—**Although the Authority takes steps to prevent conflicts of interest for volunteer judges who assist in its innovation grant-award process, it has not obtained signed conflict-of-interest policy acknowledgement forms from its volunteers as required by its policy (see Finding 2, page 19, for more information on this grant). Specifically, for the volunteers judging the innovation grant competition,

[1] Organization for Economic Cooperation and Development. (2003). *Managing conflict of interest in the public service: OECD guidelines and country experiences.*

the Authority has developed judging guidelines that provide descriptions of conflicts of interest. The Authority has also documented which judges recused themselves from decisions about specific applicants during the grant-award process. However, the Authority has not required that judges read its conflict-of-interest policy and sign the policy acknowledgement form signifying that they understand the conflict-of-interest policy. According to authority management, signatures were not obtained because judges are verbally instructed to review grant-applicant information, identify conflicts of interest, and recuse themselves if necessary. However, requiring judges to review and sign the conflict-of-interest policy acknowledgement form helps ensure that judges consider and report all potential conflicts. Therefore, the Authority should require judges for the innovation grants to sign and submit its policy acknowledgement form and disclose conflicts as required by its policy.

3. The extent to which the Authority serves the entire State rather than specific interests.

The Authority's economic development efforts are designed to assist businesses throughout the entire State. For example, to help recruit businesses from outside of Arizona to both urban and rural locations, the Authority has developed community profile reports presenting information about many rural and urban communities such as the unemployment rate, potential labor force, workforce education attainment, and industries already employing members of the community. These profiles are posted on its Web site, and according to the Authority, these community profiles are available to companies that are considering relocating to Arizona. In addition, the Authority's Web site includes other information to market Arizona, such as a list of "certified sites," which are buildings and sites that have been made ready for development in rural Arizona.

Additionally, economic development financial incentives, including tax credits/incentives, grants, and a loan participation program (see Introduction, pages 4 through 7) managed by the Authority, are available to businesses located in any part of the State, and information about these incentives is available to the public on the Authority's Web site. For example, the Authority's loan participation program, the Arizona Innovation Accelerator Fund (see Introduction, page 7), uses federal monies to provide loans to small businesses, and according to the Authority, these loans are available to businesses located in any part of the State. In addition, some of the Authority's activities are specifically focused on assisting business in rural areas. For example, according to the Authority, two full-time staff are assigned to travel to rural areas throughout the State to help educate smaller communities about the Authority's programs, provide technical assistance with economic development projects, help coordinate regional economic issues, and identify economic growth opportunities. Also, the Authority approves approximately $2 million in Competes Fund grant award monies each year to be used for infrastructure grants to rural communities to help them strengthen their competitiveness for economic development (see Introduction, pages 6 through 7).

4. **The extent to which rules adopted by the Authority are consistent with the legislative mandate.**

   General Counsel for the Office of the Auditor General has analyzed the Authority's rule-making statutes and believes that although the Authority is exempt from following typical rule-making requirements, it has established an adequate process for developing rules required by its statutes. In addition, the Authority has established most of the policies or rules required by statute, but it should continue with its efforts to establish rules in two areas. First, A.R.S. §41-1507.01 requires the Authority to adopt rules for a tax credit program intended to increase research activities by providing tax credits to companies that partner with universities. Although statute allowed this program to begin after December 2014, authority management reported that the Authority has not yet received any applications. According to an authority official, as of July 2015, rules have not been drafted for the tax credit program, but the Authority has been working with its state university partners to draft rules. Because of the moratorium on state agencies' rulemaking, authority officials report that the Authority plans on requesting an exemption to the moratorium and implementing the tax credit rules once they have been adopted.

   Second, A.R.S. §41-1519 requires the Authority to develop rules for a computer data center program. This program is designed to provide tax relief to the owner or operator of a computer data center that will bring new investments to the State totaling at least $25 to $50 million, depending on the population of the county in which the computer data center is located. According to an authority official, the Authority has been working with the Arizona Department of Revenue and industry stakeholders to finalize rules for over a year, but as of August 2015, the rules had not yet been adopted. Because statute allowed this program to be available after August 2013, the Authority has been administering this program since 2014 with interim rules. As of July 2015, the Office of the Arizona Governor had exempted the Authority from the Governor's 2015 rule-making moratorium so that it may develop rules for the Computer Data Center program and the Authority had posted a notice of rulemaking for these rules. The Authority should continue with its efforts to adopt rules for administering the research tax credits and for the computer data center program as required by statute.

5. **The extent to which the Authority has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.**

   Although it is exempt from the rule-making process, the Authority has encouraged input from the public on its rules and has informed the public of the expected impact of proposed changes to its rules. A.R.S. §41-1005 exempts the Authority from the rule-making process under the condition that it still provides notice and opportunity for public comment prior to adopting rules. The Authority has adopted its own rule-making policy that requires it to post notices of rule-making on its Web site listing the time and place where oral comments may be made and the names and addresses of authority staff who receive written communications. Between January 2014 and June 2015, the Authority adopted three rules, all of which were publicly noticed prior to finalizing them. According to the Authority, it received input for only one proposed rule. Specifically, in January and February 2014, it received some input regarding possible rule changes to the Job Training Fund.[1]

[1] Laws 2015, Ch. 10, repealed the funding for the Job Training Fund program effective January 1, 2016. The program is closed to new applicants effective January 1, 2017.

In addition, the Authority's policy states that it must post a notice of the rule's adoption with an effective date no later than 180 days after posting the initial notice of rule-making. For the three rules adopted between January 2014 and June 2015, the Authority complied with its policy by approving the rules within 180 days of the initial notice of rulemaking and posting the notice of adoption on its Web site. In addition, to help provide information to the public, the Authority posts the full text of each rule, its rule-making policy, and other board-approved policies on its Web site.

Auditors also assessed the Authority's compliance with the portions of the State's open meeting law that applies to it and determined that the Authority should make improvements in the following two areas:

- **Making meeting minutes available within 3 business days—**The Authority did not make its meeting minutes available to the public within 3 business days after the meeting, as required by statute. Specifically, 3 business days after a public meeting in April 2015, meeting minutes were not available on the Authority's Web site, and when auditors requested a copy of the meeting minutes by phone, the minutes were not available until the following day. The State's open meeting law requires that meeting minutes be available within 3 business days of the meeting. Authority officials stated that this was a special circumstance and the delay was due to personal matters, and typically, the Authority has meeting minutes available within 3 business days after the meeting. The Authority should ensure that it provides meeting minutes within 3 business days as required.

- **Including statement required by the Americans with Disabilities Act (ADA) on its meeting notices—**The Authority's fiscal years 2014 and 2015 meeting notices and agendas auditors reviewed lacked the statement that persons with a disability may request reasonable accommodation such as a sign language interpreter, and contact information and instructions for scheduling an arrangement. According to the Arizona Agency Handbook §7.6.3.2, a statement of disability should be included to conform to the ADA. Previous meeting notices had included the required statement, and according to the Authority, management was not aware that the statement had been removed from its meeting notice template. The Authority corrected this issue by adding the wording back into its template and should ensure that future meeting notices contain the statement.

6. The extent to which the Authority has been able to investigate and resolve complaints that are within its jurisdiction.

This factor does not apply because the Authority is not a regulatory agency and does not have explicit statutory authority or requirements to investigate and resolve complaints. However, according to authority officials, the Authority may receive complaints or appeals regarding decisions the Authority made regarding grant and tax incentive applications, and if so, the Attorney General may represent the Authority and hold a hearing to allow the applicant to appeal the decision.

7. **The extent to which the Attorney General or any other applicable agency of the state government has the authority to prosecute actions under the enabling legislation.**

As authorized by A.R.S. §41-192, the Authority is not required to use the Arizona Attorney General as its attorney. However, authority officials reported that the Authority seeks legal counsel from the Arizona Attorney General's Office on state-related issues, such as representation in administrative hearings held for appeals made by tax incentive applicants and for advice and counsel on state law and related matters. In addition, A.R.S. §41-1504 allows the Authority to employ or retain legal counsel. For example, the Authority has contracted for private legal counsel to assist in drafting contracts, which may include grant agreements, performing research on legal issues in policy matters, and addressing human resources matters.

8. **The extent to which the Authority has addressed deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.**

According to the Authority, there are no deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.

9. **The extent to which changes are necessary in the laws of the Authority to adequately comply with the factors listed in this subsection.**

This audit did not identify any needed changes to the Authority's statutes.

10. **The extent to which the termination of the Authority would significantly affect the public health, safety, or welfare.**

Terminating the Authority would not significantly affect the public health, safety, or welfare. However, the Authority's mission to grow and strengthen Arizona's economy facilitates the creation of quality jobs by supporting and attracting businesses and can provide important economic benefits for the State. These priorities were established in 2011 when the Authority replaced Arizona's former economic development agency, the Department. The 2010 Governor's Commerce Advisory Council report reviewed the structure of the Authority's predecessor agency and recommended many changes, including redesigning the agency as a private-public partnership. Soon after, Executive Order 2010-12 established the Arizona Commerce Authority Board of Directors (Board) and priorities for the existing Department, and then Laws 2011, 2nd S.S., Ch. 1, §29, eliminated the Department and further defined the Authority and its responsibilities with a narrower focus than the Department. As indicated in Sunset Factor 1 (see pages 27 through 29), models for economic development vary among states, and the audit did not identify a single method for designing and operating an economic development agency that is better than others.

11. **The extent to which the level of regulation exercised by the Authority compares to other states and is appropriate and whether less or more stringent levels of regulation would be appropriate.**

This factor does not apply because the Authority is not a regulatory agency.

12. **The extent to which the Authority has used private contractors in the performance of its duties as compared to other states and how more effective use of private contractors could be accomplished.**

The Authority has used private contractors to assist it in performing its duties. In the first 9 months of fiscal year 2015, the Authority reported payments of approximately $1.8 million to 47 entities to provide a variety of services. According to the Authority, its contracting activities fall within six broad categories:

- **Program services—**This includes contracts with 21 companies that cost nearly $330,000 for services to support or execute specific programs, such as services for assessing the creditworthiness or risk of a company for the Arizona Innovation Accelerator Fund loan participation program (see Introduction, page 7).

- **International—**This includes contracts with five companies that cost nearly $160,000 for services performed in support of international trade or business attraction efforts, such as the contractor who operates the Mexico City Trade Office (see Introduction, page 10).

- **Technical advisory services—**This includes contracts with seven companies that cost nearly $217,000 for general consultation services in specific focus areas such as aerospace and defense, science and technology, and rural and strategic futures sectors. The Authority incorporates the expertise of these consultants for specific programs or uses the experts to deliver programs. For example, one consultant helps coordinate a program that provides direct mentoring to early-stage companies.[1]

- **Organizational support—**This includes contracts with four companies that cost nearly $55,000, mainly for legal and audit services. For example, the Authority contracts for its annual financial statement audit.

- **Marketing/communications—**This includes contracts with eight companies that cost nearly $783,000 for services performed in support of marketing and communication efforts. Examples of these services include copywriting and design of digital advertisements and determining the target audiences and key messages and tactics to most effectively market to these audiences through paid digital media such as advertising and digital communications such as social media and e-mail marketing channels.

- **Research and analysis/economist services—**This includes two contracts for $275,000 for economists and similar services. One of the economists primarily performs economic impact studies for the Competes Fund grants, but also performs other research and analysis as needed. The other economist's work involved updating an economic impact analysis of Arizona's defense installations.

To compare the Authority's use of contracts with other states, auditors contacted four states considered to be competitors with Arizona for business attraction. These states'

[1] The Venture Ready program is a business mentor program that is a connective resource for the Arizona start-up community to strengthen Arizona's innovation ecosystem and helps small businesses to expand through all stages of development.

economic development entities reported that they contracted for some of the same services for which the Authority contracts. For example, an official from Enterprise Florida, Inc. reported that Enterprise Florida, Inc. generally contracts for advertising, economic impact studies, legal and audit services, and technical consultation, but generally uses in-house staff for social media. Officials from the Utah Governor's Office of Economic Development and the Nevada Governor's Office of Economic Development reported that they contract for services such as social media services and economic impact studies. In contrast, Colorado's Office of Economic Development and International Trade reported that it had occasionally contracted for services, such as using consultants to assist with overseas trade and Web site design and advertising in its tourism office, but more frequently works with other state agencies for legal services and generally uses its own staff to provide technical expertise.

The audit did not identify any other opportunities for the Authority to use private contractors.

Recommendations:

1. The Authority should strengthen its conflict-of-interest practices by (see Sunset Factor 2, pages 31 through 32):

    a. Ensuring that all authority decision makers comply with its policy to review and sign conflict-of-interest policy acknowledgment forms annually; and

    b. Requiring judges for the innovation grants to sign and submit its policy acknowledgement form and disclose conflicts as required by its policy.

2. The Authority should continue with its efforts to adopt rules to administer research tax credits and for the Computer Data Center Program as required by statute (see Sunset Factor 4, page 33).

3. The Authority should improve its compliance with the State's open meeting law by continuing to ensure its meeting minutes are available within 3 business days and including the required ADA statement related to reasonable accommodation on its meeting notices (see Sunset Factor 5, page 34).

APPENDIX A

When the Arizona Commerce Authority (Authority) was established in 2011, it was provided statutory exemptions and authorizations that are not typically granted to other state agencies. The exemptions, partial exemptions, and authorizations are reflected in this appendix.

Description of Authority's statutory exemptions and authorizations

The Authority is statutorily exempt from requirements in the following areas:

- **State personnel requirements**—Arizona Revised Statutes (A.R.S.) §41-803(E) exempts the Authority from state personnel requirements regarding covered service, and also compensation, leave, and retirement requirements.

- **State motor vehicle fleet**—A.R.S. §§41-803(E) and 41-1504(K) exempts the Authority from participating in the state motor vehicle fleet.

- **State information technology**—A.R.S. §41-1504(H) states that the Authority is not subject to state-wide information technology requirements.

- **State general accounting and financing**—A.R.S. §§41-1504(I) and 41-724(A) state that the Authority is not subject to state general accounting and finance practices.

- **Installation and maintenance of telecommunications systems**—A.R.S. §41-1504(J) exempts the Authority from following state requirements for the installation and maintenance of telecommunications systems.

- **Prohibition for competition with private enterprise**—A.R.S. §41-1504(M) states that the Authority is exempt from state requirements prohibiting competition with private enterprise.

- **Reimbursement of state employee expenses**—A.R.S. §41-1504(E)(1)(c) states that the Authority is exempt from following state requirements for reimbursement of state employees.

- **Health and accident insurance for state employees**—A.R.S. 41-1504(E)(1)(d) states that the Authority is exempt from following the State's health and accident insurance requirements.

The Authority is partially exempt from requirements in the following areas:

- **Open meeting law**—A.R.S. §41-1502(I) requires the Authority to follow the State's open meeting law with three exceptions: (1) executive session may be entered into for certain topics in addition to those specified in A.R.S. §38-431.03; (2) social and travel events related to the expansion, attraction, and retention of businesses are not public meetings if no legal action involving final vote or decision is taken; and (3) activities and events held in public for the purpose of announcing the expansion, attraction, and retention of projects are not public meetings.

- **State procurement rules—**A.R.S. §41-2501(GG) exempts the Authority from state procurement rules with the exception that the Authority must adopt procurement policies that are similar to the State's procurement policies.

The Authority is authorized to do the following:

- **Adopt and use a corporate seal—**A.R.S. §41-1504(A)(1) allows the Authority to adopt and use a corporate seal.

- **Sue and be sued—**A.R.S. §41-1504(A)(2) allows the Authority to sue and be sued.

- **Enter into contracts—**A.R.S. §41-1504(A)(3) allows the Authority to enter into contracts such as intergovernmental agreements and interagency service agreements.

- **Lease and improve real property—**A.R.S. §41-1504(A)(4) authorizes the Authority to lease and improve property and exempts the Authority from statutes relating to management of state properties.

- **Employ or retain legal counsel—**A.R.S. §§41-1504(A)(5) and 41-192(D)(10) state that the Authority may employ or retain legal counsel and is exempt from representation by the Arizona Attorney General.

APPENDIX B

Description of Authority's financial incentives

Table 2: Financial incentives administered by the Arizona Commerce Authority (Authority) Fiscal year 2014 (Unaudited)

Financial incentive	Total amount awarded	Number of individual awards given	Financial incentive purpose
State grants			
Arizona Competes Fund:			
Deal-closing	$ 4,300,000	4	To attract, expand, or retain Arizona industries that meet certain requirements and achieve certain performance and qualification targets outlined in statute.
Arizona Innovation Challenge	3,000,000	12	To support and advance programs and projects for small businesses that enhance economic development. The Arizona Innovation Challenge grant is awarded through a biannual, business plan competition available to start-up and early-stage companies seeking to commercialize innovative technologies for the purpose of growing and diversifying Arizona's economy.
Rural Economic Development	2,729,156	6	To support and advance programs and projects for rural businesses that enhance economic development. This grant is designed to help rural Arizona communities develop infrastructure that strengthens their capacity and competitiveness for economic growth.
Arizona Federal and State Technology (AZ FAST)	312,450	38	To provide qualified, Arizona-based, early-stage technology companies with intensive training and technical assistance to help them commercialize their innovations, grow their businesses, and create quality jobs.
Arizona Furnace Technology Transfer Accelerator	79,547	5	To launch new companies created from intellectual property licensed from Arizona's premier research institutions. According to the Authority, this grant is no longer being offered.
Job Training Fund	14,246,080[1]	52	To support the design and delivery of customized training plans for employers creating new jobs or increasing the skill and wage levels of current employees.
Federal grants			
Energy Reduction Grant	320,892	2	To help small- and medium-sized aerospace and defense manufacturing businesses to reduce energy consumption in the manufacturing process and relate those energy consumption improvements to bottom-line savings.
State Trade and Export Promotion Program	246,294[2]	N/A	To assist Arizona small businesses grow in revenues and diversify their customer bases through international sales.
Loan Participation Program			
Arizona Innovation Accelerator Fund (AIAF)	9,500,000[3]	26	To assist small businesses in creating capital investment and more jobs. Program funded through the State Small Business Credit Initiative Act of 2010 and the Authority manages monies loaned through the AIAF program.

Table 2: (Continued)

Financial incentive	Total amount awarded	Number of individual awards given	Financial incentive purpose
Tax credits and incentives			
Angel Investment Income Tax Credit	2,047,275[4]	91	To expand early-stage investments in targeted Arizona small businesses.
Commercial/Industrial Solar Energy Tax Credit	781,261[4]	34	To stimulate the use of solar energy in commercial, industrial, and other nonresidential applications by subsidizing the cost of solar energy devices.
Computer Data Center (CDC)	N/A[5]	8	To encourage computer data center operation and expansion in Arizona.
Healthy Forest	43,559[6]	7	To promote forest health in Arizona.
Military Reuse Zone	1,490,289[6]	4	To lessen the impact of military base closures by providing tax incentives to aviation or aerospace companies, insurers, and airport authorities located in a military reuse zone.
Qualified Facility Tax Credit	0[7]	4	To promote the location and expansion of manufacturing facilities and encourage business investment that will produce high-quality employment opportunities for citizens of Arizona and enhance Arizona's position as a center for corporate headquarters, commercial research, and manufacturing.
Quality Jobs Tax Credit	6,339,000[4]	19	To encourage business investment and the creation of high-quality employment opportunities in the State.
Renewable Energy Tax Incentives	1,633,333[7]	1	To promote the location and expansion of renewable energy industry-based enterprises and encourage business investment that will produce high-quality employment opportunities for citizens of Arizona and strengthen Arizona's involvement in solar energy.
Research & Development Refundable Tax Credit	5,000,000[4]	42	To encourage Arizona small businesses to continue investing in research and development activities.
Tax incentives closed to new applicants			
Enterprise Zone—Income Tax Credits	984,607[8]	15	To help improve the economies of areas in the State with high poverty or unemployment rates and enhance opportunities for private investment in certain areas that are called enterprise zones as designated by the Authority. A tax credit was available for net increases in qualified employment positions at a site located in a statutorily defined enterprise zone. Although the statute for enterprise zones was repealed by Laws 2006, Ch. 387, §5, effective July 1, 2011, Enterprise Zone designations are good for up to 5 years and can be renewed for an additional 5-year term.
Enterprise Zone—Property Tax Reclassification	N/A[8,9]	37	To help improve the economies of areas in the State with high poverty or unemployment rates and enhance opportunities for private investment in certain areas that are called enterprise zones as designated by the Authority. Property reclassification was available to qualified manufacturing businesses or commercial printing businesses in a statutorily defined enterprise zone. Although the statute for enterprise zones was repealed by Laws 2006, Ch. 387, §5, effective July 1, 2011, Enterprise Zone designations are good for up to 5 years and can be renewed for an additional 5-year term.

Table 2: (Continued)

Financial incentive	Total amount awarded	Number of individual awards given	Financial incentive purpose
Tax incentives closed to new applicants (Continued)			
Environmental Technology Manufacturer's Assistance	22,853,683[8]	4	To assist companies that manufacture, produce, or process renewable energy products or products made from recycled materials. This program was statutorily closed to new applicants as of June 30, 1996; however, the incentives are available for 10 to 20 years.
Bonds			
Private Activity Bonds	76,500,000[10]	3	Securities issued by or on behalf of a local government to provide debt financing for projects used for the trade or business of a private user, as provided by Internal Revenue Code 141 et seq.

1 Laws 2015, Ch. 10, repealed the funding for the Job Training Fund program effective January 1, 2016. The program is closed to new applicants effective January 1, 2017.

2 These monies are used to provide awards to companies and operate authority programs.

3 The total amount awarded and the total number of individual awards given for the AIAF loan participation program are since inception.

4 The total amount awarded and the total number of individual awards given represent approved tax credit amounts.

5 This incentive provides transaction privilege tax and use tax exemptions on computer data center equipment purchases. Statute does not require program beneficiaries to report the amount of tax benefits received to the Authority. The number of individual awards given is the number of CDC centers certified.

6 The total amount awarded and the total number of individual awards represent tax credit or other incentives amounts received.

7 The total amount awarded and the total number of individual awards represent tax credits approved in calendar year 2013, as reporting for these programs is done on a calendar year basis.

8 These financial programs were eliminated by statute or are closed to new applicants.

9 This incentive reclassifies a company's property for tax purposes and does not approve an award amount for companies.

10 The Authority is responsible for allocating the state ceiling for private activity bonds imposed by the Deficit Reduction Act of 1984. The allocation process is set by statute.

Source: Auditor General staff analysis of the Authority's 2014 annual report, the State's Openbooks Web site, the Authority's Web site, Arizona Revised Statutes, and other authority-provided information.

APPENDIX C

Arizona Competes Fund grant awards and outcomes

Table 3: Arizona Competes Fund grants comparison of committed and actual results by grant type As of December 31, 2014, for grants awarded in fiscal years 2012 through 2014 (Unaudited)

Grant type/entity	Fiscal year granted	Award amount	Commitment for new jobs	Actual jobs created	Commitment for average wage of jobs created[1]	Actual average wage of jobs created	Commitment for capital investment[1]	Actual capital investment
Deal-closing grants								
Clear Energy Systems, Inc.	2012	$ 1,000,000	225	5	$65,000	$92,300	$ 7,000,000	$ 810,000
Silicon Valley Bank	2012	3,000,000	220	203	88,000	106,272	5,000,000	7,846,407
Ulthera, Inc.	2012	1,000,000	111	85	67,000	101,216	1,680,000	3,611,687
United Health Care Services, Inc.	2012	200,000	400	329	37,000	38,417	4,000,000	4,161,124
Accelerate Diagnostics, Inc.	2013	1,000,000	65	65	63,000	95,431	4,520,000	4,520,000
GoDaddy.com, LLC	2013	1,500,000	300	172	58,000	58,039	27,000,000	19,746,658
Maverick Healthcare Group, LLC	2013	1,000,000	376	193	65,000	65,017	15,000,000	18,285,366
General Motors, LLC	2014	1,300,000	738	N/A[2]	71,245	N/A[2]	17,738,333	N/A[2]
HotChalk, Inc	2014	1,250,000	595	185	68,000	54,664	3,300,000	213,149
Silicon Valley Bank (Center of Excellence)	2014	1,000,000	250	N/A[2]	75,000	N/A[2]	3,500,000	N/A[2]
ZocDoc, Inc.	2014	750,000	634	72	55,000	45,199	6,000,000	408,826
Total deal closing grants		$13,000,000	3,914	1,309			$ 94,738,333	$59,603,217
Arizona Innovation Challenge grants								
Agave Semiconductor, LLC	2012	$ 250,000	2	-	N/A	-	N/A	$ 43,609
Kutta Radios, Inc.	2012	249,500	2	3	N/A	$96,373	N/A	75,000
HJ3 Composite Technologies, LLC	2012	170,000	9	34	N/A	41,533	N/A	231,318
Cancer Prevention Pharmaceuticals, Inc.	2012	229,875	-	9	N/A	95,420	N/A	-
Shelvspace Inc. formerly Wholesalefund, Inc.	2012	250,000	5	7	N/A	50,571	N/A	40,000
MaxQ Technology, LLC	2012	250,000	3	3	N/A	42,000	N/A	-
Athena Wireless Communications, Inc.—Now part of Google	2013	250,000	4	11	N/A	57,431	N/A	110,974
Serious Integrated, Inc.	2013	250,000	1	2	N/A	41,500	N/A	18,661
Instant Bioscan, LLC	2013	250,000	10	14	N/A	71,683	N/A	8,352
Post.Bid.Ship. Inc.	2013	232,000	3	5	N/A	40,140	N/A	-
Stimwave Technologies, Inc.	2013	250,000	2	5	N/A	60,000	N/A	220,000
Stat Health Services Inc.	2013	250,000	2	3	N/A	133,333	N/A	370,000
Viomics, Inc.	2013	250,000	1	-	N/A	-	N/A	26,076
Nasseo, Inc	2013	250,000	1	1	N/A	100,000	N/A	350,000
Gingerbread Shed Corp.	2013	250,000	11	13	N/A	62,169	N/A	254,072
appsFreedom, Inc.	2013	250,000	-	1	N/A	100,000	N/A	4,723
ReplyBuy.com	2013	250,000	2	1	N/A	40,000	N/A	4,900
Strongwatch Corporation	2013	250,000	1	1	N/A	90,000	N/A	-
Recoleta Partners, LLC	2014	250,000	1	-	N/A	-	N/A	103,150
Osio Corp., dba Yolia Health	2014	250,000	-	-	N/A	-	N/A	15,000
Photon Medical Communications, Inc.	2014	250,000	2	1	N/A	92,500	N/A	40,000
Clear Demand, Inc.	2014	250,000	3	2	N/A	111,500	N/A	12,000
Deliver IT, Inc	2014	250,000	6	5	N/A	81,320	N/A	6,193
Contatta, Inc.	2014	250,000	9	1	N/A	76,000	N/A	1,870,062

Table 3: (Continued)

Grant type/company	Fiscal year granted	Award amount	Commitment for new jobs	Actual jobs created	for average wage of jobs created[1]	average wage of jobs created	Commitment for capital investment[1]	Actual capital investment
Arizona Innovation Challenge grants (Continued)								
Alert GPS Holdings Corp dba Amber Alert GPS	2014	250,000	4	-	N/A	-	N/A	-
Picmonic, Inc.	2014	250,000	4	-	N/A	-	N/A	-
EndoVantage, LLC	2014	250,000	4	-	N/A	-	N/A	-
Triton Microtechnologies	2014	250,000	2	-	N/A	-	N/A	-
MarLytics, LLC dba LawLytics	2014	250,000	3	-	N/A	-	N/A	-
World View Enterprises, Inc	2014	250,000	4	-	N/A	-	N/A	-
Total Arizona Innovation Challenge grants		$ 7,381,375	101	122				$ 3,804,090
Rural Economic Development grants								
City of Yuma	2012	$ 296,263	61	N/A[3]	$35,360	N/A[3]	-	N/A[3]
Northern Arizona Center for Entrepreneurship and Technology (NACET)	2012	59,601	2	N/A[3]	72,250	N/A[3]	-	N/A[3]
City of Flagstaff	2012	95,044	8	N/A[3]	89,000	N/A[3]	-	N/A[3]
Verde Valley Wine Consortium	2012	46,768	14	N/A[3]	26,625	26,869	-	N/A[3]
Access Arizona	2013	340,000	87	53	44,577	46,508	$ 63,358,651	$61,578,941
City of Prescott	2013	55,000	9	9	65,000	104,374	55,000	53,986
City of Casa Grande	2013	150,000	59	51	38,251	34,000	5,150,000	25,000,000
City of Flagstaff	2013	100,000	5	16	45,000	37,336	1,000,000	75,231
Greater Yuma Economic Development Corporation (GYEDC)	2013	432,500	555	696	26,520	26,520	5,980,000	9,331,761
Verde Valley Wine Consortium	2013	208,500	55	39	31,471	32,040	1,082,576	1,024,791
Town of Pinetop-Lakeside	2013	185,000	35	15	49,920	47,840	500,000	486,000
Town of Prescott Valley	2014	500,000	100	N/A[2]	33,280	N/A[2]	5,000,000	N/A[2]
City of Coolidge	2014	369,156	30	N/A[2]	37,440	N/A[2]	4,000,000	N/A[2]
Mohave County	2014	500,000	269	N/A[2]	41,080	N/A[2]	22,500,000	N/A[2]
City of Globe	2014	360,000	40	N/A[2]	43,900	N/A[2]	2,500,000	N/A[2]
Yuma County	2014	500,000	75	N/A[2]	29,120	N/A[2]	13,950,000	N/A[2]
City of Nogales	2014	500,000	427	N/A[2]	22,671	N/A[2]	134,190,000	N/A[2]
Total Rural Economic Development grants		$ 4,697,831	1,831	879			$259,266,227	$97,550,710

1 Committed wages and capital investment are listed as not available for Arizona Innovation Challenge grants because the Arizona Commerce Authority (Authority) does not require these grant recipients to commit to an amount in the contract. According to the Authority, this grant is focused on improving the economic climate in the State and on helping small and start-up companies rather than creating a large number of jobs with high wages during the first few years of the grant.

2 No reporting obligation incurred as of the end of fiscal year 2014 for these deal-closing grants. According to the Authority, no reporting obligations were incurred for the Rural Economic Development grants because the companies had not had sufficient time to produce outcomes between the time the grant was awarded and the time the outcomes were to be reported.

3 No information on actual jobs created and capital investment made had been reported for these grants as of the end of fiscal year 2014. According to authority officials, this information will be provided in the *Arizona Competes Fund Annual Report* for 2015.

Source: Auditor General staff analysis of the Authority's database report of Arizona Competes Fund information, the Authority's *Arizona Competes Fund Annual Report* for 2014, and information provided by authority staff.

APPENDIX D

This appendix provides information on the methods auditors used to meet the audit objectives.

This performance audit was conducted 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 Auditor General and staff express appreciation to the Arizona Commerce Authority (Authority) Board, Chief Executive Officer/President, and staff for their cooperation and assistance throughout the audit.

Methodology

Auditors used various methods to study the issues addressed in this report. These methods included reviewing applicable state laws and authority rules; policies and procedures, other information obtained from authority staff, and the Authority's Web site; the Authority's 5-year business plan and annual reports; interviewing authority officials, management, and staff; and reviewing a previous Office of the Auditor General audit of the Authority's predecessor agency, the Arizona Department of Commerce (Report No. 03-08).

Auditors also used the following specific methods to address the audit's objectives:

- To assess the Authority's reporting practices, auditors reviewed best practices from the National State Auditors Association (NSAA) and compared these best practices to the Authority's reporting processes.[1] Auditors also reviewed several different reports that the Authority developed, including its fiscal years 2013 and 2014 summary report, its presentation slides for the April 2015 board meeting, the fiscal year 2015 second quarter Arizona Competes Fund (Competes Fund) report, and fiscal years 2012 through 2014 annual reports for the Arizona Competes Fund, and other reports that are used by authority staff to report to management; and interviewed authority officials regarding the Authority's internal policies and procedures for producing its annual report.

- To assess the Authority's grant recipient selection and monitoring processes for Competes Fund grants, auditors reviewed 18 Competes Fund grants awarded between fiscal years 2013 and 2014, including 6 deal-closing grants, 8 Arizona Innovation Challenge grants, and 4 Rural Economic Development grants. The grant selection and monitoring processes in the grant files were assessed using criteria from the NSAA best practices; the applicable state laws; documents obtained from authority staff, such as grant agreements, eligibility checklists, reporting templates, and requests for proposals; and interviews of authority officials, management, and staff regarding the Authority's internal policies and procedures for grant selection and monitoring.

- To obtain information used in the Sunset Factors, auditors contacted six other states and reviewed literature regarding other states' economic

[1] National State Auditors Association. (2004). *Best practices in carrying out state economic development efforts*: *A National State Auditors Association best practice document*. Lexington, KY: The NSAA is an organization that assists state auditors by providing opportunities to exchange information at the state and federal government levels. The NSAA states that although this document addresses many of the best practices that could apply in these situations, it should not be considered exhaustive.

development efforts and published by the National Governor's Association.[1] In addition, auditors reviewed the Authority's rule-making policies and procedures, public input documents submitted to the Authority for one rule change, the Authority's Web site, and the notices for rulemaking that were posted; observed one public Board of Directors meeting and reviewed meeting notices, agendas, and minutes for 12 public meetings held between November 2012 and May 2015; and reviewed documentation from the Authority's rural division including travel memos, community profiles, and Rural Business Development Advisory Council meeting minutes. Also, to assess the Authority's conflict-of-interest practices, auditors reviewed the Authority's conflict-of-interest policy, conflict-of-interest policy acknowledgment forms, and conflict-of-interest disclosure forms, and reviewed guidelines for managing conflicts of interest published by the Organization for Economic Cooperation and Development.[2]

- To obtain information for the Introduction section of the report, auditors reviewed a 2010 Governor's Commerce Advisory Council Report, the Authority's organization chart, and authority-provided information about full-time equivalent positions at the Authority.[3] In addition, auditors reviewed the Authority's policies and guidelines for its tax incentive programs and loan program. Auditors also analyzed audited financial statements for fiscal years 2013 through 2014 and authority-prepared financial information for fiscal year 2015.

- Auditors' work on internal controls included reviewing the Authority's policies and related documentation for conflicts of interest, reviewing Competes Fund grant-selection and monitoring processes, and reviewing the Authority's policies and processes for reporting on the outcomes of its efforts, and for its loan and tax incentive programs. Auditors' conclusions on internal controls are reported in Finding 1, Finding 2, and Sunset Factors 2 and 5 of the report.

---

1 Sparks, E. & Pappas, L. (2012). *Redesigning state economic development agencies*. Washington, DC: National Governor's Association.

2 Organization for Economic Cooperation and Development. (2003). *Managing conflict of interest in the public service: OECD guidelines and country experiences*.

3 Governor's Commerce Advisory Council. (2010). *Governor's Commerce Advisory Council report*. Phoenix, AZ: Office of the Arizona Governor.

AGENCY RESPONSE

ARIZONA
COMMERCE
AUTHORITY

September 21, 2015

Debbie Davenport
Auditor General
Office of the Auditor General
2910 North 44th Street
Suite 410
Phoenix, Arizona 85018

RE: Performance Audit and Sunset Review of the Arizona Commerce Authority

Dear Ms. Davenport:

The responses of the Arizona Commerce Authority (the "Authority") to the findings and recommendations of the Final Performance Audit of the Authority are attached.

We again extend our thanks to the Auditor General team for its efforts during the Sunset Review process.

Sincerely,

Sandra Watson
President & CEO

FINDINGS AND RECOMMENDATIONS

1.1. To help ensure the Legislature and the public can clearly understand the Authority's economic development efforts and results, the Authority should enhance its reporting in the following three ways:

a. Ensure that it reports the cumulative progress it makes toward its three 5-year goals. For example, it could consider making its summary report that shows the cumulative progress made more readily available to the public by posting it on its Web site.

Authority Response: *The finding of the Auditor General is agreed to and the recommendation will be implemented. The Authority has previously reported cumulative progress towards its goals through many channels, but will expand reporting of this information by including it in the Authority's Annual Report and by posting the report referenced in the recommendation on the Authority's website.*

b. Clarify in its annual report and other reports it produces whether the information presented on jobs created, wages, and capital investment represents actual activity or commitments.

Authority Response: *The finding of the Auditor General is agreed to and the recommendation will be implemented. The Authority believes that the Authority's stakeholders are familiar with the industry custom of reporting jobs and capital investment based on company projections. For example, in reporting on projects announced by Authority clients, the local press regularly reports the clients' jobs and capital investment projections for those projects. Nevertheless, the Authority will, wherever applicable in its reporting, make clear whether jobs and capital investment figures reported are based on projections or actual activity.*

c. Develop a report or add information that it can legally report to its existing reports or Web site that better summarizes Arizona's total economic development investment costs and the benefits that the State received as a result of these expenditures. For example, the Authority's report could show by fiscal year the financial incentives Arizona committed to provide on a company-by-company basis along with each company's announced job creation and capital investment commitments. This report should also compare actual job creation and capital investment outcomes to those announced and update this comparison each year to show progress over time. For information that cannot be disclosed on a company-by-company basis, this comparison could be presented in aggregate by combining the information for all the companies to avoid any confidentiality issues.

Authority Response: *The finding of the Auditor General is agreed to and the recommendation will be implemented. The Authority notes that it annually publishes seven separate reports on individual incentives programs, as well as two additional reports (including the Authority's Annual Report) that include aggregate information* *about incentives awarded across all programs. However, the Authority will add information to the Authority's Annual Report, including company-by-company incentives information wherever permitted by statute, to make this information more readily accessible.*

1.2. To ensure compliance with statutory reporting requirements, the Authority should include in its annual Competes Fund report:

a. Required information, such as jobs committed and created, for each grant recipient for the innovation and rural grants; and

Authority Response: *The finding of the Auditor General is agreed to and the recommendation will be implemented. Although the Authority does not agree that the recommendation reflects a matter of statutory compliance, the Authority will nonetheless provide the additional information to the extent it does not compromise sensitive company information.*

b. The median wage of the jobs each Competes Fund grant recipient created.

Authority Response: *The finding of the Auditor General is agreed to and the recommendation will be implemented. Although the Authority does not agree that this recommendation is a matter of statutory compliance, the Authority will provide the additional information to the extent it is available.*

2.1. The Authority should enhance its Competes Fund grant-awarding practices by:

a. Developing and implementing, or continuing with its efforts to develop and implement, comprehensive written procedures for all of its Competes Fund grants;

b. Training staff on these written procedures and ensuring that staff follow them; and

c. Developing procedures detailing what documentation should be maintained in its files and a final verification process to ensure that all required documentation is in the grant recipient's file.

Authority Response*: The finding of the Auditor General is agreed to and the recommendations will be implemented. The Authority notes most of the recommended steps were completed during the field work portion of the audit or soon thereafter.*

2.2. The Authority should improve its monitoring of all Competes Fund grants by developing and implementing written policies and procedures for verifying grant recipient-reported milestones and/or outcomes. These policies and procedures should:

a. Specify what milestone and/or outcome information grant recipients should report;

b. Indicate how submitted information should be verified, including the independent sources the Authority should use to verify the reported information;

c. Identify what information should be documented in the Authority's files; and

d. Specify that grant payments will not be made until the verification process is completed and documented.

Authority Response: *The finding of the Auditor General is agreed to and the recommendations will be implemented. The Authority notes that the information identified in item "a" is always made clear in grant agreements and/or reporting form templates, and that the information identified in item "d" is always made clear in grant agreements. Procedures relating to items "b" and "c" were updated during the field portion of the audit or soon thereafter.*

2.3. The Authority should develop and implement policies and procedures for making changes to grant agreements to help ensure that it consistently addresses changes to the required outcomes specified in the agreements, such as changes in milestones or delays in meeting goals within the required time. These policies and procedures should include:

a. How it will document the discussions, decisions, and any changes to the grant agreement in the grant files; and

b. Steps for ensuring that grant recipients report milestone or outcome results or, when such results are not reported, exceptions to the reporting requirements are noted in the Authority's file.

Authority Response: *The finding of the Auditor General is agreed to and the recommendations will be implemented.*

1. The Authority should strengthen its conflict-of-interest practices by (see Sunset Factor 2, pages 31 through 32):

a. Ensuring that all authority decision makers comply with its policy to review and sign conflict-of-interest policy acknowledgment forms annually; and

b. Requiring judges for the innovation grants to sign and submit its policy acknowledgement form and disclose conflicts as required by its policy.

Authority Response: *The finding of the Auditor General is agreed to and the recommendations will be implemented. Although the Authority has always required all staff and Board members to sign an acknowledgment of the Conflict of Interest Policy, the ACA will begin ensuring that such policy acknowledgments are updated annually. All staff acknowledgments have been updated for Fiscal Year 2016 and the Board acknowledgments are in the process of being updated.*

2. The Authority should continue with its efforts to adopt rules to administer research tax credits and for the Computer Data Center Program as required by statute (see Sunset Factor 4, page 33).

Authority Response: *The finding of the Auditor General is agreed to and the recommendation will be implemented. The Computer Data Center Program rules process will be complete within days. Subject to the Authority obtaining an exemption from the prohibition on agency rulemaking, the University R&D rules will be adopted in conjunction with the Department of Revenue, mostly likely in Fiscal Year 2016. The Authority notes that these programs have been open to applicants despite the rules not having yet been promulgated.*

3. The Authority should improve its compliance with the State's open meeting law by continuing to ensure its meeting minutes are available within 3 business days and including the required ADA statement related to reasonable accommodation on its meeting notices (see Sunset Factor 5, page 34).

Authority Response: *The finding of the Auditor General is agreed to and the recommendation will be implemented. The Authority's meeting notice template has been updated accordingly and staff members have been educated to always include the necessary language.*

Performance Audit Division reports issued within the last 18 months

14-102	Gila County Transportation Excise Tax
14-103	Arizona State Board of Dental Examiners
14-104	Arizona Office of Administrative Hearings
14-105	Arizona Board of Executive Clemency
14-106	State of Arizona Naturopathic Physicians Medical Board
14-107	Arizona Department of Child Safety—Children Support Services—Emergency and Residential Placements
14-108	Arizona Department of Administration—Arizona State Purchasing Cooperative Program
15-101	Arizona Department of Child Safety—Child Abuse or Neglect Reports, Substantiation Rate, and Office of Child Welfare Investigations
15-102	Arizona Department of Administration—State-wide Procurement
15-103	Arizona Medical Board—Licensing and Registration Processes
15-104	Arizona Department of Transportation—Motor Vehicle Division
15-105	Arizona Department of Revenue—Use of Information Technology
15-CR1	Independent Review—Arizona's Child Safety System and the Arizona Department of Child Safety
15-CR1SUPP	Supplemental Report to the Independent Review—Arizona's Child Safety System and the Arizona Department of Child Safety
15-106	Arizona State Retirement System
15-CR2	Independent Operational Review of the Arizona State Retirement System's Investment Strategies, Alternative Asset Investment Procedures, and Fees Paid to External Investment Managers
15-107	Arizona Sports and Tourism Authority
15-108	Arizona Department of Administration—Personnel Reform Implementation
15-109	Arizona Department of Administration—Sunset Factors
15-110	Arizona Foster Care Review Board
15-111	Public Safety Personnel Retirement System
15-CR3	Independent Operational Review of the Public Safety Personnel Retirement System Investment Strategies, Alternative Asset Investment Procedures, and Fees Paid to External Investment Managers

Future Performance Audit Division reports

Arizona Department of Transportation—Transportation Revenues

Arizona Department of Transportation—Sunset Factors