ISSUED: January 30, 2015 **AR-01-EDA-14**

THE UNITED STATES VIRGIN ISLANDS

OFFICE OF THE VIRGIN ISLANDS INSPECTOR GENERAL

AUDIT REPORT

AUDIT OF THE
ECONOMIC DEVELOPMENT PROGRAM
ADMINISTERED BY
THE ECONOMIC DEVELOPMENT AUTHORITY

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EXECUTIVE SUMMARY

The following summarizes the major findings from the Audit of the Economic Development Program Administered by the Economic Development Authority (AR-01-EDA-14).

Finding 1: Economic Impact (pages 6 to 21)

- ✓ There was no mechanism in place to require the timely measurement, assessment and reporting of the overall economic and fiscal impact of the Economic Development Program on the Territory's economy.
- ✓ The Economic Development Commission does not promote higher levels of participation by certain business types found to have a relatively low economic and fiscal impact on the Territory.
- ✓ Recent changes to the tax benefits law have created a potential "business welfare" program by providing beneficiaries with 100% benefits for 40 to 50 years.

Finding 2: Extension of EDC Benefits Awards (pages 22 to 29)

- ✓ Economic Development Commission Rules and Regulations contradicted the Virgin Islands Code regarding extension of benefits.
- ✓ Full benefits were extended to beneficiaries who were not eligible to receive them at that level under the law.
- ✓ Extensions of benefits were granted in numbers and durations in excess of what was allowed under the law.

Finding 3: Monitoring (pages 30 to 40)

- ✓ Infrequent compliance reviews were performed.
- ✓ The Economic Development Commission did not effectively ensure that beneficiaries complied with reporting requirements.

Finding 4: Reporting to Regulatory Agencies (pages 41 to 44)

- ✓ Regulatory Agencies were not always promptly informed of changes in the certification statuses of beneficiaries.

Finding 5: Application Process (pages 45 to 51)

- ✓ The Economic Development Commission did not consistently adhere to the time requirements for the various phases of the application process.
- ✓ The collection of information needed to process applications for economic development benefits were not adequately monitored.
- ✓ Applications were not always processed in an organized and systematic manner.

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January 30, 2015

Jose Penn
Acting Chairman
Economic Development Authority
8000 Nisky Shopping Center
Suite 620
Charlotte Amalie, Virgin Islands 00802

Dear Mr. Penn:

This report contains the results of our audit of the Economic Development Program administered by the Economic Development Commission (EDC). The objectives of the audit were to determine whether (i) policies and procedures were in place to measure, assess and evaluate the economic impact of the Economic Development Program on the Territory, and (ii) the EDC administered the Economic Development Program in accordance with the Code and approved rules and regulations.

Although the EDC had a positive impact in promoting the growth, development, and diversification of the Territory's economy, there was need for improvements in its administration of the Economic Development Program. Specifically, we found that the EDC (i) does not have a mechanism in place to require the timely measurement, assessment and reporting of the overall economic and fiscal impact of the Economic Development Program on the Territory's economy, (ii) does not promote higher levels of participation by certain business types found to have a relatively low economic and fiscal impact on the Territory, (iii) recommended recent changes to the tax benefits law that have created a potential "business welfare" program by providing beneficiaries with 100% benefits for 40 to 50 years, (iv) used rules and regulations that contradicted the Code regarding extension of benefits, (v) in extending benefits, granted full benefits to beneficiaries not eligible to receive them at that level under the law, (vi) granted extension of benefits in numbers and durations in excess of what was allowed under the law, (vii) performed infrequent compliance reviews, (viii) did not effectively ensure that beneficiaries complied with reporting requirements, (ix) did not always promptly inform regulatory agencies of changes in the certificate statuses of beneficiaries, (x) did not consistently adhere to the time requirements for the various phases of the application process, (xi) did not adequately monitor the collection of information needed to process applications for economic development benefits, and (xii) did not always process applications in an organized and systematic manner.

We attributed these conditions to the EDC (i) not having timely information to perform accurate economic assessments, (ii) not being required to do regular economic impact analyses, (iii) recommending and supporting a benefits package that provides overly generous beneficiary benefits for the average participation cycle of a business, (iv) not updating their internal policies and procedures to correspond with Code provisions regarding extension of benefits, (v) not following provisions of the Code regarding granting certificate extensions, (vi) not establishing policies and procedures that addressed key aspects of the compliance review process, (vii) not effectively enforcing provisions for beneficiaries' reporting under the law, (viii) not adequately prioritizing the monitoring of beneficiaries based on available staffing, (ix) not having adequate follow through policies and procedures for providing timely notification to regulatory agencies of changes in the statuses of beneficiaries' certificates of benefits, and (x) not adequately moving applications through key points of the application and decision-making process.

As a result, (i) the EDC did not maximize the potential economic benefits to the Territory through the Economic Development Program, (ii) the EDC has reduced its ability to effectively negotiate benefits packages that can provide reasonable revenues to the Territory as beneficiaries become more established and profitable, (iii) the Government lost revenues due to beneficiaries receiving extended tax benefits for which they were not entitled, (iv) the infrequent compliance reviews did not promote an environment of ongoing compliance, (v) the EDC did not have timely information to determine the compliance statuses of beneficiaries, (vi) beneficiaries potentially could have continued to receive economic benefits although their certificates were in suspension or termination status, and (vii) the application process was not always effectively used as a means to facilitate economic growth in the Territory.

We made several recommendations to address the conditions and causes cited in the report. The EDC Management was kept informed of serious conditions found during our audit and has started initiating corrective actions to address our findings and recommendations. Our recommendations addressed the following areas, (i) economic impact, (ii) extension of benefits awards process, (iii) compliance monitoring, (iv) reporting to regulatory agencies, and (v) application process.

A response dated January 9, 2015 was received from the Chief Executive Office, and is included as Appendix I beginning on page 52 of this report. Appendix II beginning on page 67 identifies the additional information needed for us to consider the recommendations resolved and implemented.

If you or your staff requires additional information, please call me at 774-6426.

Sincerely,

Steven van Beverhoudt

Steven van Beverhoudt, CFE, CGFM
V. I. Inspector General

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INTRODUCTION

BACKGROUND

The Virgin Islands Economic Development Authority (Authority) was established as a semi-autonomous governmental instrumentality of the Government of the Virgin Islands (Government) in February 2001, by Act 6390. It was established as an umbrella authority to assume, integrate and unify the functions of five subsidiary entities: the Economic Development Commission (EDC), the Enterprise Zone Program (EZP), the Government Development Bank (GDB), the Industrial Park Development Corporation (IPDC), and the Small Business Development Agency (SBDA). Through these subsidiaries, the Authority is responsible for promoting and developing the economy of the Virgin Islands.

The Authority is governed by a seven-member Governing Board (Board). It consists of three non-government employees of the Virgin Islands or the United States and are appointed by the Governor with the advice and consent of the Legislature; three who are appointed by the Governor from among the heads of cabinet-level executive departments or agencies, or the Governor's executive staff; and one appointed from the Board or executive staff of the Virgin Islands Government Employee Retirement System, Virgin Islands Port Authority, or the University of the Virgin Islands. The Authority is managed by a Chief Executive Officer (CEO) who is appointed by the Board.

The EDC was established in July 1972 under Act 3263. It was initially called the Investment Incentive Program and later the Industrial Development Commission before being renamed the Economic Development Commission in 2001. The EDC is governed by the members of the Authority's Board. According to Title 29, Section 701 of the Virgin Islands Code (Code), the EDC is tasked with, "…promoting the growth, development and diversification of the economy of the United States Virgin Islands by developing the human and economic resources of the Territory, preserving job opportunities for residents of the U.S. Virgin Islands, and promoting capital formation to support industrial development in the Territory."

To accomplish its mandate, the EDC administers an Economic Development Program. In this program, the EDC receives applications from businesses seeking tax exemptions and issues Economic Development Certificates to eligible applicants. The benefits granted consist of tax exemptions and reductions in tax liabilities up to:

- 90% Exemption on Personal Income Taxes,
- 90% Exemption on Corporate Income Taxes,
- 100% Exemption on Gross Receipts Taxes,
- 100% Exemption on Business Property Taxes,
- 100% Exemption on Excise Taxes, and
- 1% Custom Duties Rate.

The Board makes recommendations to grant tax benefits to applicants and establishes the terms and conditions of the certificates. However, the Governor gives the final decision to approve or disapprove the issuance of the economic development certificates to the respective beneficiary. The economic development certificate is an agreement between the beneficiary and the EDC in which the beneficiary agrees to provide employment, capital investment and other contributions to the Territory for the tax benefits they receive.

During the audit scope, Fiscal Years 2009 through 2011, the EDC issued 14 certificates to eligible beneficiaries each year. The number of active beneficiaries reported during the audit period was 109 active beneficiaries in Fiscal Year 2009, and 93 in each of Fiscal Years 2010 and 2011.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of the audit were to determine whether (i) policies and procedures were in place to measure, assess and evaluate the economic impact of the Economic Development Program on the Territory, and (ii) the EDC administered the Economic Development Program in accordance with the Code and approved rules and regulations.

The audit scope was limited to the Virgin Islands Economic Development Program as administered by the EDC during Fiscal Years 2009 through 2011. We also reviewed and commented on recently enacted legislation that, among other things, affected the duration of the tax benefits offered to prospective beneficiaries.

To accomplish our audit objectives, we examined provisions of the Code and other laws, the EDC Rules and Regulations, financial and annual reports, economic development certificates, organizational documents, application files, compliance reports, contracts, and other available supporting documents related to the operations of the EDC.

As part of our audit, we evaluated the application, certificate awards, monitoring, and economic impact analyses functions. This included observing the various processes and interviewing the EDC's management and Application and Compliance Units staff. We also evaluated the internal controls over the various functions controlled by the EDC to the extent necessary to accomplish the audit objectives. Weaknesses in internal controls are discussed in the Audit Results section of the report. During the audit, management was advised of significant internal control risks in the agency's application and compliance review processes.

We selected various samples in testing the EDC's effectiveness and efficiency in administering the Economic Development Program.

We selected a judgmental sample consisting of 28 applications to test whether application processing procedures had been followed by the EDC. We selected the sample from the list of applicants who had applied for benefits during Fiscal Years 2009 through 2011.

We selected a judgmental sample of 46 beneficiaries who had been active during all or part of the audit scope period to determine if their certificates of benefits had been extended or renewed in accordance with established criteria.

Based on the Authority's Annual Reports for Fiscal Years 2009 through 2011, the EDC had completed compliance reviews for 48 beneficiaries during the audit scope period. We reviewed the compliance reports and applicable supporting documents for all 48 beneficiaries to determine the effectiveness of the EDC's monitoring over their compliance with program requirements.

We selected a judgmental sample of 42 beneficiaries to test whether reporting requirements had been enforced by the EDC. We selected the sample from the universe of beneficiaries who were required to report during Fiscal Years 2009 through FY 2011.

We conducted the performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS) applicable to performance audits, contained in the "Government Auditing Standards" issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to provide a reasonable basis for our findings and conclusions. Accordingly, we performed such tests of records and performed other auditing procedures that were considered necessary under the circumstances.

PRIOR AUDIT COVERAGE

We are unaware of any performance audits completed within the past five years that relate to the EDC's Economic Development Program.

AUDIT RESULTS

CONCLUSIONS

Although the EDC had a positive impact in promoting the growth, development, and diversification of the Territory's economy, there was need for improvements in its administration of the Economic Development Program. Specifically, we found that the EDC (i) does not have a mechanism in place to require the timely measurement, assessment and reporting of the overall economic and fiscal impact of the Economic Development Program on the Territory's economy, (ii) does not promote higher levels of participation by certain business types found to have a relatively low economic and fiscal impact on the Territory, (iii) recommended recent changes to the tax benefits law that have created a potential "business welfare" program by providing beneficiaries with 100% benefits for 40 to 50 years, (iv) used rules and regulations that contradicted the Code regarding extension of benefits, (v) in extending benefits, granted full benefits to beneficiaries not eligible to receive them at that level under the law, (vi) granted extension of benefits in numbers and durations in excess of what was allowed under the law, (vii) performed infrequent compliance reviews, (viii) did not effectively ensure that beneficiaries complied with reporting requirements, (ix) did not always promptly inform regulatory agencies of changes in the certificate statuses of beneficiaries, (x) did not consistently adhere to the time requirements for the various phases of the application process, (xi) did not adequately monitor the collection of information needed to process applications for economic development benefits, and (xii) did not always process applications in an organized and systematic manner.

We attributed these conditions to the EDC (i) not having timely information to perform accurate economic assessments, (ii) not being required to do regular economic impact analyses for all beneficiaries, (iii) recommending and supporting a benefits package that provides overly generous beneficiary benefits for the average participation cycle of a business, (iv) not updating their internal policies and procedures to correspond with Code provisions regarding extension of benefits, (v) not following provisions of the Code regarding granting certificate extensions, (vi) not establishing policies and procedures that addressed key aspects of the compliance review process, (vii) not effectively enforcing provisions for beneficiaries' reporting under the law, (viii) not adequately prioritizing the monitoring of beneficiaries based on available staffing, (ix) not having adequate follow through policies and procedures for providing timely notification to regulatory agencies of changes in the statuses of beneficiaries' certificates of benefits, and (x) not adequately moving applications through key points of the application and decision-making process.

As a result, (i) the EDC did not maximize the potential economic benefits to the Territory through the Economic Development Program, (ii) the EDC has reduced its ability to effectively negotiate benefits packages that can provide reasonable revenues to the Territory as beneficiaries become more established and profitable, (iii) the Government lost revenues due to beneficiaries receiving extended tax benefits for which they were not entitled, (iv) the infrequent compliance reviews did not promote an environment of ongoing compliance, (v) the EDC did not have timely information to determine the compliance statuses of beneficiaries, (vi) beneficiaries potentially could have continued to receive economic benefits, although their certificates were in a suspension or termination status, and (vii) the application process was not always effectively used as a means to facilitate economic growth in the Territory.

We made several recommendations to address the conditions and causes cited in the report. The EDC Management was kept informed of serious conditions found during our audit and has started initiating corrective actions to address our findings and recommendations. Our recommendations addressed the following areas, (i) economic impact, (ii) extension of benefits awards process, (iii) compliance monitoring, (iv) reporting to regulatory agencies, and (v) application process.

FINDING 1: ECONOMIC IMPACT

Existing policies do not provide an adequate framework for managing, and consistently and accurately measuring the growth of the Virgin Islands' economy from the Economic Development Program. Specifically, (i) the EDC does not have a mechanism in place to require the timely measurement, assessment and reporting of the overall economic and fiscal impact of the Economic Development Program on the Territory's economy, (ii) the EDC does not promote higher levels of participation by certain business types found to have a relatively low economic and fiscal impact on the Territory, and (iii) recent changes to the tax benefits law have created a potential "business welfare" program by providing beneficiaries with 100% benefits for 40 to 50 years.

These conditions are attributable to the EDC (i) not having timely information to perform accurate economic assessments, (ii) not being required to do regular economic impact analyses, and (iii) recommending and supporting a benefits package that provides overly generous beneficiary benefits for the average life-cycle of a business.

As a result, the EDC, (i) does not maximize the potential economic benefits to the Territory, and (ii) has reduced its ability to effectively negotiate benefits packages that can provide reasonable revenues to the Territory as beneficiaries become more established and profitable.

Background

A benchmark in the economic development profession is establishing policies that allow for assessing potential economic growth as a result of specific programs. This improves accountability by providing a framework for policy decision-makers to evaluate and report on a program's impact on the overall growth of an economy. In 2011, a consulting firm hired by the Authority completed an independent study that measured the overall economic and fiscal impact of the EDC program on the territory's economy from Fiscal Years 1999 through 2009[1]. The 11-year study estimated the universe of beneficiaries' impact in relation to tax revenues forgone by the Government during that period[2]. Results of this relationship (beneficiaries' impact to the taxes forgone) comprised cost/benefit ratios, which were derived from various scenarios relative to business industry, category, size, and other factors. In relation to the tax revenues forgone, the cost/benefit ratios expressed the value added to the Gross Territorial Product (GTP) and the local tax revenues received as a result of the aggregate economic activities of the beneficiaries[3]. Cost/benefit ratio results factored in the total direct, indirect, and induced economic output or

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1 The study defined economic impacts as "total expenditures, value-added, employment, and earnings generated," and fiscal impacts as "local and/or state tax revenues generated."

2 Tax revenues forgone by the Government refer to the total tax exemptions awarded to all the beneficiaries over the study's review coverage period.

3 The GTP represents the total market value of goods and services generated by the economy of the Virgin Islands over a specified period.

expenditures by the universe of beneficiaries over the 11-year review period[4].

Among other findings, the study found that the Government received a relatively good return on investment from the beneficiaries' participation in the EDC program and that the program helped diversify the local economy by attracting and retaining businesses which had provided a high economic impact.

The study also pointed out disparities in the economic performances between various types and categories of businesses. From an industry standpoint, accommodations and food services businesses were linked to high cost/benefit ratios, which meant they had high economic and fiscal impact in relation to the tax revenues forgone. In contrast, professional services businesses were linked to low cost/benefit ratios. When analyzing businesses' performances based on the EDC's category system, the study found that "Category II and Category III firms Greatly Outperformed Category I and Category IIA Firms on Return on Investment." Analysis results were based on the businesses' impact on the Territory's economy relative to every $1 million in tax revenues forgone by the Government. The study indicated that Category II and IIA businesses comprised about 38% and 40% of all beneficiaries, respectively (or together 78%).

Under the EDC category system, hotels, agricultural and food services, and selected manufacturing firms include some of the businesses classified under Category II, and designated services such as financial and business consultants, E-commerce firms, and public relations firms include some of the businesses classified under Category IIA. Category I businesses comprise rum and milk/diaries productions, and watch and jewelry manufacturers and assemblers. Category III businesses comprise utilities, healthcare, and recreation facilities, as well as retirement residences development[5].

The consulting firm used information from beneficiaries' applications and financial and other records to process analysis results and draw conclusions. The records from which information was gathered had been submitted by the beneficiaries as part of their annual reporting to the EDC.

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4 The study points out that indirect output refers to estimates of increases in production and services from other businesses as a result of the direct economic activity of beneficiaries, and induced output refers to estimates of earnings spent by employees of beneficiaries to purchase goods and services in the Territory.

5 On October 13, 2014, Act 7651 became law that among other things reclassified the businesses into the following categories: Category I – Legacy Virgin Islands Industries – including Rum Production, Milk/Dairy Production, Watch and Jewelry Manufacturing and Assembly. Category II – Product Assembly, Manufacturing, Repair and Maintenance and or Export Operations – including but not limited to Agriculture/Mariculture and Food Processing, Marine and Aircraft Industry, Machine and Heavy Equipment, and Bottling and Packaging. Category III – Facilities, Tourism and Communications Developments – including Hotel/Guesthouses, Health Care, Recreation and Retirement Facilities, Transportation, Utilities and Telecommunications. Category IV – Designated Services Businesses – as defined in Section 703(g).

Economic Impact Review Policy

Neither the Code nor the EDC's Rules and Regulations required the measurement, assessment and reporting of the overall economic and fiscal impact of the EDC program on the Territory's economy. Although the EDC engaged the services of a consulting firm to determine the effectiveness of the program, the firm's 2011 independent study, while providing vital information, covered an 11 year period from 1999 through 2009. No other studies have been done since that 2011 report.

In our opinion, assessment of the program's overall effectiveness in promoting the local economy should be done on an annual basis. The implementation of such an approach would provide more relevant and timely information to better plan and monitor the program's impact on the local economy on an ongoing basis. For instance, the independent study concluded that businesses in certain industries and categories had a much greater impact on the economy than others relative to the tax revenues forgone by the Government during the period. Provided documents showed that businesses whose impact was low received equivalent percentage amounts in tax exemptions as businesses whose impact was high. Although the imbalance was linked in part to the nature of the businesses and requirements of the law for awarding tax exemptions, performing more regular impact reviews would have positioned the EDC to be able to timely assess the overall effectiveness of the program. Assessment results could have led to the EDC making adjustments or proposing changes to the law, earlier and as necessary, to ensure that the tax exemption award system was more equitable. More is discussed on this in the below section entitled "Impact Analysis Comparisons."

An underlying weakness in managing and measuring the EDC program was that the EDC was not required by law to measure, assess and report on the overall effectiveness of the program to appropriate governmental authorities. As a result, decisions regarding when and how impact studies would be done and to whom they would be addressed were left to the discretion of the EDC. Codifying policies requiring the measurement, assessment and reporting of the program's effectiveness would have helped ensure that not only the EDC but also appropriate governmental authorities were regularly updated on the program's aggregate impact status.

Annual Reports

As required by law, the Authority annually submits a report to the Legislature and the Governor pertaining to the business of the Authority and its five subsidiaries for the preceding year. The report publishes statistics on projected activities of new beneficiaries, to include the number and types of certificates issued, and the annual hires, wages, investments, charitable contributions, and scholarships anticipated by the certificates. However, not included in the report is information on the overall annual contributions to the Territory from the Economic Development Program. In addition, the report does not provide statistics on the taxes and benefits given-up by the Territory to the various beneficiaries. Nor does it provide the amount of direct contributions to the treasury of the Government.

In order to verify the accuracy of the projected statistics as reported in the Annual Reports, we compared the new beneficiaries' report statistics for Fiscal Years 2009 through 2011 against provided actual supporting documentation from the EDC. We found that provided documents did not always support statistics published in the annual reports for the period reviewed. There were even instances in which reviewed documents showed that the beneficiaries' collective economic outputs, for certain compliance requirements, exceeded related report statistics. Despite this, some beneficiaries still had not met their individual certificate compliance requirements. This was directly linked to inadequacies in monitoring beneficiaries. "Finding 3: Monitoring," discusses in greater detail the issues of infrequent compliance reviews and the EDC's inability to ensure that beneficiaries submit reports in a timely manner.

Fiscal Year 2009. The Fiscal Year 2009 Annual Report stated that certificates of benefits were issued to 8 new beneficiaries during the fiscal year. The report indicated that the new beneficiaries represented projected employment of 127 full-time employees, projected annual wages of $3.6 million, projected investment of $11.2 million, and projected annual contributions of $157,905. However, provided documents only supported employment of 73 full-time employees, annual wages of $1.2 million, investments of $1.7 million, and annual charitable contributions of $23,892. The differences were in part due to the EDC not providing data supporting report statistics for 4 of the 8 beneficiaries.

Based on EDC records, the 4 beneficiaries for whom data was provided were collectively responsible for making local investments totaling a projected $7.2 million. However, as of the end of Fiscal Year 2011, their combined investments totaled only $1.7 million, about $5.5 million below the required amount. Relating to employment, we found that 2 of the 4 beneficiaries were collectively required to hire 20 employees. EDC records showed that they had only hired 10.

Fiscal Year 2010. The Fiscal Year 2010 report indicated that 14 certificates of benefits were executed for new beneficiaries during the fiscal year. Supporting documents showed that the beneficiaries' collective economic outputs, for certain of the requirements, were higher than the related report statistics. For instance, the report stated that the 14 beneficiaries were projected to employ 243 local employees with annual wages of about $8 million. However, supporting documents showed employment of 274 employees, and annual wages of $16.1 million. Despite the number of individuals employed collectively by the beneficiaries, 4 of the 14 beneficiaries did not meet their certificate employment requirements. Together the 4 were required to hire at least 33 employees, but had only hired 8.

Regarding investments and charitable contributions and scholarships, the beneficiaries' economic outputs were lower than the published statistics. The report indicated that the beneficiaries were projected to contribute about $8.3 million in investments and $402,455 in annual charitable contributions. However, as of the end of Fiscal Year 2011, the beneficiaries had only invested $2.2 million in the local economy and made $336,229 in charitable contributions. We found that 8 of the 14 beneficiaries had not made any amount of their required charitable contributions as of the end of Fiscal Year 2011.

Fiscal Year 2011. The Fiscal Year 2011 Annual Report indicated that 14 certificates were issued to new beneficiaries during the Fiscal Year. Data supporting report statistics were provided for only 11 of the 14 new beneficiaries. Reviewed documents showed that the beneficiaries' projected collective economic outputs in local hires, annual wages and investments surpassed the reported amounts for those requirements. The report indicated that the beneficiaries' projected contributions to local employment totaled 1,033 full-time employees, annual wages totaled $18.3 million, and investments totaled $30.6 million during the fiscal year. In contrast, EDC supporting records documented employment of 1,200 full-time employees, annual wages of $22 million, and investments of $45.8 million. Although actual local employment was in excess of the reported amount, 3 of the beneficiaries for whom data was provided did not meet their certificate employment requirements. Together the 3 were supposed to employ at least 34 full-time local employees. EDC records showed that they had only employed 19. In addition, although the actual collective investments were higher than what was reported, we found that 6 of the beneficiaries had not met their individual required investments. Together they were supposed to invest at least $17.7 million in the local economy. However, reviewed records showed that they had invested only $12.1 million.

Regarding annual charitable contributions, the 14 beneficiaries were projected to collectively make contributions totaling $727,500; however, provided records showed that their contributions totaled only $378,340. As noted, supporting data was provided for only 11 of the 14 beneficiaries.

As can be seen from these reports, the statistics are based on projected benefits to the Territory. They do not show actual benefits realized as a result of the Economic Development Program. In addition, the reports do not provide information on the actual costs (taxes forgone) to the Territory. In essence without a current cost/benefits analysis to capture actual program outcomes from all beneficiaries, decisions are made with projected figures.

Without timely actual information from the beneficiaries, a true assessment of the benefits of the Economic Development Program cannot be determined. In addition, without a cost/benefit analysis, EDC officials cannot truly evaluate the effectiveness of the program to determine the areas to promote that would have a more positive impact on the Territory's economy. As discussed in the following sections of this report, as reported by the 2011 independent study, certain categories of beneficiaries contribute far less to the Territory than other categories.

Impact Analysis Comparisons

In 2014, the Code was amended significantly to increase the benefits that beneficiaries receive. This recent amendment will be discussed later in this report. However, since the law as discussed below was in effect during the period covered by the 2011 independent study, we will focus our discussion on the law as it was before the 2014 changes. We do note that the issues brought out by the independent study will still be relevant under the law as changed.

Title 29, Section 713a of the Code, required that the EDC grant Categories I, II, IIA, and III beneficiaries 100% benefits for 10 years as long as they remain in compliance with all requirements of the EDC program. The independent study results, however, have indirectly revealed that the law, as written, creates an unfair economic advantage for certain businesses as it relates to requiring that equivalent percentage amounts of tax exemptions be awarded to all types and categories of businesses. As noted, accommodations and food services and Categories II and III businesses were linked to high cost/benefit ratios while professional services and Categories I and IIA businesses were linked to low cost/benefit ratios. From an industry standpoint, the study indicated that from 1999 through 2009 accommodations and food services businesses contributed about $13.6 million to GTP and $2.8 million in tax revenues for every $1 million forgone in local taxes. In contrast, professional services businesses contributed only about $400,000 to GTP and $400,000 in tax revenues for every $1 million in tax revenues forgone in local taxes.

When analyzing economic impact by EDC business categories, the study found that Category II businesses (manufacturing, food services) contributed about $9.3 million to GTP and $1.9 million in tax revenues for every $1 million forgone in local taxes; however, Category IIA businesses (designated service firms) contributed only about $400,000 to GTP and $400,000 in tax revenues for every $1 million forgone in local taxes. The cost/benefit ratio results provided by the study included a composite of the estimated direct, indirect and induced impact the business types and categories had on the Territory's economy[6].

Additional Study Results. The independent study provided statistics on the direct economic activities of Category II (manufacturing, food services) and Category IIA (designated services) firms from 1999 through 2009. As noted, these two categories of businesses represented about 38% and 40% of all beneficiaries, respectively (or together 78%).

The following table compares the direct economic activities of Category II and Category IIA businesses as reported by the independent study.

6 For explanations of terms, such as GTP, indirect and induced expenditures, and others, please see footnotes on pages 6 and 7.

1999-2009 Direct Economic Activities Comparison

Category	Category II Businesses	Category IIA Businesses
Gross Sales	$3,335,100,000	$7,548,600,000
Tax Exemptions	$304,400,000	$1,626,700,000
Direct Expenditures	$1,721,800,000	$377,200,000
Capital Expenditures	$611,800,000	$153,500,000
Direct Earnings	$742,900,000	$229,300,000
Charitable Contributions	$3,300,000	$16,900,000
Direct Taxes Paid	$346,300,000	$470,700,000
Direct Employment	7,464	1,331

When comparing the direct economic activities of the two, Category II businesses had about $1.7 billion in direct expenditures, $611.8 million in capital expenditures, and $742.9 million in direct earnings. In contrast, Category IIA businesses had about $377.2 million in direct expenditures, $153.5 million in capital expenditures, and $229.3 million in direct earnings. As it related to direct employment, Category II business employed 7,464 people, while Category IIA employed 1,331 people.

When comparing gross sales, local taxes paid, and charitable contributions, Category IIA businesses had higher statistical results. Gross sales for Category IIA businesses totaled $7.5 billion, while gross sales for Category II businesses totaled $3.3 billion. Local taxes paid and charitable contributions for Category IIA businesses totaled $470.7 million and $16.9 million, respectively. However, local taxes paid and charitable contributions for Category II businesses totaled $346.3 million and $3.3 million, respectively. According to the study, Category IIA businesses received almost $1.7 billion in tax exemptions, while Category II businesses received $304.4 million in tax exemptions over the study's coverage period.

Direct Activity Cost/Benefit Ratio Analysis. Although Category IIA businesses paid more in taxes and charitable contributions, Category II businesses had significantly more direct impact on the Territory overall based on economic outputs in direct and capital expenditures, and employment earnings and hires.

To further show the wide disparity in direct economic output between the two categories of businesses, we selected and calculated cost benefit ratios from a Category II business and a Category IIA business based only on their direct economic output in the Territory for every $1 million in tax revenues forgone during Fiscal Years 2009 through 2011. Direct economic output included wages and employee taxes, local purchases, capital expenditures, charitable contributions, and tax revenue collections. Provided documents indicated that the two businesses had received identical 100% tax benefits from the Government. The Category II business, a multifaceted retail facility, grossed about $47 million in sales during the period. Its direct economic output totaled about $42 million, and it received about $1.53 million in tax exemptions. The cost benefit ratio result showed that for every $1 million forgone in taxes by the Government the Territory gained about $27.4 million in direct economic and fiscal benefits.

On the other hand, the Category IIA business, a professional services firm, grossed about $415.7 million in sales and contributed about $53.6 million in economic output during the period. The tax exemptions it received totaled about $150.7 million. The cost benefit ratio result, however, was drastically different from that of the Category II business. For every $1 million forgone in tax revenues by the Government, the territory gained only $360,000 in direct economic and fiscal benefits.

Additional comparisons drawn from the data and results show that while the two categories of businesses reportedly received 100% in tax benefits, the Category II business' direct economic and fiscal output in the Territory represented about 89% ($42 million) of gross sales ($47 million), and the Category IIA business' direct economic and fiscal output in the Territory represented only 13% ($53.7 million) of gross sales ($415.7 million). In addition, the Category II business contributed about 76 times the total direct contribution amount of the Category IIA business based on our cost/benefit ratio results ($27.4 million per $1 million forgone vs $360,000 per $1 million forgone).

As stated, we computed the cost/benefit ratios for the above comparison based only on the two businesses' direct outputs in the Territory. The cost/benefit ratio results for the two do not represent averages for all businesses in each category; results will vary from business to business. The comparison presents the potential economic impact differences between Category II and Category IIA businesses when comparing them individually. It also supports the consultant's independent study which documented the wide economic impact disparities when comparing businesses collectively by categories through their direct, indirect, and induced outputs.

Long-term EDC Benefits Awards

Special provisions in the Code allow new beneficiaries to potentially qualify to receive 100% benefits for up to 20 or 30 years in consideration for the location of their businesses or industries in specific areas of Christiansted or Frederiksted. As part of our audit, we requested documentation for 46 businesses that were active beneficiaries during all or part of the audit scope period. The purpose was to determine whether each certificate had been awarded in accordance with established criteria. From the provided documents, we ascertained that 6 of the 46 beneficiaries had been granted full benefits for 20 or 30 year periods. Five of the 6 were Category IIA businesses. Of that number, 3 were granted 20-year benefits and 2 were granted 30 year benefits. The remaining business was a Category I business, which was granted 30 years of benefits. The 6 businesses were required to hire minimums of 10 to 15 employees, of whom 80% were required to be Virgin Islands residents. Based on their respective certificate of benefits, 4 of the 5 Category IIA businesses were only required to meet the minimum mandatory onetime investment of $100,000. The other was only required to meet a onetime investment of $150,000. In Contrast, the minimum required investment for the Category I business was $1.4 million.

The certificates of benefits for 3 of the 5 Category IIA businesses obligated them to make initial charitable contributions of $50,000 each with annual increases of $5,000. The certificates for the other two required that one make annual charitable contributions of $50,000 and the other make an initial charitable contribution of $100,000 and the lesser of $40,000 or 2% of the prior year's pretax income thereafter. Based on provided documents, we were able to determine that 4 of the 5 Category IIA businesses had not met their charitable contribution requirements for one or more years of the audit scope period. We could not determine if the remaining Category IIA business had complied with its charitable contributions requirements because of the lack of supporting information.

The Category 1 business' certificate agreement provided for a $2,500 scholarship to a student/employee of the St. Croix Educational Complex vocational school pursuing careers in the civil engineering fields. The agreement did not indicate whether the scholarship was to be offered annually. In addition to the $2,500 scholarship, the business was required to offer an annual full scholarship to a student to attend a St. Croix private school. An amount was not stipulated. Based on provided information, we could not determine if the business had met its charitable contribution requirements. In addition, we did not have other key financial information such as the business' earnings and expenditures for any of the years of the audit scope period. This would have given some perspective on the business' earnings in relation to required and actual outputs. As noted, this business was given 30 years of benefits.

We were provided limited financial information for the 5 Category IIA businesses as it related to their earnings and expenditures for the audited period. No earnings or expenditures information was provided for 1 of the 5. Based on available information, gross sales for the other 4 businesses ranged from $142,000 to $22.3 million in the audit scope years for which information was provided.

Recent Increase to the Tax Benefits

During the course of our audit, some major revisions were made to the law that affected the Economic Development Program. On October 13, 2014 Act 7651 became law which among other things increased the tax benefits given to businesses participating in the program. In particular, Section 713a (b) of the Code, dealing with the tax benefits was deleted and a new section was added. Beneficiary benefits were changed as follows:

- St. Thomas/St. John District beneficiaries were entitled to 100% benefits for 20 years.
- St. Croix District beneficiaries were entitled to 100% benefits for 30 years.
- If initial or additional investments of greater than $10 million are made an additional 10 years of 100% benefits can be added.
- If initial or additional investments of greater and $1 million but less than $10 million are made an additional 5 years of 100% benefits can be added.
- Beneficiaries from both districts were entitled to one 10 year extension of 100% benefits.

This change in benefits has allowed businesses in the St. Thomas/St. John District to receive 100% benefits for 30 to 40 years and businesses in the St. Croix District to receive 100% benefits for 40 to 50 years.

The new fixed expansion of benefits has limited the ability of the EDC to effectively negotiate benefits options with prospective beneficiaries. It has created the potential of a "business welfare" program because benefits are mandated at 100% for as much as 40 to 50 years, no matter the potential increase in profitability of the beneficiaries. As will be shown in the section that follows, the life expectancy of a corporation averages 15 years.

Extending 100% Benefits Beyond 10 Years

We performed an analysis to determine the participation span for the 48 beneficiaries who received compliance reviews. For some it was unclear when they became beneficiaries. For these we used the year that they initially requested EDC benefits.

We found that 13 of the 48 beneficiaries voluntarily terminated their EDC benefits during the audit period. Their participation in the Economic Development Program ranged from 3 to 27 years. Eleven of the 13 had an average participation of 6 years. Another one whose certificate was involuntarily terminated was a beneficiary for 8 years. Only 2 beneficiaries participated for 20 or more years.

The remaining 34 beneficiaries who continued with benefits over the audit period had participation spans that ranged from 5 to 32 years. The average participation span was 15 years. Only 13 of the 34 beneficiaries (38%) participated for more than 15 years. The other 21 beneficiaries were beneficiaries for less than 15 years. Of the 21, only 8 are currently beneficiaries as of 2014.

We found that, of the other 13 who were no longer listed as active beneficiaries in 2014, 4 requested suspension of benefits and EDC records did not show that they renewed their certification. The other 9 either ended their benefits, did not request extensions after their certificate period ended, or, as in one case, was not approved for extension by the EDC Board.

We believe that providing full benefits to beneficiaries beyond 10 years is not beneficial to the Territory because most of the beneficiaries' participation span in the Territory is no more than 15 years. In fact, research shows that the life expectancy of companies today is less than 15 years.

It is our opinion that the Economic Development Program was intended to assist businesses in getting established and profitable, at which time they become tax paying members of the community. As such, the EDC should have the ability to negotiate the benefits on a sliding scale where, as a business becomes more profitable, the benefits are reduced from the 100% level. In addition, the EDC should have the ability to negotiate adjustments to the benefits to the Territory if profits of a beneficiary exceed the anticipated amounts detailed in the original prospectus.

Recommendation to Revise Tax Exemption Awards System

The wide differences in economic impact results were in part due to the nature of the businesses. Capital and labor based businesses, as a group, had a greater impact on the local economy than knowledge-based and financial services-based businesses. The consultant's study indicated that in interpreting the cost/benefit analysis results the EDC should consider that certain businesses would not have been drawn to the Territory if it was not for the tax incentive program. As a result, tax revenues forgone by the Government "are not really foregone, since tax revenues would not otherwise have been generated and collected." However, the study also stated the following regarding beneficiaries with lower estimated cost benefit ratios:

> "In this regard, the EDA has more leverage over these types of firms than it probably currently thinks it has: since these types of firms tend to produce lower estimated cost-benefit ratios, the EDA can negotiate from a position of relative strength, in encouraging such applicants to work with the EDA to figure out ways to contribute more fully to the Territory's economy."

We concur with this position. However, we believe that to maximize the potential economic benefits to the Territory, the EDC should also consider the economic and fiscal impact provided by industries and categories of businesses in determining reduction amounts in tax liabilities for new beneficiaries. For instance, businesses with smaller capital investments are more likely to leave the Territory after their EDC eligibility expires. As a result, the EDC should consider proposing changes to the law that allow for the granting of tax exemptions on a sliding scale basis, based on historical cost benefit ratio trends by categories and industries of businesses. The proposed initiative should not only support the EDC's assignment of attracting and keeping businesses in the Territory, but also help to ensure that a more equitable tax exemption award system exists for the benefit of the local economy.

Recommendations

We recommend that the Board:

1. Request that the Virgin Islands Legislature institute a law requiring the EDC to measure, assess, on a regular basis, the tax incentive program's overall economic and fiscal impact on the Territory's economy for tax revenues forgone and report impact results to the Virgin Island Legislature and appropriate governmental authorities.

2. Establish and implement policies and procedures to efficiently obtain financial data from beneficiaries in order to conduct timely and accurate assessments of the tax incentive program's impact on the Territory.

3. Establish and implement policies that encourage and require the various categories of beneficiaries to contribute more equitably to the Territory's economy based on their cost/benefit ratios.

4. Request that the Virgin Islands Legislature revise the Code allowing the EDC to grant benefits "up to 100%" to new beneficiaries, for the purpose of implementing a sliding scale approach in determining reduction amounts in tax liabilities, based on historical cost/ benefit trends for the various categories of businesses.

Economic Development Authority's Response

On behalf of the Authority, the Chief Executive Officer issued a January 9, 2015 response to audit findings and recommendations. However, the CEO's response primarily addressed audit findings and recommendations from the preliminary draft report instead of the official draft report. In the official draft, we revised and rearranged the findings and recommendations we had issued in the preliminary draft.

In its response, the Authority referred to the "Economic Impact" finding section as Finding 5 instead of Finding 1, as arranged in the official draft. Regarding Recommendation 1, the Authority asserted that the EDC's annual report quantifies the achievements of the agency and the benefits to the Territory. In addition, it stated that the Bureau of Economic Research (BER) is officially tasked with "the analysis of economic impact to the Territory." The response further stated that the EDC does not have the resources to "duplicate the responsibility of the BER," and that it has recommended that the Government incorporate the BER within the Authority. As a note, part of this recommendation was revised in the official draft. "To measure, assess" replaced "to quantify" from the preliminary draft. The Authority's response addressed the original wording of the recommendation.

In its response, the Authority incorrectly referred to Recommendation 2 as Recommendation 4. It gave the following reply to the recommendation: "The VIEDA current policies require beneficiaries to submit reports to the VIEDC upon a set schedule. Failure to submit documents timely can result in fines."

For Recommendation 3, the response clarified that Category IIA beneficiaries are now classified as Category IV. It further stated, "The Board has the power and has consistently imposed special conditions upon the granting of benefits which provide the Territory with a positive economic gain." We note that this recommendation is a revision. The original version recommended the establishment and implementation of "policies that require Category I and Category IIA beneficiaries to contribute more fully to the Territory's economy due to their low estimated cost benefit ratios." Due to recent amendments to the law after the issuance of the preliminary draft report, we reworded the recommendation by substituting "Category I and Category IIA beneficiaries" for "various categories of beneficiaries." In addition, we replaced "fully" with "equitable" and deleted the word "estimated." The Authority's response addresses the older version of the recommendation.

The Authority incorrectly referred to Recommendation 4 as Recommendation 2. In the response the Authority stated, "The Legislature amended the EDC Law in November 2014. In this amendment the maximum level of benefits was set by the Legislature. It is the responsibility of the Board to determine if the grant of benefits is beneficial to the economic development of the Territory."

In addition to addressing the recommendations, the Authority addressed specific findings that had been published in the preliminary draft. Although the findings have been revised, we have summarized the agency's responses below. The Authority's entire response begins on page 52).

The Authority acknowledged that the Code and its Rules and Regulations do not require the quantification and reporting of the overall economic and fiscal impact of the EDC program on the Territory's economy. However, "the EDC conducts an extensive cost/benefit ratio analysis of every applicant and the cumulative assessments are reported in the…Authority's Annual Report." The Authority further stated that the BER is tasked with the responsibility of collecting and reporting on all economic activity in the Territory.

In reference to our finding addressing certain business types with low cost/benefit ratios to the Territory not being held to a higher standard of participation and accountability, the Authority stated that the finding was "improper." It asserted that we were suggesting that the EDC "ignore the Law." In addition, our report "acknowledges that the Territory is not giving up anything when a company relocates here because they were not paying taxes here before, but then negates this by recommending more stringent requirements and lesser benefits for the very companies that are the Virgin Islands' target market." The Authority stated that implementing the applicable recommendation would put the Territory at a disadvantage with other jurisdictions, and would be "improper and discriminatory to hold different beneficiaries to different standards of compliance…"

In the official draft, under the "Economic Impact" finding, we stated that "recent changes to the tax benefits law have created a potential 'business welfare' program by providing beneficiaries with 100% benefits for 40 to 50 years." In response the Authority stated, "This is not a corporate welfare program." In addition, the EDC is dedicated "to being the finest Economic Development organization under the American flag," and it is routinely reviewing its "policies and procedures against best practices."

V.I. Inspector General's Comments

The Authority's response did not always accurately and adequately address audit findings and recommendations in the audit report. First, its response primarily addressed findings and recommendations from the preliminary draft instead of the official draft. As noted, the official draft was a revised report. Content revisions were based on our exit conference with agency executives in August 2014. In addition, we considered recent changes that had occurred in the tax benefits law after the exit conference. The Authority's failure to address the correct draft even resulted in the agency issuing responses to two (2) recommendations that had been removed from the audit report in the Finding 2 section, "Extension of EDC Benefits Awards."

Secondly, for the most part, the Authority's responses to the recommendations were vague. The agency did not provide clear and detailed plans of action to correct critical issues facing the Territory's Economic Development Program. More emphasis was placed on defending its position regarding certain findings than providing viable solutions to program challenges. For instance, in addressing a finding related to recommendation 1, the agency acknowledged that neither the Code nor the agency's rules and regulations require the measurement and reporting of the overall economic and fiscal impact of the EDC program on the Territory's economy. However, instead of answering the recommendation, which calls for the establishment of such a requirement through the Virgin Islands Legislature, the agency responded that an extensive cost/benefit analysis is conducted on every applicant and cumulative assessments are published in the annual report.

On the contrary, our audit found that reviewed annual reports were deficient in that they did not provide statistics on the taxes and benefits given-up by the Territory to the various beneficiaries. In addition, they did not provide information on the amount of direct contributions to the treasury of the Government. These components are essential in measuring the overall economic and fiscal impact of the EDC program on the Territory's economy. We also note that the statistics published in reviewed annual reports were not always reliable because they did not match actual supporting document information provided by the Authority.

As stated in the report, the EDC engaged the services of a consulting firm to conduct a study that measured the overall economic and fiscal impact of the EDC program on the Territory. Although the study, which was published in 2011, was useful, it covered 11 years, from 1999 through 2009. The EDC has performed no comprehensive cost/benefit analyses since the release of the firm's report.

From its responses to Recommendation 1 and the related finding, the Authority did not take ownership of the program. It seemed to place the responsibility of assessing the economic and fiscal effectiveness of the program on the Bureau of Economic Research by stating that the research agency was officially tasked with collecting and reporting on all economic activity in the Territory. The Authority also stated that it did not have the resources to duplicate the responsibility of that agency and has recommended that the Government incorporate the agency within it. Even if the Government accepts the recommendation and restructures the agencies, the Authority would still be ultimately responsible for assessing the effectiveness of the program as is its responsibility now. The first step in accepting this responsibility would be to have a mechanism in place to require the timely measurement, assessment and reporting of the overall economic and fiscal impact of the program on the Territory's economy. Recommendation 1 is calling for the Authority to work with the Virgin Islands Legislature in taking this first step.

In addressing another finding, which is linked to Recommendations 3 and 4, the Authority incorrectly asserted we were suggesting that the agency ignore the law. The finding spoke specifically to the EDC not promoting higher levels of participation by certain business types found to have a relatively low economic and fiscal impact on the Territory. Knowing that the finding could not be effectively resolved without legislative involvement, we recommended (in Recommendation 4) that the Authority request that the Virgin Islands Legislature revise the Code allowing the EDC to grant benefits "up to 100%" to new beneficiaries." This change would give the agency the flexibility to establish and implement policies that encourage and require the various categories of beneficiaries to contribute more equitably to the economy of the Territory (Recommendation 3).

The Authority also asserted that our audit report gives conflicting messages regarding the finding. On the one hand, our report "acknowledges that the Territory was not giving up anything when a company relocates here because they were not paying taxes here before;" yet, on the other hand, it "negates this by recommending more stringent requirements and lesser benefits for the very companies that are the Virgin Islands' target market." As our report clearly shows (P. 16), we were presenting report findings published by the consulting firm that the Authority had hired to conduct the comprehensive cost/benefit analysis study. In the report, the firm stated that tax revenues forgone by the Government "are not really foregone, since tax revenues would not otherwise have been generated and collected." However, the firm also stated that the Authority can negotiate from its position of relative strength to encourage businesses, with lower estimated cost/benefit ratios, to "contribute more fully to the Territory's economy." As indicated in our audit report, we agree with this position. Our purpose for presenting the finding and corresponding recommendations is not to create more stringent requirements and lesser benefits for certain businesses, but to help create a system that is more equitable and fair to all participating businesses – including the Government.

Finally, the Authority's response did not fully address our concerns over the recent changes to the tax benefits law, which allows beneficiaries to receive 100% benefits for 40 to 50 years. We are disappointed with the Authority's response to Recommendation 4, which helps to address this concern. The Authority simply made reference to the amended law and stated that the maximum level of benefits was set by the Legislature. It added that the Authority is responsible for determining if the grant of benefits is beneficial to the economic development of the Territory. An issue here is that the Authority's response basically comprised only a cursory reference to the establishment of the very law for which the recommendation was developed in the first place.

As we reported, the recent changes in the law limit the EDC's ability to effectively negotiate benefits options with prospective beneficiaries. As written, the amendment enables the EDC to give mandated full tax benefits over extended periods regardless of the potential increase in beneficiaries' profitability levels. Our position is that as beneficiaries' earnings and profitability increase, they should be willing to contribute more to the Territory's economy. Therefore, the law should allow the EDC the flexibility to negotiate tax benefits rates or options with beneficiaries based on periodic evaluations and assessments of their economic performances. Recommendation 4 helps to make this initiative a reality by requesting that the Virgin Islands Legislature insert new language in the Code which states "up to 100%" as it relates to the EDC granting benefits to new beneficiaries.

The concerns discussed above underline our position that the recent amendment creates a potential for a "business welfare" program. We agree with the Authority that the EDC is dedicated to "being the finest Economic Development organization under the American flag." In fact, our report acknowledges that the program yielded positive results. However, it also states that there was need for improvements in the way it was administered. In its introduction prior to specifically addressing report recommendations, the Authority said that our audit report is "instructive as a history lesson…" We disagree! The Authority still has pressing issues to address in the way the EDC currently runs the program. In view of the financial challenges facing the Territory, the EDC must urgently develop a mechanism for timely measuring, assessing, and reporting on the overall economic and fiscal impact of the program. Therefore, it is essential that the EDC adequately monitor beneficiaries to help ensure that they submit compliance reports as required. Recommendation 2 was issued to help improve beneficiaries' timely submission of required financial data. However, the Authority simply stated that policies exist that require beneficiaries to submit reports timely and contain provisions for issuing penalties for failure to report as required. Our audit found that although these policies existed, beneficiaries' reports were routinely delinquent. The EDC was not enforcing the reporting requirements.

The Authority did not indicate concurrence or non-concurrence with any of the recommendations. The recommendations must be adequately addressed before we consider them resolved. For instance, for Recommendation 1, we need to know whether the Authority will work with the Legislature to institute a law requiring the EDC to regularly measure, assess and report on the Economic Development Program's overall economic and fiscal impact on the Territory's economy. For Recommendations 2 and 3, we need to know what specific corrective measures will be put in place to (i) help ensure the efficient collection of beneficiaries' financial data, and (ii) encourage the various categories of beneficiaries to contribute more equitably to the Territory's economy. Regarding Recommendation 4, the Authority needs to indicate whether it will work with the Legislature to revise the Code allowing the EDC to grant benefits "up to 100%" to new beneficiaries. As stated, Recommendation 4 provides foundational support for Recommendation 3 and the EDC with the flexibility to negotiate tax benefits rates or options periodically instead of being locked in to granting full benefits over prolonged periods.

FINDING 2: EXTENSION OF EDC BENEFITS AWARDS

Deficiencies existed in the EDC program for awarding benefits and extension of benefits. Specifically, (i) the EDC Rules and Regulations contradicted the Code regarding extension of benefits, (ii) in extending benefits, the EDC granted full benefits to beneficiaries not eligible to receive them at that level under the law, and (iii) the EDC granted extension of benefits in numbers and durations in excess of what was allowed under the law.

We attributed these conditions to the EDC (i) not updating their internal policies and procedures to correspond with Code provisions, and (ii) not following provisions of the Code. As a result the Government lost revenues due to beneficiaries receiving tax benefits for which they were not entitled.

Background

According to Title 29, Section 713a (b) of the Code, all beneficiaries may receive a renewal of benefits for 10 years if they remain in compliance with Code requirements during their initial periods of benefits. Title 29, Section 715(b) of the Code, as amended, states, "no extension, modification or renewal of any exemption or subsidy benefit shall exceed an aggregate duration of more than five years at ninety (90%) percent of benefits, (or ten years at forty (40%) percent of benefits, or proportionate gradations thereof, at the applicant's option)."[7] This amended provision was added in 2005 under Act 6748, Section 14. It replaced the prior provision which contained the very same wording, except that it stipulated that extensions, modifications, or renewals could not exceed an aggregate duration of five years at one hundred (100%) percent of benefits or ten years at fifty (50%) percent of benefits. The prior provision was created in 1975 under Act 3748.

Beneficiaries in certain industries may qualify for additional extended benefits under special Code provisions. Producers of Virgin Islands rum, local watch and jewelry manufacturers and assemblers, and local processors and producers of milk and milk products may receive extended benefits for durations of 20 or 25 years at 100%.

EDC Rules and Regulations

The EDC Rules and Regulations conflicted with the Code regarding criteria used for determining the number and duration of extension of benefits. As noted, Title 29, Section 715(b) of the Code, as amended, limited beneficiaries' extension of benefits to no more than five (5) years at 90% of benefits or ten (10) years at 40% of benefits. Prior to the section's amendment, beneficiaries' benefits could be extended for no more than five (5) years at 100% of benefits or ten (10) years at 50% of benefits. In contrast, the provided Rules and Regulations, which were

7 As noted in Finding 1, the tax benefits law was amended in October 2014. The amendment resulted in changes to Title 29, Sections 713 and 715. Discussion of these Code sections reflects the law as applicable during the audit scope period.

approved in December 2004 and still in effect during all or part of the audit scope period, contradicted both the amended and prior Code provisions. The Rules and Regulations stipulated that beneficiaries could receive an extension of benefits for no more than ten (10) years at 100% of benefits or twenty (20) years at 50% of benefits.

The table below summarizes the discrepancies between the Code and the Rules and Regulations for granting extension of benefits.

VI Code before September 1, 2005	VI Code as of September 1, 2005	EDC Rules & Regulations
5 years @ 100%	5 years @ 90%	10 years @ 100%
10 years @ 50%	10 years @ 40%	20 years @ 50%

As part of the audit, we requested documents for 46 beneficiaries who were active during all or part of the audit scope period. The purpose was to determine if their certificates of benefits had been extended in accordance with established criteria. Of the 46 beneficiaries, 17 had certificates that had been extended beyond the initial benefits periods. Of that number, we identified 7 who were granted extension of benefits outside the requirements of the law. The EDC extended their benefits using its Rules and Regulations criteria. All 7 were each granted 100% benefits for extensions of 10 years, when, based on the approval dates of their certificate agreements, they were only eligible to receive either 40% or 50% of benefits over a 10 year period.

EDC officials stated that based on the provisions of Title 29, Section 713a (b) (3) of the Code, as amended, the Board voted to extend the term of benefits for 10 years. However, the Section does not authorize the EDC to extend the benefits beyond 5 years at 100%. Although the Section states that approved applicants may receive a renewal of benefits for 10 years, it does not speak to the specific terms under which renewals will be granted. As previously stated, the specific terms for granting renewals or extensions are detailed in Title 29, Section 715 (b) of the Code, which is under the main section entitled, “Certificate modification, extensions or renewals; reopening of industries.”

EDC officials also stated that Title 29, Section 715 (b) was amended in September 2009 exempting hotels of 150 rooms or less from the provisions of that subsection. This meant that hotels meeting this occupancy criterion could be approved to receive renewal or extension of benefits beyond 5 years at 100%. Although we acknowledge the amendment, our findings specifically address violations that occurred prior to the effective date of the amendment.

<u>Multiple Extensions of Benefits</u>

The EDC, as a practice, repeatedly extended the benefits of certain beneficiaries over several years, dating back from as far as the early 1990s. The number and durations of the extensions granted the beneficiaries exceeded what was allowed under the law. We found that 5 of the 17 beneficiaries whose certificates had been extended received this kind of treatment. The EDC had extended their benefits from two to five times following their initial benefits periods.

As a result, 4 of the 5 beneficiaries had received a total of 15 to 25 years in extensions when they were only eligible to receive up to 5 or 10 years, depending on their selected renewal options. The remaining beneficiary had received two 5-year extensions totaling 10 years. However, the second extensions were not allowable under the law. As noted, the law places restrictions on the length or duration of extended benefits awarded beneficiaries. Beneficiaries are essentially limited to one extension and may receive up to 10 years at 40% of benefits. If a higher tax exemption is desired, they can apply for up to 5 years at 90% of benefits. As stated, prior to September 1, 2005, extensions were limited to no more than five (5) years at 100% of benefits or ten (10) years at 50% of benefits.

The following table summarizes information on the multiple extensions granted to the 5 beneficiaries. In addition to that information, the benefits periods of the beneficiaries' initial certificates are given.

Beneficiaries	Benefits Periods of Initial Certificates	Benefits Extension Periods	Number of Years Per Extension
1	1989-2003	1/2004-12/2008 1/2009-12/2013	5 5 **10**
2	1978-1988	1/1990-12/1994 1/1995-12/1999 1/2000-12/2004 1/2006-12/2015	5 5 5 10 **25**
3	1993-2003	10/2003-10/2013 10/2013-10/2023	10 10 **20**
4	1997-2002	12/2002-12/2012 12/2012-12/2022	10 10 **20**
5	1991-2001	12/2001-11/2011 12/2011-11/2016	10 5 **15**

As shown, Beneficiary 2 was granted four successive extensions totaling 25 years. The duration for each of the first three extensions was five years and the duration for the fourth extension was 10 years. The beneficiary was granted 100% benefits for all four extensions. The EDC's noncompliance of granting multiple extensions ignored provisions of the law limiting the beneficiary's extension to no more than 5 years at 100% of benefits or 10 years at 50% of benefits, as was applicable on the approval date of the first certificate extension agreement. Beneficiaries 3 and 4 received 2 extensions of 10 years each. The EDC granted them 100% benefits for their first extensions when they were only eligible to receive 50% of benefits. Their second extensions, which were all also granted at 100%, should not have been granted under the law.

EDC officials' position was that Title 29 Section 715 (b) of the Code did not restrict applicants from applying for more than one extension or renewal. Their interpretation of the

Section was that it speaks specifically to the duration and its applicable terms, whether 5 years at 100% or 90% of benefits or 10 years at 50% or 40% of benefits, as applicable. We agree that Section 715 (b) defines the duration terms under which extensions or renewals can be granted; however, it does not allow for additional extension or renewals. The Section limits the duration of extensions or renewals to 10 years, with the amount of tax exemption given based on the duration option of the applicant – the longer the duration the lower the awarded percentage in benefits. Although not allowed, the EDC's historical approach to granting multiple extensions circumvented the law in that applicants were permitted to select shorter durations of extensions at higher tax exemption amounts every time they received additional extensions. For instance, Beneficiary 1 (listed in the above table) was granted two successive 5-year extensions at 100% of benefits. If the law had been correctly applied, the beneficiary would have been limited to one extension of either 5 years at 100% of benefits or 10 years at 40% of benefits.

Justification for Granting Multiple Extensions

The 5 beneficiaries with multiple extensions were granted a total of 12 extensions, with 7 not permitted under the law. We received documents justifying the approval decisions of the Board for only 3 of the 7 additional extensions. The Board cited Section 715-4(1) of the EDC Rules and Regulations as the reason for granting the 3 extensions. The specific section states that the Board may grant an extension if the business or industry of a beneficiary "(i) is deserving of the benefits to be granted; and (ii) will continue to promote the economic development of the United States Virgin Islands." Although the section gives criteria for granting an extension, it does not authorize the EDC to grant multiple extensions. Even if the section did, it could not supersede the provisions of the Code.

Other Jurisdictions

As part of our audit, we reviewed selected economic development programs for three other jurisdictions, specifically focusing on provisions governing extension of benefits awards. The jurisdictions included Puerto Rico, Guam, and Texas. Our review showed that their respective provisions either did not allow extensions or, if allowed, limited the durations of extensions.

- In 2001, the Texas Legislature enacted Tax Code Chapter 313, under the Texas Economic Development Act to promote large scale capital investments in the state through manufacturing, research and development, and energy projects. Participating companies are required to make minimum amounts of qualified investments to be eligible for up to a ten-year reduction in property taxes (as long as approved by the local school district). The enactment, as amended, does not offer extensions to participating companies.

- Puerto Rico has established industry specific tax incentive programs related to manufacturing, export services, and tourism to promote the growth of its economy.

- The Economic Incentives Act for the Development of Puerto Rico provides a variety of tax credits and exemptions to eligible manufacturing companies. The Act limits the tax exemption period to 15 years. Its provisions do not allow for an extension of benefits.
- Puerto Rico established the Export Services Act to help develop it as an international export services hub. Tax incentives include a 3% or 4% flat income tax rate on export services income and 100% exemption from property taxes during the first 5 years of operation, after which the exemption percentage amount is reduced to 90% for the remaining authorized period. Under the Export Services Act, participating companies receive 20 years of benefits, which may be renewable for 10 additional years, provided certain conditions are met.

- Various tax credit and exemptions are offered to companies in the tourism industry under the Tourism Development Act. Tax benefits include 90% or 100% exemptions on tourism development income and properties used for approved industry related activities. Exemption amounts may be based on the location of the companies or whether they are new or existing businesses. The exemption period is 10 years, which may be extended 10 additional years, provided authorities determine that the exemption is essential to the economic growth of the island.

- The Guam Economic Development Authority administers the Qualifying Certificate Program, which was established in 1965 under Guam's Public Law (PL) 8-80 and amended under PL 20-178 and PL 22-159. The purpose of the program is to develop the island's economy and quality of life by attracting and keeping various businesses and industries in the territory through offering tax incentives. Tax incentives include up to 75% rebate on corporate income tax for up to 20 years and 100% abatement of real property tax for up to ten years. Upon recommendation from the Authority and approval from the Governor, companies may instead opt to receive 50% of the standard abatements and rebates for a period of double the term. The law does not allow for an extension of benefits to participating companies and industries except for insurance companies. Under the Guam Captive Insurance Program, insurance underwriters and non-resident shareholders may apply for an extension of their certificates for an additional 20 years.

The Code, from the creation of the Virgin Islands Economic Development Program, has limited the duration of EDC extension of benefits awards. Title 29, Section 734 of the 1972 Code indicated that certificate extensions, modifications, or renewals were to be for periods recommended by the Board and approved by the Governor. However, it stipulated that no extension, modification or renewal was to exceed, at the time, a duration of more than five years. To ensure fair application of EDC benefits to program participants, there must be strict adherence to the law by the Board. If extenuating circumstances exist for certain beneficiaries that require exceptions in extending benefits, then the Board must work with the Legislature to revise the law.

Recommendation

We recommend that the Board:

1. Update the EDC Rules and Regulations to be in conformance with provisions of the Code regarding extension of benefits.

Economic Development Authority's Response

The Authority issued responses to two recommendations that had been removed from the audit report in this finding section. They were Recommendations 2 and 3. Although they were a part of the preliminary draft, they were not included in the official draft because of recent changes to the law since the exit conference with agency executives. Regarding the official draft recommendation, the Authority indicated that the law had been amended in November 2014 and that its Rules and Regulations would be updated to include the amendments.

In addition to responding to the recommendation, the Authority addressed findings in the section. The specific findings addressed related to EDC Rules and Regulations contradicting the Code, and the EDC extending full benefits to beneficiaries not eligible to receive them and granting benefits in numbers and durations in excess of what was allowed under the law. In addition, the Authority also responded to our research that compared extension of benefits policies in other jurisdictions.

The Authority indicated that our interpretation of the law regarding the extension of benefits was inaccurate. Its Rules and Regulations, as amended in December 2004, and staff recommendation for grant of benefits were based on the law. The Authority stated that the law provided two options for renewal or extensions: Title 29, Section 713 of the Code which allowed for renewal of benefits for 10 years and Section 715 which allowed for modification, extensions, or renewals for 5 years. In regard to the EDC granting full benefits to beneficiaries ineligible to receive them, the Authority implied that there was no violation because the EDC Board had voted to extend benefits to 10 years in accordance with Section 713a(b)(3) of Title 29 of the Code. In addition, the Authority made reference to Act 7092, which amended 713(b) of Code. It stated that the amendment exempted hotels of 100 rooms or less from any provisions limiting renewals and extensions at full benefits.

Based on the specific language in Section 715(b) of the Code, the Authority's interpretation of the Section was that it did not limit the granting of multiple extensions to beneficiaries.

In response to our research that compared extension of benefits policies in other jurisdictions, the Authority stated that we should have done a more thorough comparison, one which was not limited to extensions.

V.I. Inspector General's Comments

The Authority did not indicate concurrence or non-concurrence with the recommendation. To resolve the recommendation, we require a copy of the updated Rules and Regulations containing the current provisions of the Code regarding extension of benefits.

The Authority stated that our interpretation of the law regarding extension of benefits is inaccurate. It said that the law provided two options for renewing or extending the benefits of beneficiaries: Title 29, Section 713 of the Code, which allowed for renewal of benefits for 10 years and Section 715 which allowed for modification, extension, or renewals for 5 years. Although we have addressed this matter extensively in our audit report, we will briefly restate our position. Title 29, Section 713a (b) of the Code limited extension of benefits to 10 years. Beneficiaries' benefits could be extended for that length of time if they were in compliance with Code requirements. The Section, however, did not define the terms and conditions under which benefits could be extended. That was done in Title 29, Section 715 (b) of the Code, which stated that extensions, modifications or renewals would not exceed an aggregate duration of five (5) years at 100% or 90% benefits or ten (10) years at 50% or 40% benefits. As the law was eventually amended, the percentage of benefits beneficiaries received over the respective periods was based on the approval date of the renewal or extension.

The Authority indicated that the Rules and Regulations and staff recommendations for grant of benefits did not contradict the law. However, based on our report findings, they did. The Rules and Regulations allowed for the granting of benefits for 10 years at 100% benefits and 20 years at 50% benefits, which were clear departures from the language of the Code. As it related to our finding of the EDC granting full benefit to beneficiaries not eligible to receive them under the law, the Authority said that the EDC Board voted to extend benefits from 5 to 10 years in accordance with Section 713a(b)(3) of the Code. This meant that the agency could grant extensions at 100% benefits beyond 5 years. However, Section 713 did not allow this. Although the Section stated that approved applicants could receive a renewal of benefits for 10 years, it did not speak to the specific terms of the renewal. As stated, the terms were stipulated in Section 715. Also, based on the referenced sections of the Code, the Authority was not authorized to grant multiple extensions.

The Authority stated that Act 7092 amended Section 713 (b) exempting hotels of 100 rooms or less from provisions limiting the granting of renewals and extensions at 100% benefits. However, the Act and Code Section referenced by the Authority are incorrect. The correct references are Act 7233 and Section 715 (b), respectively. In addition, 715 (b) actually stated that hotels of 150 rooms or less (not 100 rooms or less) were exempt. We acknowledge the amendment relating to the exemption of hotels meeting certain criteria; however, our findings specifically addressed violations that occurred prior to the effective date of the amendment. We made this clear in our audit report.

The Authority expressed concerns over the extent of our research comparing extension of benefits policies in other jurisdictions. It said that our comparison should not have been limited to only extensions. Based on the scope and needs of our audit, conducting a research beyond the referenced subject matter would have been unnecessary and impractical. We were conducting an audit, not an independent study. Suffice it to say, we believe that we did a thorough comparison and the jurisdictions selected were appropriate.

FINDING 3: MONITORING

The EDC did not adequately monitor beneficiaries to ensure compliance with certificates requirements. We found that the EDC (i) performed infrequent compliance reviews, and (ii) did not effectively ensure that beneficiaries complied with reporting requirements.

We attributed these conditions to the EDC not (i) adequately prioritizing the monitoring of beneficiaries based on available staffing, (ii) establishing policies and procedures that addressed key aspects of the compliance review process, and (iii) effectively enforcing provisions for beneficiaries' reporting under the law.

As a result, (i) the infrequent compliance reviews did not promote an environment of ongoing compliance, and (ii) the EDC did not have timely information to determine the compliance statuses of beneficiaries.

Background

Title 29, Section 705 of the Code authorizes the Board to determine compliance of beneficiaries with the terms and conditions of their certificates based upon the investigation and recommendation of the EDC's Director. The established system for advising the Board involves the use of the Compliance Division (Division), which is responsible for performing compliance reviews. The finished product of the reviews is a written compliance report of findings and recommendations, which is addressed to the beneficiary and forwarded to the Board through the Director. The Division uses information from several beneficiaries' required reports to investigate compliance. The reports include Employer's Quarterly Wage and Contribution Report, Affidavit of Residency of Employees, and Annual Report to the EDC. The Annual Report, which is the most comprehensive of the reports, is due within 30 days of the filing deadline of beneficiaries' income tax returns and any filed extensions to the Virgin Islands Bureau of Internal Revenue. Section 723-1 of the EDC's Rules and Regulations authorizes the Board to issue fines to beneficiaries for late reporting. The fines range from $100, compounded 10% daily, starting on the 31st day after the report filing deadline to $1,000, compounded 25% daily, after 90 days of the filing deadline. Failure to file within 151 days may result in suspension or revocation of benefits. According to EDC officials, beneficiaries' compliance is reviewable after one year of receiving benefits; however, priority is given to beneficiaries who have received benefits for three or more years after first receiving benefits or after their last compliance review.

Compliance Monitoring Timeliness

The EDC's monitoring of beneficiaries' compliance with certificate requirements was infrequent. We found that time lapses between beneficiaries' compliance reviews were prolonged and uneven. In some instances, it took from 11 to 15 years for beneficiaries to receive their first and only compliance reviews. The irregularity in monitoring did not ensure a culture of ongoing compliance by beneficiaries.

Based on provided documents, there were as many as 109 beneficiaries in the EDC's Economic Development Program during Fiscal Years 2009 through 2011. During that period, the EDC performed compliance reviews for 48 beneficiaries. One of the 48 had two reviews performed; the others only had one. Based on provided compliance review reports, the 48 beneficiaries represented at least $81,462,712 in initial investments and $25,643,483 in charitable contributions and scholarships to the Territory.

As noted, wide gaps of time had transpired between compliance reviews for some beneficiaries. In addition, for others, it had taken several years for the EDC to conduct first-time compliance reviews. All of the first-time reviews were the only ones that had been performed for the beneficiaries as of the fieldwork stage of the audit. Of the 48 beneficiaries analyzed, we found that the intervals between compliance reviews for 23 ranged from 3 to 9 years, with the reviews for 12 of the 23 being 5 to 9 years apart. The reviews for the other 11 were 3 or 4 years apart. The remaining 25 of the 48 beneficiaries had received only one review since the issuances of their certificates. These reviews had occurred from 10 to 15 years after the certificate issuances for 3, from 4 to 8 years after the certificate issuances for 13, and from 1 to 3 years after the certificate issuances for 9.

The beneficiaries' infrequent compliance reviews were in part attributable to the EDC not adequately prioritizing its monitoring based on available staffing and not having written policies and procedures that covered key aspects of the compliance review process. These findings are discussed later in this section.

<u>Compliance Environment</u>

The EDC's infrequent compliance reviews did not promote an environment of ongoing compliance. The scope of some reviews covered distant years in the past and excluded more recent ones. This meant that compliance violations were not always readily detectable and addressed. As a result, the EDC was at a disadvantage in enforcing certificate requirements. For instance, an April 4, 2011 compliance report showed that the review scope covered the period of January 1, 2003 to December 31, 2004. The review found that the beneficiary had not met the terms of its certificates regarding investment, reporting, and other requirements. Specifically, the Compliance report indicated that the beneficiary had under invested in its business or industry in the territory by $16,355. In addition, the beneficiary had been delinquent in its reporting by as many as 6 years. In a letter response dated May 25, 2011, the beneficiary informed the EDC that it disagreed with the findings and gave the reasons for its position. The EDC was at a disadvantage in enforcing the certificate requirements because at the time of the completion of the compliance review the beneficiary was no longer operating in the territory and no longer an EDC beneficiary. In the letter response, the beneficiary indicated that its operations had ended in the territory on December 31, 2004, about 6 ½ years prior to the compliance report date of April 4, 2011. However, provided documents revealed that the beneficiary was not officially approved for termination as an EDC company until October 15, 2009. In resolving the issues of noncompliance, the Board decided to withdraw the findings that the beneficiary did not comply with investment requirements. In addition, regarding reporting, employment, and other violations, the Board required that the beneficiary contribute $7,500 to the University of the

Virgin Islands and two EDC funds, the Industrial Promotion Fund and the Territorial Scholarship Fund. The contribution was split evenly among the three.

In another example, the EDC compliance review spanned 15 years, from 1992 to 2006. The Compliance report was dated February 17, 2009. Among other things, the review found that the beneficiary failed to meet procurement requirements for 1993, 1994, and 1996. Specifically, the EDC asserted that the beneficiary did not provide documentary evidence that bids had been solicited for Virgin Islands purchases to show that full and equal competition was given to all suppliers. According to financial records, reported capital and other expenditures, to include goods and services, totaled as much $19,893,416 for those years. In a written response dated April 1, 2009, the beneficiary requested a waiver on the basis that it could not readily retrieve documentation to address findings raised in the report due to the length of time that had passed. In response, on July 9, 2009, the Board decided to find the beneficiary in compliance for 1994 and grant waivers for 1993 and 1996. Expenditures for the years for which waivers were granted totaled $3,359,964.

The infrequent compliance reviews inherently contributed to the lengthy review coverage periods. Although resolutions were reached to address stated violations, the EDC's leverage over enforcing certificate terms and other requirements was diminished due to the infrequent reviews. By compromising with beneficiaries to settle noncompliance, the Virgin Islands economy does not benefit fully from the EDC program because beneficiaries are no longer required to comply with the original terms of their certificate agreements.

<u>Compliance Review Findings</u>

Of the 48 beneficiaries for which compliance reviews were provided, 28 or more than half were found not in compliance with the terms of their certificates by the EDC. Noncompliance was found in a variety of areas, some of which included not meeting requirements for charitable contributions, investments, procurement, residency, employment, and reporting. The table below shows the types of certificate compliance requirements and the number of beneficiaries that were noncompliant in those areas. Some beneficiaries were linked to multiple violations.

Types of Compliance Requirements	No. of Non-compliant Beneficiaries
Charitable Contributions/Scholarships	16
Investments	4
Procurement	8
Reporting	6
Employment/Residency/Retirement	9
Internship	7

Charitable Contributions/Scholarships. The 16 beneficiaries found not compliant with their charitable contributions and scholarships obligations were collectively required to contribute no less than $1,913,550. Based on the provided compliance reports, the EDC determined they had unmet charitable and scholarship obligations totaling at least $903,865, almost half of the required total amount. As of the fieldwork phase of our audit, about $614,474 of the unmet obligations had not yet been resolved by the beneficiaries coming into compliance.

Of greater significance is the fact that over $500,000 of the unresolved unmet charitable obligations were attributed to 4 of the 16 beneficiaries, yet these 4 beneficiaries received tax benefits of over $87 million. In addition, when compared to other beneficiaries, they contributed less to the Territory when their respective cost/benefit analysis ratios are compared. According to the cost/benefit analysis cited in their compliance reviews, on average, they contributed only $54,000 for every $100,000 they received. We saw no evidence that the EDC made any demands on these beneficiaries to rectify their non-compliance within a specified deadline.

Another beneficiary who failed to contribute $97,000 in charitable contributions had received $2.5 million in tax benefits. And although they provided about $300,000 for every $100,000 in tax benefits they received this was significantly less than what many other beneficiaries contributed to the Territory.

Investments. The 4 beneficiaries found not in compliance with investment requirements were supposed to invest a combined minimum of $1,415,000 in the development of their industry or business in the Territory, not including inventory. The EDC determined that they had under invested by at least $320,691. In addressing the investment non-compliances, the Board waived or rescinded the findings for 2 of the beneficiaries, and approved a payment plan for another. As of the fieldwork phase, the Board had informed the remaining beneficiary that it was not compliant with its investment requirement and would be held responsible for continued noncompliance. However, no demand was made to rectify the noncompliance within a specified time as of the time of our review. The unmet investment obligation for that beneficiary totaled $43,530. This beneficiary received tax benefits of over $5 million and contributed only $79,000 for every $100,000 in tax benefits they received.

Procurement. The procurement requirements are designed to promote the economy of the territory through beneficiaries' primary acquisition of goods and services from local suppliers, unless otherwise justified. They allow for full and equal competition among local suppliers. The 8 beneficiaries with findings for procurement noncompliance collectively had capital and goods and services expenditures totaling at least $291,492,277. Based on the provided compliance reports, the EDC determined that 7 of the beneficiaries had not provided proof of competitive bidding or solicitation for procurements above specific threshold amounts in certain years. The other had not provided sufficient information to the EDC about suppliers who received bid packages or procurement awards. During the years for which violations were cited the beneficiaries' procurement amounts totaled $126,288,297. The Board eventually resolved the noncompliance for all 8 beneficiaries. For 4 of the 8, the Board either granted waivers or reached a settlement with the beneficiaries to bring them into compliance for the years they were deemed in violation of the requirements. Three of these beneficiaries contributed only between $24,000 and $140,000 for every $100,000 in tax exemptions they received. The fourth beneficiary contributed over $1.4 million for every $100,000. For the other 4, fines were issued totaling $92,980.

Reporting. The 6 beneficiaries with reporting violations were found noncompliant in filing various reports with the EDC in a timely manner. All 6 were delinquent in providing documentary proof that they had published supplier notices to Virgin Islands businesses in local newspapers. The notices publicly provide an opportunity for eligible local businesses to become suppliers of good and services for EDC beneficiaries. Two (2) of the 6 were delinquent in submitting their EDC Annual Reports. In addition, either had not provided documentary evidence that certain annual and quarterly reports had been filed with the Lieutenant Governor's office and Virgin Islands Department of Labor as required by law. We found that the reporting delinquencies to the EDC for 3 of the 6 beneficiaries dated back 5 to 7½ years. As of the fieldwork phase of the audit, the EDC had resolved the reporting violations for 4 of the 6 beneficiaries by granting a waiver or issuing fines or penalties totaling $3,913. For the remaining 2, the EDC had informed them that they had to come into compliance with reporting requirements and would be held responsible for continued noncompliance. At least 3 of the beneficiaries who were negligent in submitting the required reports received in excess of $30 million in tax exemptions and contributed only about $150,000 each for every $100,000 in tax exemptions received compared to others who contributed as much as $4.2 million per $100,000.

Employment Related Findings. Eligibility for EDC benefits requires that businesses meet certain conditions regarding employment. Certificate agreements may call for businesses to employ a minimum number of fulltime employees within a certain period of the commencement of receiving benefits. In addition, at least 80% of all the employees must be Virgin Islands residents, in accordance with Title 29, Section 711 of the Code. Certificate agreements may also require that businesses provide retirement and insurance benefits to employees, as well as offer internship opportunities to students and residents. According to an EDC official, the most prevalent noncompliance findings are employment related issues. Beneficiaries may neglect to hire the required amount of Virgin Islands residents based on the total employees. For instance, the certificate of agreements for 3 of the 9 beneficiaries with employment related findings (not to include internship issues) were collectively supposed to hire a minimum of 18 Virgin Islands residents based on the total employees. The EDC found that they had only employed 13 residents. One beneficiary hired only 4 when it should have hired a minimum of 7. The compliance reports showed that the residency hiring violations dated back to 2003.

As it related to the employment of all fulltime employees regardless of residency, 3 of the 9 were found in violation of this requirement. Collectively, they were required to hire a minimum of 34 fulltime employees, but only hired a total of 16. Regarding the offering of retirement and insurance benefits, 4 of the 9 were found to be noncompliant, with 3 not providing at least one of the benefits to any of their employees, while the other provided retirement benefits to only some of its employees. The Board addressed the violations for the 9 beneficiaries by issuing penalties totaling $337,031 to 5 and granting waivers or reprieves[8] to four. One of the 9 beneficiaries hired only an average of 4 employees when it should have hired 10 and failed to provide retirement benefits for its employees. This beneficiary was penalized $312,304 and terminated. It is significant to note that this beneficiary received over $17 million in tax exemptions and contributed only about $120,000 for every $100,000 in tax exemptions they received.

Internship. As noted in the table on page 32, 7 beneficiaries were found in violation of their internship requirements. Six were required to employ a minimum of 35 interns but only employed 16. Four of the 6, whose review scope dated as far back as 2002, were issued penalties totaling $34,800. The other two were either granted a waiver or deemed non-compliant by the Board without further action being implemented as of the fieldwork phase. The seventh beneficiary had a different arrangement. It was required to hire interns during holidays and peak industry seasons. The agreement did not require that a specified number of interns be hired. The EDC found that over a five-year period, from 2003 to 2007, there were only 2 years in which the requirement was observed. The Board addressed the violation by granting a reprieve.

Two of the beneficiaries who violated their internship requirement to hire a total of 4 interns together received over $6 million in tax exemptions and contributed less than $100,000 each for every $100,000 they received.

Monitoring Efficiency

The EDC did not adequately prioritize the monitoring of beneficiaries based on available staffing. Despite staffing limitations, the coverage periods for compliance reviews were usually extensive, covering as many as 15 years of business activities per review. This limited the number of compliance reviews that could be completed yearly and meant that the current compliance statuses of a number of beneficiaries were not readily known.

During Fiscal Years 2009 through 2011, the EDC Compliance Division comprised a staff of six, which included the Director of Compliance and five compliance officers. The division was responsible for overseeing the compliance of 109 EDC beneficiaries in Fiscal Year 2009 and 93 EDC beneficiaries in Fiscal Years 2010 and 2011. According to an EDC official, the Division was understaffed. For each beneficiary, the compliance review process could take a minimum of 6 weeks for every year of review. The length of the review process placed limitations on the number of reviews the staff could complete yearly. Consequently, the Division attempted to review about 30% of the universe of EDC beneficiaries annually, with a goal not to go beyond a 5-year review cycle for each beneficiary. For Fiscal Years 2009, 2010, and 2011, records showed that the Division completed compliance reviews for only 24, 11, and 14 beneficiaries, respectively. Considering the universe of beneficiaries in the respective years, no more than 23%, 12% and 15% of the beneficiaries had completed compliance reviews.

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8 Reprieves are decisions by the Board not to impose penalties or not to require that certificate obligations be met based on certain considerations.

Compliance Review Scopes. Our audit found that a predominant contributing factor to the monitoring inefficiency was the extensive scope or coverage periods set for compliance reviews in relation to the number of beneficiaries and available staff. An EDC official indicated that the Division, established in 2002, was required to ensure beneficiaries' compliance over the life of their certificate agreements. This resulted in Division staff reviewing several years of beneficiaries' business activities at one time. As noted, the EDC performed infrequent reviews, with some beneficiaries receiving only one review years after the issuance of their certificates. This was the primary reason the review coverage periods were so extensive. However, dedicating the limited staff to the prolonged reviews restricted the number of beneficiaries that could be reviewed yearly. This restriction resulted in the EDC not knowing the current compliance statuses of a large percentage of the beneficiaries. For instance, a compliance review completed in Fiscal Year 2009 had a coverage period from 1992 to 2006, a span of 15 years. Considering the February 17, 2009 completion date of the compliance report, the review went back 17 years. As noted, for Fiscal Year 2011, the Division completed compliance reviews for only 14 or 15% of the 93 beneficiaries. This meant that the EDC did not know the compliance statuses for 79 or 85% of the beneficiaries over the fiscal year.

Although we are not advocating that the entire universe of beneficiaries could have been reviewed over the course of the year, we are advocating optimizing the review process through more efficient use of staff hours. For each review, the scope's time period should be narrowed and cover more recent years. The scope should be expanded to address additional years only after the EDC has greater control over the review process and knows the current compliance statuses of a wider population of the beneficiaries.

Terminated Beneficiaries. The monitoring inefficiencies were evident by the EDC's inability to determine the compliance statuses of some beneficiaries before their requests for termination of benefits were approved by the Board. Even in instances where the review completion date preceded the Board's decision, recent years of the beneficiaries' business activities were not always included in the reviews. Of the 48 beneficiaries for which reports were provided, 7 had voluntarily requested termination of their certificate agreements during the audit scope period. The Board had approved the termination requests for 4 of the 7 before the compliance reviews had been initiated or completed. In 3 of the 4 instances, the completion dates of the compliance reviews ranged from just over 1 year to almost 2½ years after the decision of the Board. This practice put the EDC at a disadvantage in enforcing certificate requirements because reported discovery of violations occurred after the approval dates of the Board. In at least one instance, the beneficiary had already ceased operations in the territory almost 5 years before the Board had rendered its decision, and the subsequent compliance review had been completed. Review findings included investment, residency, and reporting violations, which were disputed by the former beneficiary. In resolving the matter, the Board decided to allow the former beneficiary to make contributions of about half of the required unmet investment amount. The inefficiency in the process is that the Board approved the former beneficiary's request for termination and then later had to address findings brought out in the subsequent compliance review. It would have been more advantageous for the Board to have already had the compliance review findings to use in determining whether to grant or deny the termination request.

Although the compliance reviews for 3 of the 7 beneficiaries were completed prior to the Board's decision, the reviews for 2 did not cover the most recent periods they were EDC beneficiaries. For instance, records show that the review coverage period for one of the beneficiaries ranged from January 1, 2004 to December 31, 2007 while its termination effective date was July 30, 2010. Although more than 1½ years of recent business activity had not been covered by the review, the Board approved the termination request on May 4, 2010 (See Beneficiary E in the below table). For the third beneficiary, although the compliance review covered up to the beneficiary's termination date, it took the Board three years to make a decision regarding the termination status after the review (See Beneficiary G in the below table).

The following table shows details related to the 7 beneficiaries which had voluntarily requested termination of their certificate agreements.

Beneficiaries	Board Approval Date	Effective Termination Date	Compliance Report Date	Review Coverage Period	Comments
A	10/09/08	6/26/07	3/30/11	9/1/03 – 6/30/07	*Review completed almost 2 ½ years after Board's approval.*
B	10/15/09	6/30/05	3/30/11	1/1/03 – 12/31/04	*Review completed almost 1 ½ years after Board's approval. It did not include 1/1/05 – 6/30/05*
C	1/21/10	12/31/09	4/12/11	1/1/08 – 12/31/09	*Review completed more than 1 year after Board's approval*
D	5/28/09	4/15/09	9/30/09	1/1/05 – 12/31/07	*Review completed 4 months after Board's approval. It did not include 1/1/08 – 4/15/09*
E	5/04/10	7/30/10	4/28/10	1/1/04 – 12/31/07	*Review did not include 1/1/08 – 7/30/10.*
F	10/15/09	6/3/08	9/30/09	11/1/02 – 12/31/07	*Review did not include 1/01/08 – 6/02/08*
G	12/13/13	12/31/06	12/21/10	10/1/04 – 12/31/06	*Board's decision was made 3 years after review*

The table shows that 6 of the 7 beneficiaries' effective termination dates preceded the Board's approval dates. At the time of their voluntary request for termination of benefits, the beneficiaries either had already ceased doing business in the territory or had already been approved for suspension of benefits, a classification that provides beneficiaries temporary release from certificate requirements. As a result of these and other factors, the Board approved the termination dates for the earlier periods.

<u>Policies and Procedures</u>

Title 29, Section 705 of the Code authorizes the Board to create rules and regulations necessary to implement the powers and duties afforded it under the law. This provision allows the Board to document in writing policies and procedures that have been established to help ensure beneficiaries' compliance with certificate requirements. We found that the EDC's policies and procedures did not sufficiently address the compliance review process. We are specifically referring to the set of written internal policies and procedures used by the Division to standardize and conduct compliance reviews. For instance, an EDC official informed us that beneficiaries' compliance is reviewable after one year of receiving benefits. However, priority is given to beneficiaries that have received benefits for three or more years after initially receiving benefits or after their last review. The provided policies and procedures did not include guidance that addressed the frequency of reviews and the criteria used for prioritizing reviews. In addition, they did not include criteria to aid in determining and monitoring the length of the compliance review process. This was in contrast to application processing guidelines which more specifically outlined timetables for completing various phases of the process.

EDC Annual Reports

The EDC did not always ensure that beneficiaries submitted their EDC annual reports in a timely manner. For the periods reviewed, beneficiaries had filed reports with the EDC as many as 18 months late or had not filed reports as of the fieldwork phase of the audit. As part of our audit, we selected a judgmental sample of 42 beneficiaries to determine the timeliness of their reporting during Fiscal Years 2009 and 2010 of the audit scope period. We did not review the timeliness of reporting for Fiscal Year 2011 since the annual reports for that period were due at varying times during our 2012 fieldwork. Of the 42 beneficiaries comprising our sample, 20 were linked to late or outstanding reports. Of the 20, reporting exceptions existed for 15 for both Fiscal Years 2009 and 2010. Thirteen (13) of the 15 had submitted their reports from 1½ to 18 months late or had not submitted any reports for either fiscal years. Two (2) of the 15 had not submitted any reports for both years. The remaining 5 of the 20 beneficiaries had reporting violations for only one of the fiscal years. All 5 had submitted their reports from 1 to 6 months after the respective due dates.

According to EDC officials, most of the reporting delays were due to beneficiaries awaiting audited financial statements which accompany the submission of annual reports. Despite this, the EDC is tasked with ensuring compliance with reporting requirements. We found that the EDC did not adequately implement the enforcement provisions afforded it under the law. Based on provided documents, none of the 20 beneficiaries with reporting exceptions were assessed the required fines for submitting annual reports late or not reporting. According to the certificate agreements, the 20 beneficiaries potentially represented $37 million in investments and 555 jobs to the territory. One beneficiary, which was linked to an outstanding 2010 report, represented a potential investment of $3.2 million and the creation of 22 jobs. The timely submission of annual reports provides information to the EDC for readily determining beneficiaries' compliance with certificate requirements and measuring the economic impact of the EDC program on the Territory's economy.

Recommendations

We recommend that the Board:

1. Implement measures to reduce the scopes of compliance reviews to shorter, manageable time periods and ensure that they cover more recent years in an effort to better prioritize the monitoring of beneficiaries based on available staffing.

2. Make final determinations on beneficiaries' requests for terminations or suspensions after the completion of compliance reviews.

3. Establish formal written policies and procedures that sufficiently address the internal practices adopted by the EDC for governing the compliance review process.

4. Direct the Chief Executive Officer to provide the necessary oversight required to ensure that beneficiaries adhere to reporting requirements.

Economic Development Authority's Response

The Authority acknowledged that deficiencies existed in the compliance process. However, most of the deficiencies had been resolved through the establishment and implementation of plans, policies, and procedures. A challenge faced by the agency was that the Compliance Unit, which was not established until 2002, had a large backlog of comprehensive compliance reviews it was required to do. This backlog consisted of performing reviews for not only existing beneficiaries, but also new beneficiaries.

The Authority agreed with all the recommendations. Regarding Recommendation 1, it stated, "Procedures are in place which place priority on current beneficiary reviews, with a goal of reducing the review period to two year." For Recommendation 2, the following was stated, "Current procedure provides the Board with a complete compliance review so that they can make an informed decision as to a requested termination or suspension." In response to Recommendation 3, the Authority indicated that the Compliance Unit has standard operating procedures that will be incorporated into a comprehensive policy. In addressing Recommendation 4, the agency stated, "There currently is oversight and fines and penalties are established for non-compliance." It added that "only the Board…can order the fines and/or penalties."

For all the recommendations, the Authority indicated that the EDC had already started implementing corrective measures to address the findings during the audit. Some were implemented starting in Fiscal Year 2013. The completion of the implementation for others would occur no later than Fiscal Year 2015.

V.I. Inspector General's Comments

We are pleased that the EDC started initiating corrective actions to address findings we informed them of during the audit. We consider the measures taken to be acceptable. However, to satisfy the recommendations, we require copies of revised plans, policies, and procedures and documentary evidence confirming adequate implementation of the compliance monitoring corrective measures.

FINDING 4: REPORTING TO REGULATORY AGENCIES

The EDC did not always promptly inform regulatory agencies of changes in the certificate statuses of beneficiaries. We attributed this condition to the EDC not having adequate follow-through policies and procedures for providing timely notification to the agencies. As a result, beneficiaries potentially could have continued to receive economic benefits although their certificates were in suspension or termination status.

Background

Section 705-1 of the Rules and Regulations requires the EDC to notify regulatory agencies concerning businesses that have been approved by the Board to receive economic development benefits. Notice must be provided within sixty (60) days of the approval date to the Office of Lieutenant Governor, Virgin Islands Bureau of Internal Revenue, Virgin Islands Office of the Tax Assessor, U.S. Customs and Border Protection, Virgin Islands Department of Labor, and other federal and territorial government agencies as considered necessary by the EDC. In addition, an annual listing must be prepared and submitted of all businesses approved for benefits, whether they are currently operational or not.

Neither the Code nor the Rules and Regulations have written policies and procedures for reporting to applicable regulatory agencies changes in the statuses of beneficiaries whose certificates have been suspended or terminated. The EDC, however, has adopted the practice of providing written notification to the regulatory agencies regarding such changes in beneficiaries' certificates. The purpose is to help ensure that businesses whose certificates are in suspension or termination status no longer receive EDC benefits. The notification letters request that the agencies update their records to help provide assurance that benefits are not granted to ineligible businesses. No specific timeframe was given for notifying regulatory agencies after certificate suspensions or terminations.

The suspension or termination of benefits may be voluntary or involuntary. Beneficiaries may voluntarily request that their benefits be suspended or postponed for a specific period of time, which provides a temporary release from certificate requirements. Additionally, if beneficiaries wish to end their certificate agreements with the EDC, they may request a voluntary termination of their certificates. Such changes in the statuses of beneficiaries' certificates must be approved by the Board and may have effective dates of approval prior to official request dates. The option of approving the suspension or termination of certificates on a retroactive basis may be considered if beneficiaries' businesses closed or ceased operations in the Territory prior to their requests.

Suspension and Termination Petitions

The EDC did not always provide timely notification to regulatory agencies regarding beneficiaries who had their benefits suspended or terminiated. During Fiscal Years 2009 through 2011, the Board had approved suspension or termination requests for 25 beneficiaries. As part of our audit, we requested supporting documents to determine if regulatory agencies were notified of the beneficiaries' suspensions or terminations. We received supporting documentation for only 19 of the beneficiaries. Based on the records, notification for the 19 beneficiaries was sent to regulatory agencies from at least 4 to 20 months after the approval dates of changes in the certificate statuses. The notification letters to the various agencies each listed all 19 beneficiaries and were all dated November 5, 2010. The below table shows the estimated length of time it took for the EDC to notify the agencies regarding each beneficiary based on the Board's approval dates and the notification letters' date of November 5, 2010.

Beneficiaries	Board's Approval Dates for Certificate Changes	Number of months to Notify Agencies*
A	3/5/09	20
B	4/27/09	18
C	5/28/09	17
D	5/28/09	17
E	7/9/09	16
F	10/15/09	12
G	10/15/09	12
H	10/15/09	12
I	10/15/09	12
J	10/15/09	12
K	10/15/09	12
L	10/15/09	12
M	11/12/09	12
N	11/12/09	12
O	11/12/09	12
P	12/17/09	11
Q	1/21/10	9
R	5/4/10	6
S	7/8/10	4

*Notification letters were all dated November 5, 2010.

The delayed notifications made the EDC program susceptible to beneficiaries potentially receiving benefits during periods of ineligibility or after they had ended their certificate agreements. For instance, Beneficiary A was granted temporary release from the requirements of its certificate agreement for the period January 1, 2008 to December 31, 2009. As shown, the EDC did not notify regulatory agencies until 20 months after the March 5, 2009 approval date. By the time notice was sent to the agencies, the suspension period had already expired by more than 10 months. Similarly, Beneficiary B was granted a suspension of benefits on April 27, 2009 for the period January 1, 2009 to December 31, 2009. By the time regulatory agencies had been notified about the beneficiary's suspension some 18 months later, it had also expired more than

10 months earlier. Other examples of delayed notification included certificate terminations for Beneficiaries D and E. The Board approved their termination requests on May 28, 2009 and July 9, 2009, respectively. However, as shown, it took about 17 and 16 months to notify the agencies about the Board's actions on the certificates.

Notification Policies and Procedures

EDC officials stated that the majority of the businesses granted termination had already resolved or closed their businesses as of the dates of the Board's actions. As a result, they would not have been able to continue to have received benefits. However, to reduce the potential risk of breaches occurring and help ensure the integrity of the program, prompt notifications must be given to regulatory agencies. In addition, the EDC must establish and implement written rules and procedures for notifying regulatory agencies after beneficiaries' benefits have been suspended or terminated. Just as the Rules and Regulations require notification be given to the agencies within 60 days of beneficiaries' approval for benefits, written rules should be established requiring the that EDC notify the agencies within a reasonable time of the approval dates of beneficiaries' certificate suspensions or terminations.

Recommendations

We recommend that the Board:

1. Direct the Chief Executive Officer to promptly notify regulatory agencies after beneficiaries' petitions have been granted for suspension and termination of benefits.

2. Establish written policies and procedures requiring that the EDC notify regulatory agencies within a reasonable time of granting beneficiaries' petitions for suspension and termination of benefits.

3. Establish open lines of communications and cooperation with all Government agencies to ensure timely information on beneficiary status and compliance.

Economic Development Authority's Response

In response to Recommendation 1, the Authority acknowledged that the EDC had not at times promptly informed regulatory agencies of changes in the certificate statuses of beneficiaries. However, it stated that the EDC has adopted the practice of notifying the regulatory agencies in writing about such changes. In addition, the EDC has a taskforce that meets routinely to discuss EDC issues. An updated listing of all active beneficiaries is shared with members of the Task Force, which comprise all applicable regulatory agencies. The response also indicated that since Fiscal Year 2013, the Authority provides copies of all compliance reviews completed during the fiscal year to the VI Bureau of Internal Revenue.

Regarding Recommendation 2, the Authority stated that the referenced adopted practice "has been codified in operating procedures and will be incorporated into a comprehensive policy."

The Authority did not issue a response to Recommendation 3, which was included in the official draft but not the preliminary draft. As noted, the Authority's responses primarily addressed the preliminary draft.

V.I. Inspector General's Comments

Although concurrence or non-concurrence was not indicated for Recommendations 1 and 2, there was implied agreement with the recommendations and related findings. Based on the actions taken, we consider the two recommendations resolved. However, we require copies of the updated operating procedures and the "comprehensive policy" manual.

As noted, the Authority did not issue a response to Recommendation 3. However, some answers were provided for Recommendation 3 in the responses given for Recommendation 1. For instance, the Authority indicated that the EDC taskforce meets regularly to discuss matters related to the EDC program. In addition, since Fiscal Year 2013, the EDC has been providing the VI Bureau of Internal Revenue with copies of all compliance reviews completed during the fiscal year. As it relates to the taskforce meetings, the agency did not indicate how often the taskforce meets. We believe that this is an important detail. To resolve the Recommendation 3, we require documentation confirming adequate implementation of the corrective measures.

FINDING 5: APPLICATION PROCESS

The EDC did not exercise adequate control to ensure the expeditious and timely movement of the application process. Specifically, we found that the EDC (i) did not consistently adhere to the time requirements for the various phases of the application process, (ii) did not adequately monitor the collection of information needed to process applications for economic development benefits, and (iii) did not always process applications in an organized and systematic manner.

We attributed these conditions to the EDC's failure to adequately move applications through key points of the application and decision-making process. As a result, the application process was not always effectively used as a means to facilitate economic growth in the Territory.

Background

The mission of the EDC's Application Unit is to facilitate economic growth and development in the Territory. The unit is primarily responsible for accepting and processing applications from businesses that apply for economic development benefits. Upon acceptance of an application, Section 716-5 of the Rules and Regulations authorizes the EDC's CEO to conduct investigations and inquiries as deemed necessary. Investigation findings and recommendations are documented in the evaluation report which accompanies the application to the Board in preparation for a public hearing. According to Section 717-103 of the Rules and Regulations, a public hearing must be held 75 calendar days (2 ½ months) after the application has been accepted as complete. The public hearing affords the applicant an opportunity to make oral presentations before the Board, as well as to answer inquiries and provide additional information as requested.

Section 717-302 of the Rules and Regulations requires the Board to meet to make its decision on an application within 45 calendar days (1 ½ months) of the following two dates, whichever occurs later: (1) the date of the public hearing, or (2) the date by which requested additional information was provided by the applicant and accepted as complete by the CEO. If the Board is unable to reach a decision, another meeting must be scheduled within a month. If an application is approved, the EDC is required to notify the Governor and the applicant within 10 days after receipt of the transcript of the decision meeting. Transcripts are to be prepared within 30 days after the meeting dates. If the application is denied, the Governor is not required to review the decision or finding.

The Rules and Regulations stipulate that upon receipt of the decision from the Board to grant economic development benefits, the Governor has 60 days, excluding Sundays and holidays (which could total up to 2½ months), to make a determination on the Board's decision. If the Governor does not make a determination within the specified period, the application will be considered approved, and the Board will proceed to issue the economic development certificate.

Provisions in the Rules and Regulations allow applicants and beneficiaries to petition the Board to reconsider decisions made regarding applications and certificates. A petition for reconsideration must be submitted by letter to the Board within 30 days from receiving the Board's decision. The Board can, on its own initiative, reconsider decisions made with respect to applications and certificates. The Rules and Regulations provide flexibility to the Board on the time by which to take action on reconsideration petitions or initiatives. A vote to reconsider a decision halts all applicable time limits. Except for the applicant's requirement to submit petitions for reconsideration within 30 days of receiving notification of the Board's decision, "…time limits for actions which must take place within a certain time following a public hearing or meeting at which a determination is made shall begin anew upon final action on the reconsideration." If the Board votes to reconsider a decision on an application, it has 45 calendar days from the date of the vote to take action on the reconsideration.

EDC officials informed us that the estimated application processing time, without request for reconsideration, is usually within 230 calendar days (about 8 months). If there is a request for reconsideration, the processing time should be within 305 calendar days (10 months) or more, depending upon the next scheduled meeting of the Board.

Monitoring of the Application Process

The EDC did not ensure timely movement of the application process for economic development benefits. Based on our sample results, applications were not always moved along key phases of the application process within the given time frames established by the Rules and Regulations. Delays occurred mostly during the Board decision phase. Provided documents showed that the EDC received 51 applications during Fiscal Years 2009 through 2011. The applications were submitted by new applicants or existing beneficiaries who had applied for certificate modifications or extensions. We limited our sample to 28 of the 51 applications. The 28 represented the applications for which the Board made determinations during the audit scope period. Of the 28, the Board approved 23 and denied 5. As noted, the Governor is not required to review applications denied by the Board. Of the 23 Board approved applications, 21 were forwarded to the Governor for a decision. Two were not forwarded because one had been voluntarily terminated by the beneficiary after the Board's approval and the other did not require a decision by the Governor due to basic adjustments to the terms of the original certificate. Of the 21 forwarded to the Governor, final determinations were made on 19. Four (4) of 19 had overall processing times ranging from 325 to 808 calendar days (or about 30 months or 2.5 years). This was from the point of their initial acceptance by the EDC to the point of the Governor's decision.

The following table details exceptions in the processing times of the 28 sampled applications through each phase of the application process. The required processing time for each phase is given in the top row of the table. As noted, a second decision meeting of the Board will be required if a decision was not reached during the initial Board meeting.

Beneficiaries	Public Hearing (75 days)	EDC Board Initial Meeting (45 days)	EDC Board Second Meeting (30 days)	Office of the Governor (90 days)
1	✓	✓		✓
2	✓	✓		✓
3	✓	✓		✓
4	✓	✓	83	✓
5	✓	75		✓
6	✓	112		✓
7	✓	105		✓
8	✓	✓	137	✓
9	✓	130		NA
10	✓	✓		NA
11	✓	✓		✓
12	✓	✓		✓
13	✓	✓		✓
14	252	✓		111
15	✓	114		✓
16	✓	✓		✓
17	✓	✓	248	✓
18	✓	✓		✓
19	✓	✓		✓
20	✓	56		✓
21	✓	✓	210	✓
22	✓	✓		NA
23	✓	✓		NA
24	90	97		NA
25	✓	72		NA
26	✓	✓		✓
27	✓	✓		✓
28	✓	167		NA

✓ Processed in required time
NA: Denied by the Board or was not required to be forwarded to Governor

Public Hearing. For 2 of the 28 applications in our sample, public hearings were not held within 75 calendar days of the applications' acceptance as required by the Rules and Regulations. The public hearings were held 90 and 252 (8.5 months) calendar days after the EDC had accepted the applications as complete for processing. The application for which it took 8.5 months to hold a public hearing was originally accepted as complete on August 26, 2009. The public hearing was not held until May 6, 2010 due to at least two postponements by the EDC in response to the applicant's rescheduling requests. The elapsed time between the application's date of acceptance and the date of the public hearing exceeded the entire estimated processing time from acceptance of the application to the final decision of the Governor. As noted, the estimated application processing time, without a petition of reconsideration by an applicant, is about 230 calendar days (or 8 months).

EDC Board. Sample results revealed that more occurrences of delays took place between the public hearing and the Board decision meetings. The initial Board decision meetings for 9 of the 28 applications were held from 56 to 167 days after the public hearing or, where applicable, after requested additional information was received and accepted by the EDC. The elapsed time for 6 of the 9 was more than 100 days. According to established criteria, the elapsed time should not exceed 45 days.

We also found instances of application processing delays where a second decision meeting was needed by the Board for 4 of the 28 applications in our sample. The second decision meetings for the 4 applications ranged from 83 to 248 days after the Board's initial meetings, with 1 exceeding 100 days and 2 exceeding 200 days. As noted, the Rules and Regulations state that the second meeting, if needed, must be held 30 days after the initial Board meeting.

We understand that the nature of the Economic Development Program requires that careful consideration and review be undertaken in processing applications for economic benefits and, to this end, unique circumstances may dictate the processing time of some applications. However, our audit found that certain delays were attributable to the EDC's inadequacy in moving applications along key points of the application and decision-making process, primarily at the Board decision point. At times, it appeared that the applicant controlled the process. For instance, it took 8 months – the length of time allotted for finalizing an application's processing through the Office of the Governor – for a beneficiary's application to reach the Board for a determination meeting on a certificate modification request. The beneficiary's application was accepted as complete on January 25, 2011 and the public hearing was held on April 14, 2011. However, the application did not reach the Board for the decision meeting until September 1, 2011. Based on minutes of the meeting, the Board's chairperson inquired of the EDC staff why the application package had taken so long to reach the Board for decision. The EDC staff responded, "…The applicant was submitting documents. We were negotiating back and forth on some terms." Further reference was made to the postponement of meetings due to full schedules.

In another example, the Board approved the application for a new applicant on July 8, 2010. On August 24, 2010 the EDC notified the beneficiary of the decision, stipulating that a response of acceptance concerning the proposed economic benefits was due by September 3, 2010. Based on provided documents, the applicant did not respond with a decision to the Board until October 14, 2010, 1 ½ months after the due date for the response. From the acceptance of the application to the point that it was approved by the governor took 406 calendar days (about 13 ½ months) to process. The applicant's delay in notifying the EDC contributed in part to delays in the application's overall processing time. Ultimately, the EDC is responsible for ensuring timely movement of the application along key points of the decision-making process.

Office of the Governor. Based on the criteria set for our sample, we found one instance in which the time allotted to the Governor to make decisions on applications after receiving them from the EDC was not met. After the application had been forwarded to the Governor's office, it took more than 100 days, excluding Sundays and holidays, for a final determination to be made on the application. The delay was in part due to the EDC's failure, during the initial application process, to ascertain the final disposition of legal matters involving the applicant. More is discussed on this in the below section entitled "Methodology of the Application Process."

Methodology of the Application Process

The EDC did not always process applications in an organized and systematic manner. Specifically, at times, the EDC moved applications through key phases of the application process without ensuring that prerequisite steps and information were completed and collected. For instance, for beneficiaries requesting extensions of benefits, the EDC tries to ensure that beneficiaries' compliance reviews are up-to-date before accepting applications as complete for processing. Compliance reviews help to ensure that beneficiaries have been compliant with the terms of their certificates.

In the case of one beneficiary who had applied for an extension of benefits, the application process was lengthy in part due to the EDC not completing the necessary compliance reviews prior to the application's acceptance for processing. The beneficiary's application was accepted as complete on January 29, 2009, and the public hearing was held on February 12, 2009. Based on provided documents, the Board did not meet within 45 calendar days of the hearing or receipt of additional information as required by the Rules and Regulations. The reason was that the EDC did not conduct the beneficiary's compliance review until March 30, 2010, which was more than a year after the date of the public hearing. On June 1, 2010, the Board held a decision meeting in which it tabled the beneficiary's petition for extension of benefits to address issues related to compliance review results. On August 26, 2010, the Board finally approved the beneficiary's application. However, we noted that during the lengthy application process the property tax benefits awarded the beneficiary had expired. Despite this, EDC records indicated that the beneficiary continued to receive real property tax benefits. The delays in processing the beneficiary's application were directly linked to the issue of untimely compliance reviews by the EDC. This issue is discussed in detail in Finding 3 of this report.

On April 16, 2009, an applicant filed an application with the EDC for economic benefits. In the application package, the applicant informed the EDC of past litigations or legal matters involving principals of the company. After almost 10 months of processing delays, the Board finally approved the application on July 8, 2010. After still further delays, the application reached the Office of the Governor for a decision on or about November 3, 2010. On January 4, 2011, the Governor's office requested, from the EDC, proof regarding the final disposition of the past litigations involving the principals. Based on provided documents, it took two months from the date of the request for the EDC to provide information that satisfied the Office of the Governor's inquiries regarding the matter. The Governor eventually approved the application on March 22, 2011, almost 2 years after the application was initially accepted as complete for processing.

We believe that information regarding the disposition of the past litigations or legal matters should have been readily available when the application was forwarded to the Governor's office, considering the length of time it took to process the application through the EDC. Ensuring a thorough, systematic processing of the application would have helped reduced its overall processing time.

Rules and Regulations

As stated, the Rules and Regulations require that the Board meet for its decision meeting on an application within 45 calendar days of the latter of either the date of the public hearing or the date of receipt and acceptance of additional information requested from the applicant. As it relates to requested information, a strict interpretation of the rules reveals that the starting date to determine the Board's decision meeting date does not begin until the applicant or beneficiary provides the information. This is potentially problematic in that the scheduling of the Board's decision meeting date could be prolonged if the EDC does not actively monitor collection of the additional information requested from the applicant or beneficiary. Provisions of the Rules and Regulations do allow the Board to set reasonable dates by which applicants are required to furnish information. The provisions also allow the EDC to withdraw applications from consideration for EDC benefits if the information is not supplied by the specified dates.

EDC officials have acknowledged deficiencies in monitoring the application process and have taken steps to streamline the process through the development of a February 25, 2011 Board Resolution. In addition, they have stated that they are currently drafting new standards of procedures to clarify and expedite the process. The Board Resolution limits the time a new applicant or beneficiary has to complete the application package to six (6) months after the date of initial filing with the EDC. If application package requirements remain incomplete beyond the specified period, the application will not be accepted for processing and will be removed from the list for active consideration for EDC benefits. Although the policy changes may help to provide a framework for improvement, the EDC must actively monitor the collection of documents to ensure the timely movement of applications through the process. This applies prior to and after the acceptance of an application as complete by the EDC.

Recommendations

We recommend that the Board:

1. Establish and implement policies and procedures designed to streamline the application process.

2. Ensure that the EDC management consistently and thoroughly monitors the collection of information requested from applicants through the various phases of the application process.

Economic Development Authority's Response

The Authority referred to the "Application Process" finding section as Finding 1 instead of Finding 5, as arranged in the official draft. It did not indicate whether it agreed or disagreed with the recommendations. Regarding Recommendation 1, it was stated that since 2011 policies and procedures have been implemented to streamline the application process. These policies and procedures include pre-application conferences, more frequent Board meetings, and more direct communication with applicants.

Similar responses were provided for Recommendation 2. Reference was made to the use of pre-application conferences to ensure the collection of all required documentation before approving an application as complete.

The Authority indicated that delays in the processing of some applications were due to requests from applicants to reschedule for various reasons. It added, "The existing time requirements work in the case of a perfect situation. It is important to note that there is a positive economic benefit of retaining an application versus recommending a denial for lack of information."

V.I. Inspector General's Comments

To resolve the two recommendations, we need copies of the updated policies and procedures developed to streamline the application process, including copies of policies and procedures that address the use of pre-application conferences and the revised schedule for Board meetings. In addition, we require documentation confirming adequate implementation of applicable corrective measures.

We must address a point expressed by the Authority related to delays in the processing of some applications. The agency indicated that delays were due to rescheduling requests by applicants for various reasons. It also stated, "It is important to note that there is a positive economic benefit of retaining an application versus recommending a denial for lack of information." In response to this statement we provide a quote from our audit report:

> "We understand that the nature of the Economic Development program requires that careful consideration and review be undertaken in processing applications for economic benefits and, to this end, unique circumstances may dictate the processing time of some applications. However, our audit found that certain delays were attributable to the EDC's inadequacy in moving applications along key points of the application and decision-making process, primarily at the Board decision point. At times, it appeared that the applicant controlled the process."

We emphasize that the EDC is ultimately responsible for ensuring timely movement of the application along key points of the application and decision making process.

ECONOMIC DEVELOPMENT AUTHORITY'S RESPONSE

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January 9, 2015

Steven van Beverhoudt, CFE, CGFM
V. I. Inspector General
Office of the V. I. Inspector General
2315 Kronprindsens Gade #75
St. Thomas, VI 00802-6468

Dear Mr. van Beverhoudt:

We are pleased to enclose our response to the final draft of the Economic Development Commission's (EDC) audit covering the period 2009 to 2011.

We thank you for addressing our requests for the audits as it has provided us the opportunity to look at deficiencies in processes, grey areas within V.I. Code Title 29 as they relate to the EDC Program Law, Rules and Regulations so we can implement improvements to identified weak areas.

We shall certainly use the findings as a work in progress while we continue to focus our efforts on economic development initiatives throughout the Territory which will result in increasing job opportunities, increasing the tax base and improving the standard of living for each resident of the Territory.

Best wishes to you and your staff for 2015.

Sincerely,

Percival E. Clouden
Chief Executive Officer

PEC:cvc

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VIRGIN ISLANDS ECONOMIC DEVELOPMENT COMMISSION

RESPONSE TO OIG 2009-2011 AUDIT REPORT

The Virgin Islands Economic Development Commission is committed to excellence and best practices. We recognize that change is inevitable and we must be open to adjust practices which have become out-dated, administratively cumbersome or are not efficient and effective anymore. We are constantly researching best practices and welcome constructive criticism and new ideas.

The Virgin Islands Economic Development Commission requested this audit in 2001 and again in 2007. We are pleased that it is finally here. The Office of the Inspector General's (OIG) audit report before us covers the period Fiscal Year 2009 through Fiscal Year 2011. While this is instructive as a history lesson it does not address measures which have been put in place since Fiscal Year 2011. The VIEDC also looks to our past performance to gauge how to better achieve our goals and fulfill our mission. As a result of our internal review of our practices and procedures we have implemented many changes and adjustments.

The Virgin Islands Economic Development Commission Tax Incentive Program is complex and ever adjusting to changing economic trends and competition from other jurisdictions. We appreciate the efforts of the Office of the Inspector General to gain an understanding of this program and understand how some items might be mis-interpreted by the OIG.

The report contains five (5) areas of findings: Finding 1: Application Process; Finding 2: Extension of EDC Benefits Award; Finding 3: Monitoring; Finding 4: Reporting to Regulatory Agencies; and Finding 5: Economic Impact.

Finding 1: Application Process

Finding: EDC did not consistently adhere to the time requirements for the various phases of the application process

Response: The EDC continues to implement process improvements to adhere to the time requirements of the program. We recognize the need to retain applicants in a competitive environment and work with potential applicants to ensure that we efficiently and effectively process applications timely. Having re-instituted pre-application meetings we have improved this process. In addition, meetings are now scheduled twice monthly to minimize the gap between receipt of information and the next scheduled date for consideration by the Board.

In some cases delays in the process time were due to request from the applicant to reschedule and/or requests from the EDC to the applicant to provide additional information so that staff and the Board can make an informed decision. The existing time

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requirements works in the case of a perfect situation. It is important to note that there is a positive economic benefit of retaining an application versus recommending a denial for lack of information.

It is important to note that the applicant is required to appear before the EDC Governing Board to orally present their application and answer questions. The public hearing also provides the opportunity for the public to speak in support or against the application. If the applicant is unavailable the benefit of having a public hearing will not be realized.

The processing time set forth in the Virgin Islands Rules & Regulations (VIRR) sets forth times subject to the need for additional information. However, this does not address requests of the applicant/beneficiary, and unforeseen circumstances, such as hurricanes, laws suits, deaths, etc.

As a response to extended time periods, the VIEDC has established a policy of conducting two (2) board meetings a month. The boards also have adopted the use of telephonic and video conferencing. Also the Applications Division conducts pre-application meetings with applicants to insure the applications when received are complete and clear.

Finding: EDC did not adequately monitor the collection of information needed to process applications for economic development benefits,

Response: EDC recognized that in some instances requests for information did not provide a response time to the applicant and in recommendations to the Board. Process improvements have been put in place to improve the monitoring and timely follow up on the collection of information. It is important to note that the Board Resolution 005-2011 was adopted on February 25, 2011 to encourage responsiveness by applicants and to provide a process for the EDC to remove incomplete applications or unresponsive applicants from pending items list.

Finding: EDC did not always process applications in an organized and systematic manner.

Response: The strict interpretation of the law did not indicate that the compliance review is required prior to the scheduling of the public hearing. However, it is now procedure to complete a compliance review prior to public hearings and Board meetings. As a part of our process improvements, staff specifically indicates a response time in request for information and in recommendations to the board that would allow for board

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GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

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OIG 2009-2011 Audit Report response

consideration of withdrawal of applications or to grant extensions of time for the applicants to respond. Specific timelines will be incorporated in the revised Standard Operating Procedures (SOP).

Applications Recommendations:

1. Establish and implement policies and procedures designed to streamline the application process.

   Since 2011 many policies and procedures have been implemented to streamline the application process, including the use of pre-application conferences, increased Board meetings and closer communication directly with the applicant.

2. Ensure that the EDC management consistently and thoroughly monitors the collection of information requested from applicants through the various phases of the application process.

   The VIEDC conducts pre-application conferences to ensure that all necessary documentation is received prior to determining the application complete. Thereafter there is constant communication between the VIEDC and the applicant.

Finding 2: Extension of EDC Benefits Award

Finding: EDC used rules and regulations that contradicted the Code regarding extension of benefits

Response: Act 3748 as enacted on September 23, 1975 allowed for benefits at no more than five years at 100 percent of benefits, (or 10 years at 50% of benefits, or proportionate gradations thereof, at the applicants option). The provisions under § 713a (b)(3) was amended by Act 6390 effective February 1, 2001, that allows for renewals or extensions at 10 years. The EDC Rules and Regulation was amended on December 22, 2004. Act 6748 enacted on September 1, 2005 in subsection (b), substituted "ninety (90%)" for "one hundred (100%)" and "forty (40%)" for "fifty (50%)".

The staff recommendation for grant of benefits is based upon the law, noting that this supersedes the Rules and Regulations. It is important to note that the law provided two options for extensions/renewals, namely Section 713 that allows for a renewal of benefits for 10 years and Section 715 of the 29 VIC allows for modifications, extensions or renewals for 5 years. A comprehensive review and update of the EDC Rules & Regulations will be completed to incorporate applicable polices relating to SOP and legislative amendments.

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Finding: In extending benefits, granted full benefits to beneficiaries not eligible to receive them at that level allowed under the law

Response: This finding is not accurate. Pursuant to 29 VIC § 713a(b)(3) , as amended by Act 6390 effective February 1, 2001, the EDC Governing Board voted to extend benefits for 10 years. The grant of benefits to extend the term of benefits from 5 to 10 years was made in accordance with 29 VIC § 713a (b) (3).

The EDC Governing Board also made decisions on two hotels on December 15, 2010 and February 24, 2011, respectively. At the time of application Act 7092 (effective September 11, 2009) amended 29 VIC § 713(b) exempting hotels of 100 rooms or less from the provision of that subsection. The grant of benefits to aforementioned hotels was made in accordance with this provision.

The reference to VIRR 714 on the "grant or denial of benefits form" does not relate to the provision for terms of benefits. It is generally used to define the type of applicant and/or the criteria for granting extensions or modifications.

Finding: Granted extensions of benefits in numbers and durations in excess of what was allowed under the law

Response: This finding is not accurate. EDC interpretation and application of VIC §715 (b) regarding no extension, modification or renewal of any exemption or subsidy benefit shall exceed an aggregate duration of more than five years at ninety (90%) percent of benefits, (or ten years at forty (40%) percent of benefits, or proportionate gradations thereof, at the applicant's option), is that the aggregate duration is applicable to the term of an extension, modification or renewal and does not restrict an applicant from applying for subsequent extension, modification, or renewal of benefits and the EDC from granting such.

Other Jurisdictions

Response: The Virgin Islands Economic Development Authority understands that the OIG has looked to other jurisdictions to try and understand the complex process of economic development in a highly competitive global market. However, if the OIG wishes to compare the Virgin Islands tax incentive program to other jurisdictions, it should do a complete comparison, not just with regard to extensions. Each jurisdiction has unique needs based upon its unique economy and demographics. The Virgin Islands Economic Development Commission is continually reviewing and researching other

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jurisdictions' tax incentive programs and making recommendations to our Legislature, to maintain the Virgin Islands' competitive advantage in the global competition for businesses.

Extension of EDC Benefits Award Recommendations

1. Update the EDC Rules and Regulations to be in conformance with provisions of the Code regarding extension of benefits.

   The Law was just changed again in November 2014 and changes are being incorporated into the revised Rules & Regulations.

2. Ensure that the Chief Executive Officer applies the required Code criteria for determining tax exemption amounts for extension of benefits.

   Under the recent change to the Law there is now only one (1) extension of ten (10) years allowed. This is designed to eliminate the conflicting provisions of the law which existed in the audit period of 2009 – 2011.

3. Follow the provisions of the Code limiting the number and duration of extension of benefits awards.

   Under the recent change to the Law there is now only one (1) extension of ten (10) years allowed. This is designed to eliminate the conflicting provisions of the law which existed in the audit period of 2009 – 2011.

Finding 3: Monitoring. We acknowledge that there have been deficiencies in the compliance process, most of which have been addressed. It must be noted that due to the fact that the Compliance Unit was not established until 2002 none of the existing beneficiaries had a comprehensive compliance review. As a result, a large backlog had to be brought up to date in addition to the review of new beneficiaries. Staff continues to receive training on compliance and ethics. We continue to be committed to consistent compliance and ethics training to reinforce compliance industry standards In addition, the compliance unit will continue to work with accounts payable staff to support their collection efforts and make recommendations to revise and refine procedures for EDC related transactions.

Compliance Monitoring Timeliness

Findings: Performed infrequent compliance reviews

Response: The unit has significantly decreased the number of current beneficiaries awaiting compliance reviews for extensive coverage periods. A procedure was implemented in FY 2013 to prioritize the reviews of active beneficiaries with pending petitions, then first time beneficiaries, then two-year anniversary dates. As of June 2014,

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the majority of the inactive beneficiaries have compliance reports through the date they ceased operations or the latest reporting year.

Compliance Environment

Findings: did not promote an environment of ongoing compliance

Response: A procedure was implemented in FY 2013 to ensure that the scope of the compliance reviews covered was through the date the beneficiary ceased operations or the most recent year of benefits (whichever was later). There has been an increase in site visits, which allow compliance officers to meet with beneficiaries to discuss matters in person and verify that they are actively engaged in the approved business activities. There is consistent and documented follow-up subsequent to cursory reviews of reports as they come in to ensure timely reporting and corrective action. This has resulted in a decline in the fines/penalties assessed for late reporting and an increase in having timely information to determine the compliance statuses of beneficiaries and timely resolution of non-compliance matters.

Compliance Review Findings

Findings: more than half of sampled reviews were non-compliant

Response: We acknowledge this finding.

Regarding unmet obligations not resolved during the period of the audit, we have reviewed the auditors' comments, and note that the following procedures were developed since FY 2013 to improve the situation

- If a response is received within the required 30 days, EDC staff requests that a petition for resolution of non-compliance matters be placed on the next available Board decision meeting agenda
- If no response to the compliance review is received within 60 days of sending it out, EDC staff requests that a petition for resolution of non-compliance matters be placed on the next available Board decision meeting agenda. This includes requesting that the Board issue a Notice to Show Cause and have the Beneficiary appear before the Board to present their case as to why their benefits should not be revoked, terminated, or suspended.

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We have taken steps to ensure that these matters of non-compliance are brought to the Board for resolution in a timely manner. Hence, since FY 2013 there has been an increase in petitions for resolution of non-compliance matters within the fiscal year that the compliance report was completed. We also note that employment violations are not the most prevalent non-compliance issue.

Charitable Contributions/Scholarships

Findings: unmet obligations were not yet resolved

Response: We have reviewed the auditors' comments, and have taken steps to ensure that these matters of non-compliance are brought to the Board for resolution in a timely manner. The following procedures were developed since FY 2013 to improve the situation:

- If a response is received within the required 30 days, EDC staff requests that a petition for resolution of non-compliance matters be placed on the next available Board decision meeting agenda.
- If no response to the compliance review is received within 60 days of sending it out, EDC staff requests that a petition for resolution of non-compliance matters be placed on the next available Board decision meeting agenda. This includes requesting that the Board issue a Notice to Show Cause and have the Beneficiary appear before the Board to present their case as to why their benefits should not be revoked, terminated, or suspended.

Investments

Findings: unmet obligations

Response: We have taken steps to ensure that these matters of non-compliance are brought to the Board for resolution in a timely manner. Hence, since FY 2013 there has been an increase in petitions for resolution of non-compliance matters within the fiscal year that the compliance report was completed.

Procurement

Findings: unmet obligations were not yet resolved

Response: We have taken steps to ensure that these matters of non-compliance are brought to the Board for resolution in a timely manner. Hence, since FY 2013 there has

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been an increase in petitions for resolution of non-compliance matters within the fiscal year that the compliance report was completed.

Reporting

Findings: unmet obligations were not yet resolved

Response: We have taken steps to ensure that these matters of non-compliance are brought to the Board for resolution in a timely manner. Hence, since FY 2013 there has been an increase in petitions for resolution of non-compliance matters within the fiscal year that the compliance report was completed.

Employment Related Findings

Findings: minimum full time requirement, residency, and internship violations were not yet resolved

Response: This is not the most prevalent non-compliance issue. We have taken steps to ensure that all matters of non-compliance are brought to the Board for resolution in a timely manner. Hence, since FY 2013 there has been an increase in petitions for resolution of non-compliance matters within the fiscal year that the compliance report was completed.

Monitoring Efficiency

Findings: did not adequately prioritize the monitoring of beneficiaries based on available staffing.

Response: Given the number of existing Beneficiaries, the current staff is able to handle the workload. We have also taken steps to ensure that we complete reviews for beneficiaries with extended review coverage periods or who have never had a review through the most recent reporting year. We also prioritized those beneficiaries who have petitions that require a Board decision. Processes and procedures were improved and since FY 2013, there has been a significant increase in compliance reports. As of June 2014, the majority of the inactive beneficiaries have compliance reports through the date they ceased operations.

Findings: length of review process placed limitations on the number of reviews staff completed annually.

Response: With additional procedures in place (e.g., cursory reviews of reports and timely corrective action, increased site visits), reports are timelier, and this in turn has

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decreased the length of time it has taken to complete a report due to not having documentation or clarification from the Beneficiary. The unit has also increased the number of compliance reports completed per fiscal year on current beneficiaries.

Compliance Review Scopes

Findings: a predominant contributing factor to the monitoring inefficiency was the extensive scope or coverage periods set for compliance reviews in relation to the number of beneficiaries and available staff; infrequent reviews.

Response: We have taken steps to ensure that we complete reviews for beneficiaries with extended review coverage periods or who have never had a review through the most recent reporting year. This allows the scope for future reports to be narrowed and ensures that EDC staff has greater control.

We also prioritize those beneficiaries who have petitions that require a Board decision. This has resulted in EDC staff knowing the compliance status of a large percentage of the current beneficiaries. Processes and procedures were improved and since FY 2013 there has been a significant increase in compliance reports. In addition, as of June 2014, the majority of the inactive beneficiaries have compliance reports through the date they ceased operations.

Terminated Beneficiaries

Findings: EDC is unable to determine the compliance statuses of some beneficiaries before their request for termination of benefits were approved by Board; reviews did not cover the most recent periods

Response: We have taken steps to ensure that we complete reviews through the most recent reporting year for beneficiaries requesting termination or suspension prior to a Board decision. This has allowed us to enforce certificate requirements and address non-compliance matters through Board decision prior to approval/denial of termination or suspension.

Policies And Procedures

Findings: the EDC's set of written internal policies and procedures used by the Division to standardize and conduct compliance reviews, didn't sufficiently address the compliance review process

Response: The following action has been taken to improve the situation and allow EDC staff to effectively enforce provisions for beneficiaries' reporting under the law:

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- We continue to document the unit's policies and procedures for our business processes, including the key aspects of the compliance review process (e.g., frequency of reviews, compliance review process timeline).
- We will consolidate this documentation into a SOP manual that will be available to all unit staff members via our shared drive.
- SOPs will be available for review by executive management no later than December 2014 and we anticipate implementation by the end of the first quarter of 2015.
- Revisions to the SOP manual will be made as needed to ensure the manual is current at all times. The staff will be advised of all revisions.

EDC Annual Reports

Findings: EDC did not always ensure that beneficiaries timely submitted their annual reports

Response: Since FY 2013, we have implemented a procedure that requires EDC staff to ensure the receipt of the reports no later than 31 days following the deadline date (penalties are assessed).

Auditor's recommendations to the Board:

- Implement measures to reduce the scopes of compliance reviews to shorter, manageable time periods and ensure that they cover more recent years in an effort to better prioritize the monitoring of beneficiaries based on available staff

  Response: We agree with this recommendation and had already implemented measures to do so.

- Make final determinations on beneficiaries' requests for terminations or suspensions after the completion of compliance reviews.

  Response: We agree with this recommendation and implemented measures in FY 2013 to do so.

- Establish formal written policies and procedures that sufficiently address the internal practices adopted by the EDC for governing the compliance review process

  Response: We agree with this recommendation and have implemented measures to do this no later than FY 2015.

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- Direct the Chief Executive Officer to provide necessary oversight required to ensure that beneficiaries adhere to reporting requirements

Response: We agree with this recommendation and believe that there is currently adequate staffing to oversee the current beneficiaries and ensure compliance with all program requirements.

Monitoring Recommendations

1. Implement measures to reduce the scopes of compliance reviews to shorter, manageable time periods and ensure that they cover more recent years in an effort to better prioritize the monitoring of beneficiaries based on available staffing.
   Procedures are in place which place priority on current beneficiary reviews, with a goal of reducing the review period to two years.
2. Make final determinations on beneficiaries' requests for terminations or suspensions after the completion of compliance reviews.
   Current procedure provides the Board with a complete compliance review so that they can make an informed decision as to a requested termination or suspension.
3. Establish formal written policies and procedures that sufficiently address the internal practices adopted by the EDC for governing the compliance review process.
   The VIEDC Compliance Unit has standard operating procedures and they are being incorporated into a comprehensive policy.
4. Direct the Chief Executive Officer to provide the necessary oversight required to ensure that beneficiaries adhere to reporting requirements.
   There currently is oversight and fines and penalties are established for non-compliance, however, only the Board, after review of the files, can order the fines and/or penalties, or issue an Order to Show Cause.

Finding 4: Reporting to Regulatory Agencies.

Finding: The EDC did not always promptly inform regulatory agencies of changes in the certificate statuses of beneficiaries.

Response: While this may have happened a few times during the audit period, the OIG does acknowledge: "The EDC, however, has adopted the practice of providing written notification to the regulatory agencies regarding such changes in beneficiaries' certificates." It must also be pointed out that the EDC has a taskforce whose membership is comprised of all regulatory agencies affected by the EDC program. The taskforce meets regularly to discuss EDC matters that arise and they are also provided with a

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beneficiary listing that is updated regularly to reflect the active companies. Additionally, since FY 2013, the VI Bureau of Internal Revenue receives copies all compliance reviews completed during the fiscal year.

Reporting to Regulatory Agencies Recommendations

1. Direct the Chief Executive Officer to promptly notify regulatory agencies after beneficiaries' petitions have been granted for suspension and termination of benefits.

   The EDC has adopted the practice of providing written notification to the regulatory agencies regarding such changes in beneficiaries' certificates. The EDC has a taskforce whose membership is comprised of all regulatory agencies affected by the EDC program. The taskforce meets regularly to discuss EDC matters that arise and they are also provided with a beneficiary listing that is updated regularly to reflect the active companies. Additionally, since FY 2013, the VI Bureau of Internal Revenue receives copies all compliance reviews completed during the fiscal year.

2. Establish written policies and procedures requiring that the EDC notify regulatory agencies within a reasonable time of granting beneficiaries' petitions for suspension and termination of benefits.

   The practice stated above has been codified in operating procedures and will be incorporated into a comprehensive policy.

Finding 5: Economic Impact

Finding: the Code and Rules and Regulations did not require the quantification and reporting of the overall economic and final impact of the EDC program on the Territory's economy.

Response: While the VIC and VIRR do not specifically require the quantification and reporting, as prudent management procedures and a fundamental of our agency, the EDC conducts an extensive cost/benefit ratio analysis of every applicant and the cumulative assessments are reported in the Virgin Islands Economic Development Authority's Annual Report. Further, it is the mission of the Bureau of Economic Research to collect and report on all economic activity in the Territory.

Finding: the EDC did not ensure that certain business types with a relatively low economic and fiscal impact on the Territory were held to a higher standard of participation and accountability.

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Response: We find this improper. The OIG would suggest that the EDC should ignore the Law. The Law sets forth the minimum requirements for receiving the tax incentives of the program. Each applicant is reviewed as an individual case and each certificate of benefits is unique to that beneficiary. The Virgin Islands is not the only jurisdiction with economic development incentives. The battle for businesses to relocate is global and the Virgin Islands must be competitive if our economy is to survive. The report acknowledges that the Territory is not giving up anything when a company relocates here because they were not paying taxes here before, but then negates this by recommending more stringent requirements and lesser benefits for the very companies that are the Virgin Islands' target market. To implement this recommendation would seriously hinder our marketing efforts and place the Virgin Islands in a weak position when compared to other jurisdictions, such as Puerto Rico, also trying to attract businesses.

In granting benefits, the staff, the Board, and the Governor each decide whether there is a benefit to the Territory's economy based upon qualitative factors, the ratio of benefits, direct and indirect expenditures, output and value added to the GTP in relation to the cost to the Territory. It would also be improper and discriminatory to hold different beneficiaries to different standards of compliance, not to mention the negative effect it would have on our position in the global economic development competition.

Economic Impact Recommendations

1. Request that the Virgin Islands Legislature institute a law requiring the EDC to quantify, on a regular basis, the tax incentive program's overall economic and fiscal impact on the Territory's economy for tax revenues forgone and report impact results to the Virgin Island Legislature and appropriate governmental authorities.

   The VIEDC issues an annual report which does quantify the achievements of the agency and the benefits to the Territory. The Bureau of Economic Research which is a semi-autonomous agency is charged with the analysis of economic impact to the Territory. Without sufficient funding the EDC does not have the resources to duplicate the responsibility of the BER. The VIEDA has made recommendations to incorporate the BER within the VIEDA.

2. Request that the Virgin Islands Legislature revise the Code allowing the EDC to grant benefits "up to 100%" to new beneficiaries, for the purpose of implementing a graduated scale approach in determining reduction amounts in tax liabilities, based on historical cost benefit trends for the various categories of businesses.

   The Legislature amended the EDC Law in November 2014. In this amendment the maximum level of benefits was set by the Legislature. It is the responsibility

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of the Board to determine if the grant of benefits is beneficial to the economic development of the Territory.

3. Establish and implement policies that encourage and require Category I and Category IIA beneficiaries to contribute more fully to the Territory's economy due to their low estimated cost benefit ratios.

   Under the current law category IIA beneficiaries are categorized as category IV. The Board has the power and has consistently imposed special conditions upon the granting of benefits which provide the Territory with a positive economic gain.

4. Establish and implement policies and procedures to efficiently obtain financial data from beneficiaries in order to conduct timely and accurate assessments of the tax incentive program's impact on the Territory.

   The VIEDA current policies require beneficiaries to submit reports to the VIEDC upon a set schedule. Failure to submit documents timely can result in fines.

CONCLUSION

This is not a corporate welfare program. The Virgin Islands Economic Development Commission is committed to being the finest Economic Development organization under the American flag. Through this program, the U.S. Virgin Islands becomes less dependent upon the resources of the federal government. A strong and vibrant program has a demonstrable link to a strong and sustainable Virgin Islands economy. We are constantly and consistently reviewing our policies and procedures against industry best practices. We are continuously reviewing the tax incentives we offer in relationship to the ever changing global competition for business relocation.

With our revised compliance policies we have become more proactive with our beneficiaries to assist them in being and remaining in compliance with all the conditions of their certificate.

We appreciate the effort placed into the production of this report, and reiterate that our initial request for audits were intended to provide the organization with a guidance to correct issues and to move forward in a more efficient and effective way. We have instituted process improvements since the audit period, and continue to update our current policies and procedures.

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ADDITIONAL INFORMATION NEEDED TO CLOSE RECOMMENDATIONS

Recommendation Number and Status	Additional Information Needed
Finding 1:	
1-1 Unresolved	Provide a specific action plan to address an underlying weakness in managing and measuring the effectiveness of the EDC program by proposing, to the Virgin Islands Legislature, the establishment of a law requiring that the EDC regularly measure, assess, and report on the program's overall economic and fiscal impact on the Territory's economy.
1-2 Unresolved	Provide documentation showing specific measures that will be established and implemented to help ensure the efficient collection of beneficiaries' financial data.
1-3 Unresolved	Provide documentation showing the specific measures that will be put in place to encourage the various categories of beneficiaries to contribute more equitably to the Territory's economy.
1-4 Unresolved	Provide a specific action plan to achieve the goal of allowing the EDC the flexibility of negotiating tax benefits options periodically by proposing, to the Virgin Islands Legislature, that the Code be revised allowing the EDC to grant benefits "up to 100%" to new beneficiaries.
Finding 2:	
2-1 Unresolved	Provide documentary evidence showing that the EDC Rules and Regulations have been updated to conform to provisions of the Code regarding extension of benefits.

ADDITIONAL INFORMATION NEEDED TO CLOSE RECOMMENDATIONS

Recommendation Number and Status	Additional Information Needed
Finding 3:	
Finding 3-1 Resolved	Provide documentary evidence confirming adequate implementation of corrective measures addressing the monitoring of beneficiaries based on available staffing.
Finding 3-2 Resolved	Provide documentation showing the establishment and implementation of corrective measures designed to ensure that final determinations on beneficiaries' requests for terminations and suspensions are made after the completion of compliance reviews.
Finding 3-3 Resolved	Provide a copy of Board approved written policies and procedures that sufficiently address the internal practices adopted by the EDC for governing the compliance review process.
Finding 3-4 Resolved	Provide evidence confirming adequate implementation of corrective measures which allow the Chief Executive Officer to give the necessary oversight required to help ensure timely reporting by beneficiaries.
Finding 4:	
Finding 4-1 Resolved	Provide a copy of the updated policies and procedures that reflect the practices adopted by the EDC to help ensure that proper notification is given to regulatory agencies concerning the granting of suspension and termination of benefits.

ADDITIONAL INFORMATION NEEDED TO CLOSE RECOMMENDATIONS

Recommendation Number and Status	Additional Information Needed
Finding 4-2 Resolved	Provide a copy of the updated policies and procedures, including a copy of the comprehensive policy manual, which address timely reporting to regulatory agencies after the EDC has granted suspension and termination of benefits.
Finding 4-3 Unresolved	Provide documentation showing the specific corrective measures that will be established to help improve the EDC's communication with all Government agencies regarding timely information on beneficiary status and compliance.
Finding 5:	
Finding 5-1 Resolved	Provide copies of the approved updated policies and procedures developed to streamline the application process, including copies of the policies and procedures that address the use of pre-application conferences and the revised schedule for Board meetings.
Finding 5-2 Resolved	Provide copies of the approved updated policies and procedures developed to help ensure that the EDC management consistently and thoroughly monitors the collection of information requested from applicants.

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