STATE OF UTAH
Office of the Legislative Auditor General

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KADE R. MINCHEY, CIA, CFE
AUDITOR GENERAL

Audit Subcommittee of the Legislative Management Committee
President J. Stuart Adams, Co–Chair • Speaker Brad R. Wilson, Co–Chair
Senator Evan J. Vickers • Representative Francis D. Gibson
Senator Karen Mayne • Representative Brian S. King

April 26, 2021

Senator Dan McCay, Chair
Representative Robert Spendlove, Chair
Representative Adam Robertson, Vice Chair
Revenue and Taxation Interim Committee
Utah State Capitol Complex
Salt Lake City, UT 84114

Dear Senator McCay and Representatives Spendlove and Robertson:

Attached is the legislative audit report #2021-06, *A Limited Review of the Utah Rural Jobs Act*. In accordance with ***Utah Code*** 36-12-8, the Legislative Audit Subcommittee passed a motion referring this audit report to your committee for further review and action as appropriate. The audit report was also referred to the *Business, Economic Development, and Labor Appropriations Subcommittee*, but your committee is designated as the lead committee, so we would like a response from you.

The Legislative Auditor General and staff have done extensive work and used valuable resources to perform the audit in a professional and thorough manner. We anticipate a response from your committee. Therefore, **for each recommendation to the Legislature**, we ask that your committee reach one of the following conclusions, or some combination of the three, by a motion and a vote:

- Draft legislation for the next legislative general session, if applicable;
- Conclude that the issues are significant but that more time is needed to develop solutions and consensus; or
- Conclude that there is insufficient committee support to study the issues further.

In addition, **for other (non-legislative) recommendations**, we ask that as part of your oversight role you determine whether appropriate action is being taken to address the audit findings. We ask that you report back to the Legislative Audit Subcommittee the conclusion(s) reached by your committee with a summary of the reasons for reaching this (these) conclusion(s).

Thank you for your efforts in this vital legislative role of oversight.

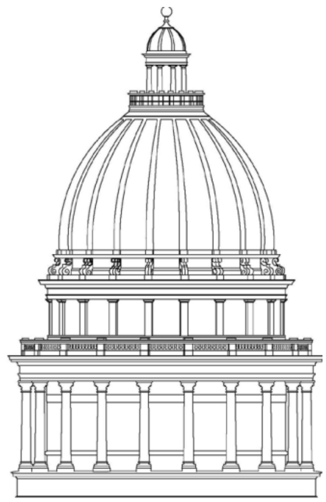
Sincerely,

J. Stuart Adams	Brad R. Wilson
President of the Senate	Speaker of the House
Utah State Senate	Utah House of Representatives

REPORT TO THE

UTAH LEGISLATURE

Number 2021-06



A Limited Review of the Utah Rural Jobs Act

April 2021

Office of the
LEGISLATIVE AUDITOR GENERAL
State of Utah

STATE OF UTAH

Office of the Legislative Auditor General

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KADE R. MINCHEY, CIA, CFE
AUDITOR GENERAL

April 14, 2021

TO: THE UTAH STATE LEGISLATURE

Transmitted herewith is our report, **A Limited Review of Utah Rural Jobs Act** (Report #2021-06). An audit summary is found at the front of the report. The objectives and scope of the audit are explained in the Introduction.

We will be happy to meet with appropriate legislative committees, individual legislators, and other state officials to discuss any item contained in the report in order to facilitate the implementation of the recommendations.

Sincerely,

Kade Minchey

Kade R. Minchey, CIA, CFE
Auditor General

LIMITED REVIEW AUDIT

AUDIT REQUEST

The co-chairs of the Revenue and Taxation Interim Committee requested an audit of the Utah Rural Jobs Act program after concerns were raised during the October 2020 subcommittee. meeting. Subsequently, the Legislative Audit Subcommittee approved limited survey work of the Utah Rural Jobs Act in December 2020.

BACKGROUND

The Utah Rural Jobs Act enables small businesses located in rural Utah to expand and create full-time, high wage jobs by providing flexible and affordable capital. The program authorizes $42 million in investment authority to rural investment companies (RICs), who then invest the capital in eligible small businesses.

The intent of the Utah Rural. Jobs Act is to encourage business expansion and development in rural areas throughout the state. Eligible small businesses may receive up to $5M in capital for business development and expansion needs.

This limited review focuses on the return on investment and the average cost per job created by the Utah Rural Jobs Act to date. We were specifically asked to examine the economic impact of the investment, and the cost to the state (tax credit), including the return on investment for the number of new annual jobs created as defined in statute.

Utah Rural Jobs Act

KEY FINDINGS

- Determining an accurate return on investment (ROI) for the Utah Rural Jobs Act program is not possible because statute is unclear and does not provide the Governor's Office of Economic Development (GOED) access to necessary tax documents.
- Concern among legislators over the perceived high cost of the program's tax credits relative to the value of jobs created. This report provides a "cost of investment per job" as an ROI alternative.
- Concern with the method of calculation as it relates to the number of new annual jobs created by the program, including the potential for double counting.
- Improvements to performance metrics that should be considered if the Legislature were to authorize a similar tax credit program in the future.

RECOMMENDATIONS

- Depending on the Legislature's preference of calculating the program's actual return on investment, we recommend that the Legislature consider authorizing GOED access to applicable tax documents.
- We recommend that GOED track the net number of new annual jobs created.
- We recommend that the Legislature consider clarifying the method for counting new annual jobs when two rural investment companies (RICs) invest in the same small business.
- We recommend that the Legislature consider the following suggestions related to performance metrics prior to starting a new or similar tax credit program: (a) Performance metrics should be directly tied to predefined goals or standards and reflect intended outcomes, and (b) Performance metrics should be timely and include an end date.

Summary continues on back >>

REPORT SUMMARY

Determining ROI for the Utah Rural Jobs Act Will Require Statutory Changes

Without statutory changes authorizing access to applicable tax documents, it is impossible to know the amount of tax revenue generated by the program. This limits the information we can provide in this audit report because knowing the amount of tax revenue generated by the program is essential in determining the current value of the investment (net profit or loss). Consequently, actual ROI cannot be calculated. Without the ability to calculate the current value of investment and actual ROI, the cost of investment per job became the next viable option for addressing the Legislature's concerns. Depending on the Legislature's preference, granting access to applicable tax documents could result in a more meaningful program metric; however, we also recognize that there may be policy considerations as to why these tax records remain protected.

The Potential to Double Count the Number of New Annual Jobs Is Created When RICs Invest in the Same Small Business

Our review found three instances of two RICs investing in the same eligible small business. The concern in the current model is the potential for double counting the number of new annual jobs created.

Performance Metrics Should Be Reevaluated for Future Programs that Issue Tax Credits

We identified several improvements linked to performance metrics that should be considered if the Legislature authorizes a similar tax credit program in the future. Metrics should: (a) be directly tied to program performance, (b) be linked to predefined goals or standards and reflect intended outcomes, (c) provide incentive to program participants directly responsible for program outcomes and overall performance, and (d) be timely and include an end date.

The Cost of Investment per Full-Time, High Wage Job Created Ranges Between $22,200 and $41,700

Scenario A (based on statute) attempts to measure the amount of tax revenue added to the state each year through new and sustained jobs, while Scenario B measures the net number of new annual jobs created. Because Scenario B considers only the net number of new annual jobs created and not the number of new annual jobs sustained over time, it controls for what could be interpreted as "double counting" in Scenario A.

	Scenario A: Investment Date Baseline		Scenario B: Revised Annual Baseline	
Investment Company	# of Jobs Reported	Tax Credits per Job*	Net # of Jobs Created	Tax Credits per Job*
RIC A	43	$47,200**	27	$75,200
RIC B	217.2	9,300	111.16	18,300
RIC C	14.6	139,000	7.94	255,700
TOTAL	**274.8**	**$22,200**	**146.1**	**$41,700**

Source: Auditor generated

* The Utah Rural Jobs Act recently entered calendar year four. As such, this calculation has been adjusted to use 25 percent of the total tax credit in an attempt to prorate the issuance of tax credits according to the program's timeline.

** Method of calculation for RIC A, Scenario A:
Total allowable tax credit = $24.36M.
25% of the total tax credit = $6.09M
$6.09M/3 Participating RICs = $2.03M
$2.03M/43 jobs for RIC A = $47,200

REPORT TO THE

UTAH LEGISLATURE

Report No. 2021-06

A Limited Review of the Utah Rural Jobs Act

April 2021

Audit Performed By:

Audit Manager	Darin Underwood, CIA
Audit Supervisor	Nicole Luscher

Table of Contents

Chapter I
Introduction

Rural Utah communities have been identified as lacking in business development. In 2018, the National Conference of State Legislatures (NCSL) reported that only 1.1 percent of private equity investments in Utah went to businesses in rural areas. In his 2017 State of the State address, Governor Gary Herbert challenged Utah businesses to build 25,000 jobs throughout rural Utah within four years. The Legislature responded by adopting a joint resolution[1] to encourage business development in rural areas and by enacting the "Utah Rural Jobs Act.[2]" This act provides a nonrefundable tax credit for investments in eligible small businesses located primarily in rural counties.

The Governor's Office of Economic Development Oversees the Utah Rural Jobs Act Program

The Utah Rural Jobs Act program enables small businesses located in rural Utah to expand and create full-time, high wage jobs[3] by providing flexible and affordable capital. The program authorizes $42 million ($42M) in investment authority to rural investment companies (RICs) and includes three main types of participants:

- Investors
- RICs
- Eligible small businesses

The Utah Rural Jobs Act program encourages business expansion and development in rural areas throughout the state.

The intent of the Utah Rural Jobs Act is to encourage business expansion and development in rural areas throughout the state. Eligible small businesses may receive up to $5M in capital for business development and expansion needs. The Governor's Office of Economic Development (GOED) statutorily manages the Utah Rural Jobs Act program by determining program compliance, reviewing program metrics, and providing tax credits. Figure 1.1 illustrates the

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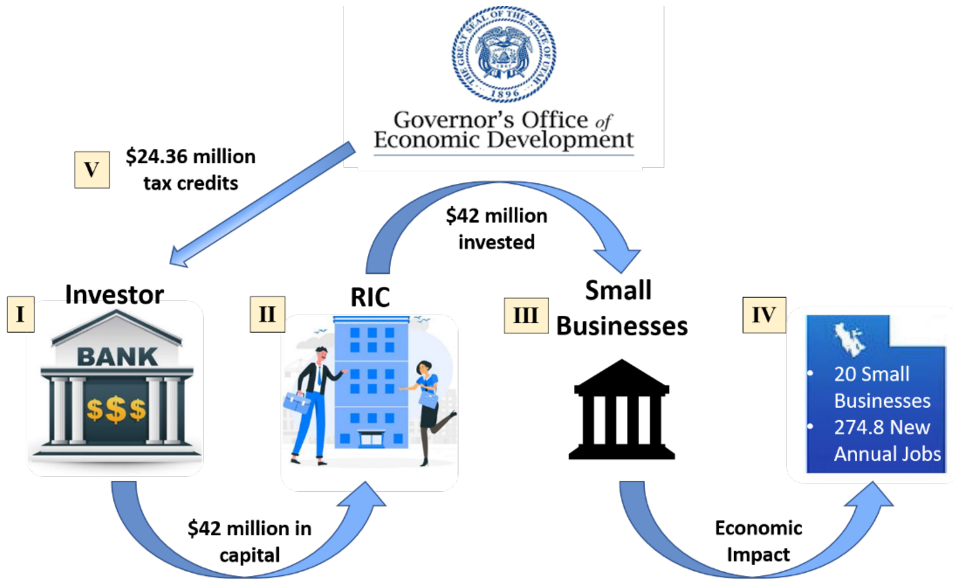
[1] SJR 14 2017 General Legislative Session
[2] SB 267 2017 General Legislative Session
[3] Statute defines "high wage" as a wage that is at least 100 percent of the county average wage.

five main components of the program, each of which will be discussed in detail following the figure.

Figure 1.1 The Utah Rural Jobs Act Encourages Business Expansion and Development in Rural Areas. Statute allows GOED to distribute up to $24.36M in tax credits to investors for credit-eligible contributions.



Source: Auditor generated

Figure 1.1 illustrates that investors, such as financial institutions, provide capital to RICs who then invest the capital in eligible small businesses. Each component of the figure is discussed in detail below–investors, RICs, small businesses, economic impact, and tax credits.

I. Investors: Investors Provide Capital To Rural Investment Companies (RICs)

The Utah Rural Jobs Act currently has six total investors providing $42M in capital to three participating RICs.

The Utah Rural Jobs Act currently has six investors providing $42M in capital to three participating RICs. An investor (referred to as a claimant in statute) must be a resident or nonresident person that has a state taxable income. If an investor makes a credit-eligible contribution to an RIC, the investor will qualify to receive a percentage of their investment back in the form of a non-refundable tax credit certificate.

II. RICs: RICs Provide Small Business Loans to Eligible Small Businesses

GOED received three applications from RICs seeking approval to participate in the Utah Rural Jobs Act program. Per statute, an RIC must be a federally licensed rural business investment company or a federally licensed small business investment company. To qualify for the program, each of the RICs had to show proof of $50M in previous investments to nonpublic companies located in counties with fewer than 50,000 residents. According to GOED, all three RIC applicants were qualified, and their applications were approved.[4] The investment authority and credit-eligible contributions for each RIC were proportionally reduced according to statute. Therefore, each of the RICs were approved for an individual investment authority of $14M, reaching a collective total investment authority of $42M.

The investment authority for each RIC was proportionally reduced to $14M according to statute.

Once approved, each RIC was required to raise their respective $14M in capital within 65 days (known as the closing date[5]) and to invest 100 percent of the funds within three years of the closing date. Statute requires 70 percent of the total investment authority ($9.8M of the $14M) to be invested in eligible small businesses located in rural Utah counties.[6] An RIC may exit the program on or after the seventh anniversary of the closing date, meaning that RICs are statutorily required to maintain 100 percent of their investment authority for a minimum of seven years. The economic impact of the Utah Rural Jobs Act program, which recently commenced its fourth year, will be discussed in detail in Chapter II.

Statute requires 70 percent of the total investment authority to be invested in eligible small businesses located in rural Utah counties.

III. Small Businesses: Eligible Small Businesses Receive Capital from RICs for Expansion and Development

Eligible small businesses work directly with an RIC to secure a potential investment and NOT with the state. Twenty small businesses

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[4] To participate in the program, each RIC is required to pay an annual administrative fee to GOED. The annual fee is calculated by dividing $50,000 by the number of RICs approved to participate in the program. In this case, there are three participating RICs; therefore, each RIC pays an annual fee of $16,667 to GOED.

[5] Statute defines the closing date as the date on which an RIC has collected all of the investments; therefore, calendar year beginning and end dates for each RIC vary. The closing date for RIC A is January 25, 2018; the closing date for RIC B is January 8, 2018; and the closing date for RIC C is February 9, 2018.

[6] Statute defines a rural county as any county in Utah except: Weber, Davis, Salt Lake, Utah, Tooele, Cache, Washington, and Summit counties.

in seven counties were recipients of the $42M total investment authority for the Utah Rural Jobs Act program. Small businesses that receive a capital investment from an RIC must

- Maintain principal business operations in the state of Utah
- Have fewer than 150 employees
- Have less than $10M in net income for the preceding taxable year, and
- Conduct business within a specified industry[7]

According to statute, small business loans cannot exceed $5M per eligible small business.

According to statute, small business loans cannot exceed $5M per eligible small business. All terms and conditions related to a potential investment are strictly between the small business and the RIC. Eligible small businesses are expected to use the capital to develop and expand operations, ideally creating new full-time, high wage jobs in rural Utah.

IV. Economic Impact: Statute Measures Economic Impact by the Number of New Annual Jobs Created

Statute establishes the baseline for measuring new annual jobs as the number of full-time, high wage employees at the time of initial investment. To calculate the number of new annual jobs created, a small business subtracts the preceding year's monthly average of full-time, high wage employees from the baseline number. The difference between the monthly average and the baseline is the number of new annual jobs created.

[7] Statutorily accepted industry types include aerospace, defense, energy and natural resources, financial services, life sciences, outdoor products, software development, information technology, manufacturing, and agribusiness.

(monthly average of full-time, high wage employees for [YEAR])

–

(number of full-time, high wage employees on the date of initial investment)

=

(number of new annual jobs)

At the end of calendar year 2020, GOED reported an overall program total of 274.8 new annual jobs created from investments in 20 eligible small businesses. The ongoing program is currently in its fourth year of operation; therefore, the number of new annual jobs created will change over time. Chapter II addresses concerns with this metric and how it is applied at a programmatic level.

The ongoing program is currently in its fourth year of operation; therefore, the number of new annual jobs created will change over time.

V. Tax Credits: $24.36M in Tax Credit Certificates Will Be Issued for Credit-Eligible Contributions

Investors who make credit-eligible contributions to an RIC will receive a non-refundable tax credit issued by GOED. For investors to qualify for the tax credit, the RIC must comply with all program criteria and requirements. According to statute, GOED may not approve more than $24.36M in tax credits for credit-eligible contributions, which equates to roughly 58 percent of the total investment authority ($42M).

GOED may not approve more than $24.36M in tax credits for credit-eligible contributions, which equates to roughly 58 percent of the total investment authority.

The tax credit is incrementally issued on the fourth through seventh anniversaries of the closing date. In other words, 25 percent of the tax credit is issued in year four of the program, another 25 percent is issued in year five, and so on. Tax credits, just as the total investment authority, are divided proportionally among each of the three participating RICs. Therefore, investors of each RIC will qualify for a total of $8.12M in tax credits by the end of year seven, pending the RIC's compliance with program criteria and requirements.

Investors of each RIC will qualify for a total of $8.12M in tax credits by the end of year seven, pending the RIC's compliance with program criteria and requirements.

The Classification of a High Wage Job Varies by Year and by County

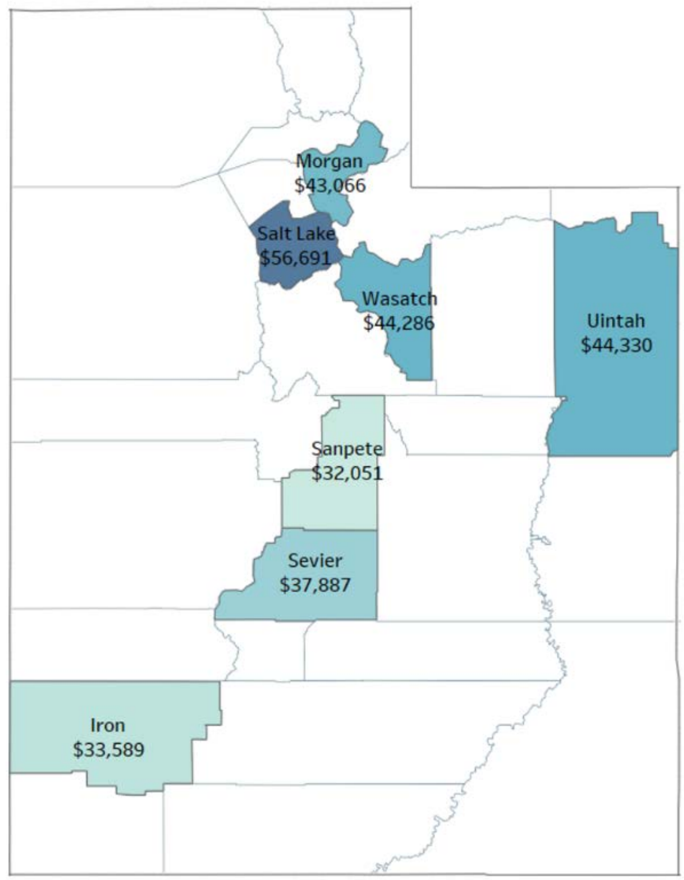
Statute defines "high wage" as being at least 100 percent of the county average wage. GOED uses an average wage schedule provided by the Department of Workforce Services for each calendar year and each county in Utah. Figure 1.2 shows the average wage in each of the

Statute defines "high wage" as being at least 100 percent of the county average wage.

GOED reports that 78 percent ($32.7M) of the total investment authority was placed in six in rural counties, while 22 percent ($9.3M) was placed in one urban county, Salt Lake County.

seven counties that have received capital since the Utah Rural Jobs Act program began.

Figure 1.2 The Average Wages of Counties that Received Small Business Investments Ranged Between $32,000 and $57,000 in Calendar Year 2020. Statute defines high wage jobs as being at least 100 percent of the county average wage. Additionally, statute requires at least 70 percent of the total investment authority to be invested in rural Utah counties.



Source: Auditor generated

Twenty small businesses in seven counties were recipients of the $42M total investment authority for the Utah Rural Jobs Act program. Statute requires at least 70 percent of the $42M investment authority to be invested in rural Utah counties. GOED reports that 78 percent ($32.7M) of the total investment authority was placed in six in rural counties,[8] while 22 percent ($9.3M) was placed in one urban county, Salt Lake County.

Audit Scope and Objectives

The co-chairs of the Revenue and Taxation Interim Committee requested an audit of the Utah Rural Jobs Act program after concerns were raised during the October 2020 subcommittee meeting. The audit request was for us to conduct a limited review of the return on investment and the average cost per job created by the Utah Rural Jobs Act to date. We were specifically asked to examine the economic impact of that investment, and the cost to the state of the tax credit, including the return on investment for the number of new annual jobs created as defined in statute. The remainder of the audit request will be addressed in the following chapter:

- Chapter II – Economic impact and the return on investment

[8] RICs are required to invest 100 percent of the investment authority within three years of the closing date. Since the program recently commenced year four (February 2021), the required amount of investment authority has been placed. As of March 9, 2021, the amount invested in each rural county is as follows: Wasatch $12.02M, Sanpete $10.13M, Iron $3.85M, Sevier $2.92M, Uintah $2.5M, and Morgan $1.28M.

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Chapter II
Legislature Should Consider Changes to Utah Rural Jobs Act and Like Programs

Based on our limited review of the Utah Rural Jobs Act program, we found the following:

- Determining an accurate return on investment (ROI) for the Utah Rural Jobs Act program is not possible because statute is unclear and does not provide the Governor's Office of Economic Development (GOED) to access necessary tax documents.

- Concern among legislators over the perceived high cost of the program's tax credits relative to the value of jobs created. This chapter provides a "cost of investment per job" as an ROI alternative.

- Concern with the method of calculation as it relates to the number of new annual jobs, including the potential for double counting.

- Improvements to performance metrics that should be considered if the Legislature were to authorize a similar tax credit program in the future.

Determining ROI for the Utah Rural Jobs Act Will Require Statutory Changes

Under the Utah Rural Jobs Act, the statutory method of calculating new annual jobs attempts to measure the amount of tax revenue added to the state each year by that program. However, without statutory changes authorizing access to applicable tax documents, it is impossible to know the amount of tax revenue generated by the Utah Rural Jobs Act program. This limits the information we can provide in this audit report because knowing the amount of tax revenue generated by the program is essential in determining the current value of the investment (net profit or loss). Depending on the Legislature's preference, granting access to applicable tax documents could result in a more meaningful program metric; however, we also recognize that there may be policy considerations as to why these tax records remain protected.

The amount of tax revenue generated by the program is an essential factor in determining the current value of the investment (net profit or loss).

ROI is expressed as a percentage and is calculated by dividing an investment's current value (net profit or loss) by its initial cost, as follows:

$$\frac{\text{Current value of investment}^{9} - \text{Cost of investment}}{\text{Cost of investment}}$$

The amount of tax revenue generated by the program remains unknown; therefore, there is no way to accurately determine the current value of the investment.

While the amount of tax revenue generated by the program remains unknown, there is no way to accurately determine the current value of the investment. Consequently, actual ROI cannot be calculated. As such, this audit report uses an alternative measure that calculates economic activity (job creation) as it relates to the cost of investment (tax credits), and is expressed by the following equation:

$$\frac{\text{Cost of investment (tax credits)}}{\text{Number of new annual jobs}}$$

The above calculation represents the "cost of investment per job," and will be referred to as such throughout the remainder of this report.

Without the ability to calculate the current value of investment and actual ROI, the cost of investment per job became the next viable option for addressing the Legislature's concerns.

We included this calculation to address legislative concern over the perceived high cost of the program's tax credits relative to the value of jobs created.[10] More specifically, the Legislature would like to know the economic impact of the state's investment (tax credit). However, without the ability to calculate the current value of investment and actual ROI, the cost of investment per job became the next viable option for addressing the Legislature's concerns. The cost of investment per job will be computed in the following section.

[9] In this case, the current value of investment should be determined by subtracting the total cost of investment (tax credits) from the total amount of tax revenue generated by the Utah Rural Jobs Act program.

[10] Legislative concern over the perceived high cost of the program's tax credits relative to the value of jobs created was expressed during the October 2020 Revenue and Taxation Interim Committee meeting.

Cost of Investment per Job Varies Depending on the Method Used to Calculate the Number of New Annual Jobs

The statutory method of counting the number of new annual jobs rewards rural investment companies (RICs) for the extra tax revenue brought to rural areas by new and sustained jobs over time. For example, if a small business had a baseline of 10 employees on the date of the initial growth investment in 2017, and a monthly average of 14 employees over three subsequent years, the report of new annual jobs would look like this:

2018 New Annual Jobs: 4
2019 New Annual Jobs: 4
2020 New Annual Jobs: 4

Total Sum: 12

While the net number of new annual jobs created by the small business in this example is 4, the total sum of new annual jobs reported to the state is 12.

While the net number of new annual jobs created by the small business in this example is 4, the total sum of new annual jobs reported to the state is 12. It is important to note that this method of calculation is limited in its analysis as it does not measure the net number of new annual jobs added. Therefore, according to the statutory method of counting new jobs, RICs are receiving credit for the number of new annual jobs created as well as the number of new annual jobs sustained over time. Ideally, job retention increases the amount of annual tax revenue in a participating rural county; however, statute does not currently provide a way for that to be measured.

The need to clearly communicate the calculation set forth in statute proved necessary for this audit, because the number of new annual jobs created does not adequately measure the program's actual ROI. Furthermore, measuring the cost of investment relative to the value of jobs created proved challenging when considering alternative methods of counting.

The remainder of this chapter discusses two likely outcomes. Scenario A represents the number of new annual jobs created based on *current statute,* while Scenario B represents the *net number* of new annual jobs created.

To address potential questions about the net number of new annual jobs created and the amount of tax revenue generated by the new annual jobs, the remainder of this chapter discusses two likely outcomes. Scenario A represents the number of new annual jobs created based on **current statute**, while Scenario B represents the **net number** of new annual jobs created.

Our calculation of the cost of investment per job represents a point in time and does not attempt to draw any final conclusions about the Utah Rural Jobs Act program.

The program recently entered calendar year four, which marks the first year that tax credits can be statutorily distributed.

Cost of Investment per Job Does Not Consider the Amount of Tax Revenue Generated by the Program

Prior to introducing the two scenarios, we would like to provide some additional context to the cost of investment per job calculation. This calculation represents a point in time and does not attempt to draw any final conclusions about the Utah Rural Jobs Act program. The ongoing program is currently in its fourth year of operation; therefore, the cost of investment per job will change over time as new jobs are created. Furthermore, because the program is ongoing, the cost of investment per job has been adjusted to represent the number of jobs created and the amount of tax credits distributed[11] up to this point (pro rata).

The Utah Rural Jobs Act program issues tax credits over a seven-year period from the time the RIC has raised its total investment authority (closing date).[12] The tax credit distribution schedule is as follows:

- 0 percent issued in years one through three
- 25 percent issued each year in years four through seven

The program recently entered calendar year four, which marks the first year that tax credits can be statutorily distributed. According to statute, GOED may not approve more than $24.36M in tax credits for credit-eligible contributions. Therefore, investors of each RIC can expect to receive a proportional amount of the tax credit ($8.12M) by the end of year seven, pending the RIC's compliance with program requirements. To date, no tax credits have been issued; however, it is anticipated that the first 25 percent will be issued by the end of April 2021.

Figure 2.1 illustrates two distinct methods of calculating the number of new annual jobs created. Scenario A (based on statute) attempts to measure the amount of tax revenue added to the state each

[11] At the time of this writing, no tax credits have been issued; however, it is anticipated that the first 25 percent will be issued by the end of April 2021. The first issuance of tax credits pertains to the number of new annual jobs created during the first three years of the program.

[12] Statute defines the closing date as the date on which an RIC has collected all of the investments; therefore, calendar year beginning and end dates for each RIC vary. The closing date for RIC A is January 25, 2018; the closing date for RIC B is January 8, 2018; and the closing date for RIC C is February 9, 2018.

year through new and sustained jobs, while Scenario B measures the net number of new annual jobs created.

Figure 2.1 The Cost of Investment per Full-Time, High Wage Job Created Ranges Between $22,200 and $41,700. Scenario A shows the cost of investment per job ($22,200) using the current method of calculation defined in statute. Scenario B shows the cost of investment per job ($41,700) using a revised annual baseline to calculate the net number of new annual jobs created.

	Scenario A: Investment Date Baseline		Scenario B: Revised Annual Baseline	
Investment Company	**# of Jobs Reported**	**Tax Credits per Job***	**Net # of Jobs Created**	**Tax Credits per Job***
RIC A	43	$47,200**	27	$75,200
RIC B	217.2	9,300	111.16	18,300
RIC C	14.6	139,000	7.94	255,700
Total	**274.8**	**$22,200**	**146.1**	**$41,700**

Source: Auditor generated

** The Utah Rural Jobs Act recently entered calendar year four. As such, this calculation has been adjusted to use 25 percent of the total tax credit in an attempt to prorate the issuance of tax credits according to the program's timeline.*

*** Method of calculation for RIC A, Scenario A:*
Total allowable tax credit = $24.36M
25% of the total tax credit = $6.09M
$6.09M/3 Participating RICs = $2.03M
$2.03M/43 jobs for RIC A = $47,200

The calculations in Figure 2.1 are based on the distribution of the first 25 percent of the total tax credit. We believe that this adjustment allows for a more accurate estimate since the program is still in progress.

The calculations in Figure 2.1 are based on the distribution of the first 25 percent of the total tax credit. For the remaining years of the program, a collective tax credit total of $6.09M will be distributed annually until the $24.36M tax credit limit is reached. Because the program recently entered year four, the tax credit total used in Figure 2.1 was adjusted down to match the first collective distribution amount of $6.09M ($2.03M per RIC). We believe that this adjustment allows for a more accurate estimate since the program is still in progress.

As of December 31, 2020, GOED reported a new annual job count of 274.8 (Scenario A). However, the net number of new annual jobs created is 146.1 (Scenario B)—a difference of 128.7 jobs. Scenario B considers only the net number of new annual jobs created and not the number of new annual jobs sustained over time, thereby controlling for what could be interpreted as "double counting" in Scenario A. Depending on the Legislature's preference of how to measure the cost of investment per job, the different methods of calculation may prove to be significant.

Concerns with Calculation Methods and Job Count May Directly Impact the Cost of Investment

The potential to double count the number of new annual jobs exits when two RICs invest in the same small business.

The statutory calculation of the number of new annual jobs created (Scenario A) measures the amount of tax revenue added to the state each year through new and sustained jobs over time, and not the net number of new annual jobs created (Scenario B). The need to clearly communicate the calculation set forth in statute proved necessary for this audit because the number of new annual jobs created does not adequately measure the program's actual ROI. Understanding the number of new annual jobs created—and the method of calculation used—is crucial because statute includes a reimbursement provision. For example, depending on the number of new annual jobs created, RICs may be required to reimburse the state up to $4.1M each; therefore, making job count a particularly important consideration. In addition to issues related to the preferred method of calculation as it pertains to job count (see Figure 2.1), the potential to double count the number of new annual jobs also exits when two RICs invest in the same small business.

RICs Will Be Required to Reimburse the State If a Threshold of New Annual Jobs Is Not Achieved

The number of new annual jobs created, and the method of calculation used to derive that number, are crucial when an RIC decides to exit the Utah Rural Jobs Act program. This is because RICs could be required to reimburse the state if they do not achieve a certain threshold of new annual jobs created.

Based on available information, the cost of investment per job, as envisioned by statute, is approximately $40,000 per job. Depending on the method of calculation (Scenario A vs. Scenario B) and the average wage of the investment county, the program appears to be on track at this point in time.

Statute defines the "state reimbursement amount" as 50 percent of the rural investment company's credit-eligible capital contributions, and the product of the total sum of the number of new annual jobs created and $20,000. Mathematically, this means that each of the three participating RICs is responsible for creating 203 jobs, for a program total of 609 jobs.[13] Based on available information, the cost of investment per job, as envisioned by statute, is approximately $40,000 per job ($24.36M/609 jobs). Depending on the method of calculation

[13] More specifically, 50 percent of the total tax credit (credit-eligible contribution) is $12,180,000 ($24.36M * 0.5). Statute equates this amount to $20,000 per job, multiplied by the number of new annual jobs created. Solving for the number of new annual jobs created, we divide $12,180,000 by $20,000 to yield a program total of 609 new annual jobs.

(Scenario A vs. Scenario B) and the average wage of the investment county, the program appears to be on track at this point in time. That said, the program is ongoing and this analysis will change over time as new jobs are created.

According to statute, if an RIC does not meet the assigned threshold upon exiting the program, it will be required to reimburse the state $20,000 per job, up to a maximum amount of $4.1M. Additionally, any such reimbursements would directly affect the state's return on investment. However, because the program is ongoing, we are not able to determine whether the reimbursement provision will take effect.

According to statute, if an RIC does not meet the assigned threshold upon exiting the program, it will be required to reimburse the state $20,000 per job, up to a maximum amount of $4.1M.

Statute Does Not Account for the Net Number Of New Annual Jobs Added Each Year

The method used to calculate the number of new annual jobs created (Scenario A vs. Scenario B) yields two very different performance metrics. As previously mentioned, Scenario A attempts to measure the amount of tax revenue added to the state each year through new and sustained jobs, while Scenario B measures the net number of new annual jobs created. Figure 2.2 includes excerpts from two annual reports submitted to GOED by one of the RICs. In the figure, Scenario A depicts the RIC's actual reports, while Scenario B was auditor generated for the purpose of contrasting these two methods.

Figure 2.2 Statute's Current Method of Calculating of New Annual Jobs May Overreport Economic Impact. Scenario A uses the initial investment date baseline to calculate the number of new (and sustained) annual jobs. Scenario B uses a revised annual baseline to calculate the net number of new annual jobs.

Scenario A

RIC A 2018 Annual Report	BUSINESS A	TOTALS
(A) Baseline # of Jobs as of Investment Date:	20	20
(B) Monthly Average (# of Jobs):	24	24
(B) – (A) New Annual Jobs:	4	**4**
RIC A 2019 Annual Report	**BUSINESS A**	**TOTALS**
(A) Baseline # of Jobs as of Investment Date:	20	20
(B) Monthly Average (# of Jobs):	24	24
(B) – (A) New Annual Jobs:	4	**4**
RIC A 2020 Annual Report	**BUSINESS A**	**TOTALS**
(A) Baseline # of Jobs as of Investment Date:	20	20
(B) Monthly Average (# of Jobs):	10	10
(B) – (A) New Annual Jobs:	0	**0**

Total Number of Jobs Counted By GOED: **8**

Scenario B

RIC A 2018 Annual Report	BUSINESS A	TOTALS
(A) Baseline # of Jobs as of Investment Date:	20	20
(B) Monthly Average (# of Jobs):	24	24
(B) – (A) New Annual Jobs:	4	**4**
RIC A 2019 Annual Report	**BUSINESS A**	**TOTALS**
(A) Revised Annual Baseline:	24	24
(B) Monthly Average (# of Jobs):	24	24
(B) – (A) New Annual Jobs:	0	**0**
RIC A 2020 Annual Report	**BUSINESS A**	**TOTALS**
(A) Revised Annual Baseline:	24	24
(B) Monthly Average (# of Jobs):	10	10
(B) – (A) New Annual Jobs:	0	**0**

Total Number of Jobs Counted By GOED: **4**

Source: RIC A Annual Report provided to GOED and auditor generated

In the figure, Scenario A depicts the RIC's actual reports, while Scenario B was auditor generated for the purpose of contrasting these two methods.

As the sole performance metric in statute, Scenario A considers the number of new annual jobs created and the number of new annual jobs sustained over time, for what could be interpreted as double counting. In the absence of tax revenue data, we believe that this method of counting new annual jobs could be misleading and should be reviewed by the Legislature.

While we understand the need to produce jobs with "high wages" to ensure that sufficient tax revenues are created, the existing performance metric (job count) does not match the calculation set forth in statute (tax revenue).

A legal review conducted by a representative from the Attorney General's office stated that the intent of statute was not to count the net number of new jobs added, but rather to measure the amount of tax revenue added to the state each year through newly created jobs. While we understand the need to produce jobs with "high wages" to ensure that sufficient tax revenues are created, the existing performance metric (job count) does not match the calculation set forth in statute (tax revenue). These concerns are addressed in greater detail in the final section of this chapter.

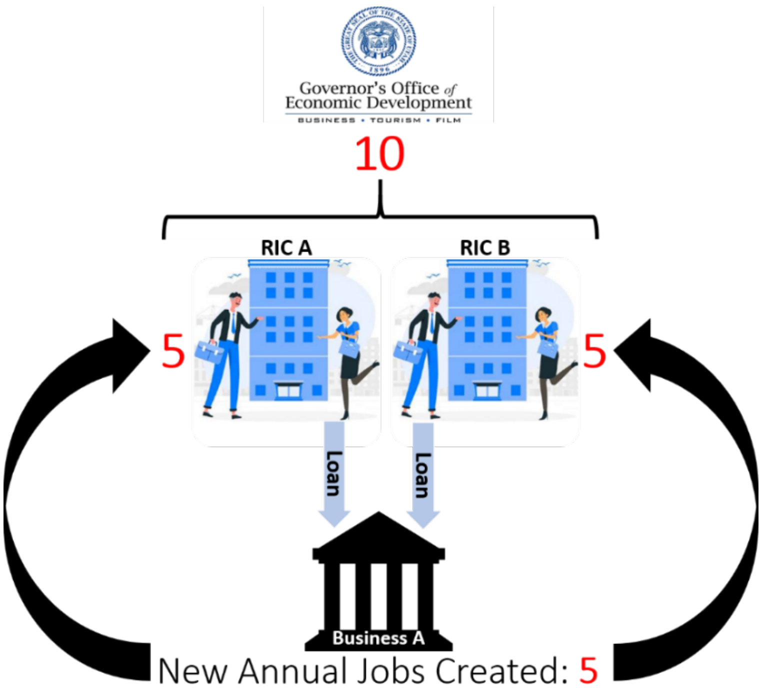
The Potential to Double Count New Annual Jobs Is Created When RICs Invest in the Same Small Business

Our review found three instances of two RICs investing in the same small business; therefore, the potential for double counting the new number of annual jobs created exists in the current model.

Our review found three instances of two RICs investing in the same eligible small business. In these examples, the combined totals of the amounts invested did not surpass the $5M cap specified in statute; however, there is no directive in statute or Administrative Rule had the combined total exceeded the $5M limit. Additionally, each RIC reported slightly different totals for the number of new annual jobs created. Although the discrepancies were nominal,[14] the potential for double counting the number of new annual jobs created exists in the current model. Figure 2.3 illustrates this potential and demonstrates the need for clear guidance moving forward.

[14] The discrepancies in the number of new annual jobs reported in each of these three instances were 0.2, 0.09, and 1.

Figure 2.3 The Number of New Annual Jobs Created Could Be Double Counted if Two RICs Invest in the Same Small Business. In the current model, there is no directive in statute or Administrative Rule that considers two RICs investing in the same small business. Without clear guidance, there is potential to report the new annual jobs total twice resulting in the total being double counted.



Source: Auditor generated

The concern in the current model, as illustrated in Figure 2.3, is the potential for double counting the number of new annual jobs created. When considering the statutory method of calculating new annual jobs (which consistently uses the baseline number of full-time, high wage employees on the date of the initial growth investment) the number becomes further inflated over time.

The concern in the current model is the potential for double counting the number of new annual jobs created.

In response to these concerns, GOED management suggested implementing an apportionment, whereby each RIC would count the number of jobs according to the percentage of its total investment. Similarly, to avoid overreporting economic impact, we recommend that the Legislature consider clarifying the method for counting new annual jobs in situations where two RICs invest in the same small business.

During our review, we identified several improvements linked to performance metrics that should be considered if the Legislature authorizes a similar tax credit program in the future.

Performance Metrics Should Be Reevaluated for Future Programs that Issue Tax Credits

During our review, we identified several improvements linked to performance metrics that should be considered if the Legislature authorizes a similar tax credit program in the future. Based on criteria from the Economic Development Tax Increment Financing (EDTIF) program[15] administered by GOED, along with our office's *Best Practices Guidebook*, performance metrics should:

- Be directly tied to program performance
- Be linked to predefined goals or standards and reflect intended outcomes
- Provide incentive to program participants directly responsible for program outcomes and overall performance
- Be timely and include an end date

The final section of this audit report provides suggestions about performance metrics to aid future decision-making and program design.

The Utah Rural Jobs Act Program Issues Tax Credits Independent of Program Performance

To retain the tax credit and successfully exit the program, an RIC is subject to several statutory provisions; however, none of the provisions immediately link job creation to program performance.

To retain the tax credit and successfully exit the program, an RIC is subject to several statutory provisions; however, none of the provisions immediately link job creation to program performance. For example, tax credits are distributed each year in years four through seven regardless of the number of new annual jobs created. By comparison, the EDTIF program issues post-performance tax credits to companies that meet programmatic milestones.

[15] The EDTIF program is a post-performance tax credit that offers companies up to 30 percent of new state revenues (Utah sales, corporate and withholding taxes) during a defined period (typically 5 to 10 years). The EDTIF program helps attract or retain companies that would otherwise choose another state to deploy capital investments and create new full-time, high wage jobs.

The Program's Performance Metric Does Not Adequately Measure the Intended Outcome Specified in Statute

Because the performance metric for the Utah Rural Jobs Act program is not directly tied to a predefined goal or standard in statute, there is no way to meaningfully interpret the results of the current metric. For example, the number of new annual jobs created does not reflect the amount of tax revenue brought to rural areas through job creation. Unless statutory changes are made to authorize access to applicable tax documents, GOED will remain unable to measure the amount of tax revenue created by this program.

Because the performance metric for the Utah Rural Jobs Act program is not directly tied to a predefined goal or standard in statute, there is no way to meaningfully interpret the results of the current metric.

In contrast, statute[16] for the EDTIF program authorizes the Utah State Tax Commission to disclose a business entity's tax returns (and other information subject to confidentiality) to determine the amount of new state revenues collected as a result of investments made in new commercial projects. For example, as new high-paying job milestones are met, tax credits are calculated as a percentage of new state revenues generated. Therefore, the tax credits in the EDTIF program are directly tied to the predefined goal of measuring new state revenue generated by high wage job creation.

Tax Incentives Are Not Tied to Program Outcomes

While investors in the Utah Rural Jobs Act program provide much-needed capital, they are not directly responsible for program outcomes. Providing a benefit to a program participant that is directly responsible for program outcomes may create a heightened sense of accountability. For example, tax credits in the EDTIF program are issued to companies that are directly responsible for meeting predefined performance metrics and outcomes. In other words, post-performance tax credits are issued to companies that are directly responsible for program outcomes, and tax credits are provided only if the company meets its obligations.

Providing a benefit to a program participant that is directly responsible for program outcomes may create a heightened sense of accountability.

[16] ***Utah Code 63N-2-105(2)(e)***

An open-ended performance metric without a defined timeline lacks incentive and motivation for completion.

Statute Does Not Specify a Program Exit Date for RICs

The Utah Rural Jobs Act does not specify an exit date in statute. This means that an RIC can exit the program at any time on or after the seventh anniversary of the closing date. Without a defined timeline, an RIC can choose to exit the program at year 7, 10, 15, 20, or at any other time that is convenient for the RIC. However, to retain the tax credit, an RIC must remain in the program until the threshold for the number of new annual jobs is achieved. An open-ended performance metric without a defined timeline lacks incentive and motivation for completion. By contrast, the EDTIF program specifies an end date in statute, which allows GOED to hold investment companies accountable for producing results in a reliable, timely manner.

While these suggestions for improving performance metrics may not be immediately applicable to the ongoing Utah Rural Jobs Act program, future programs may benefit from these considerations.

Recommendations

1. Depending on the Legislature's preference of calculating the program's actual return on investment, we recommend that the Legislature consider authorizing the Governor's Office of Economic Development access to applicable tax documents.

2. We recommend that the Governor's Office of Economic Development track the net number of new annual jobs created (as shown in Scenario B of this report).

3. We recommend that the Legislature consider clarifying the method for counting new annual jobs when two rural investment companies (RICs) invest in the same small business.

4. We recommend that the Legislature consider the following suggestions related to performance metrics prior to starting a new or similar tax credit program:

    a. Program performance metrics should be directly tied to predefined goals or standards and reflect intended outcomes.

b. Program performance metrics should be timely and include an end date.

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Agency Response

Utah Governor's Office *of*
Economic Development

SPENCER J. COX
Governor

DEIDRE M. HENDERSON
Lieutenant Governor

DANIEL HEMMERT
Executive Director

BENJAMIN L. HART
Deputy Director

April 5, 2021

Auditor General Kade R. Minchey
Office of the Auditor
Utah State Capitol Complex
East Office Building, STE 310
Salt Lake City, UT 84114

Dear Auditor General Minchey,

This letter is in response to the recent audit *A Limited Review of the Rural Jobs Act, April 2021* as administered by the Governor's Office of Economic Development (GOED). As identified in the audit, this programs increases private equity investment in rural Utah by engaging with Rural Investment Companies (RICs) with job creation outcomes that define success. The Rural Jobs Act as enacted in 2007 and amended in 2020 has helped provide more than $42 million in additional capital to rural Utah.

A statutory defined job calculation measurement is currently being used to determine the amount of recapture for RICs who hold the credit risk and reporting outcomes as defined in the Rural Jobs Act (RJA). GOED is following its statutory prescribed role in this program as an evaluator of economic impact using established performance metrics, but as the report recommends, would need additional statutory authority to determine the amount of revenue being generated to calculate the actual return on investment. The concerns expressed in the recommendations have been agreed upon, resulting in GOED providing additional new high-paying job tracking and reporting methodology to help determine the job creation. Again, statutory changes would be needed to determine ROI.

Utah companies receiving the increased capital are fully engaged in the program by providing employee reports to the RICs to annually to track the number of new high-paying jobs that are independently reviewed by 3rd party auditors using agreed-upon-procedures.

We express our gratitude to your auditing staff who were quickly up to speed and highly engaged throughout all phases of the audit. We appreciate the level of professionalism and the valuable objective insight pursuant to understanding the current needs of the RJA and any potential future programs the Legislature desires to create.

LIFE UTAH ELEVATED

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Sincerely,

Dan Hemmert
Executive Director
Governor's Office of Economic Development

to: Kade Minchey, kminchey@le.utah.gov
cc: Darren Underwood, dunderwood@le.utah.gov
cc: Nicole Luscher,nluscher@le.utah.gov

The following identifies the position of GOED related to the audit report and recommendations provided.

1. Depending on the Legislature's preference of calculating the program's actual return on investment, we recommend that the Legislature consider authorizing the Governor's Office of Economic Development access to applicable tax documents.

   GOED agrees with recommendation number 1.

   GOED has statutory authority for programs such as the Economic Development Tax Increment Financing, Motion Picture Incentive and Hotel Convention Center to receive an Authorization to Disclose (ATD) from a company who enters into an agreement for an incentive. If the legislature would enact statute that would require a company to provide an authorization to disclose, GOED would collect the information and provide the ATD to the Utah State Tax Commission who would then release the documents to GOED through their Taxpayer Access Point.

   GOED would review the amount of employee withholding, sales and use and company income tax for the 12 months prior to the investment to set a baseline. Annual reviews of this information would help determine how much new revenue, revenues in excess of the baseline period, occurred during the time of investment. These revenues could then be offset to the cost of the tax credits issued to determine an accurate return on investment.

2. We recommend that the Governor's Office of Economic Development track the net number of new annual jobs created moving forward. (as shown in Scenario B)

   GOED agrees with recommendation number 2 and has already implemented the recommendation.

   RICs report annually on the number of new high paying jobs for each eligible business for the preceding year on the last day of February. GOED provides each RIC an annual determination letter of new annual jobs as statutorily required on March 31. Calendar year 2020 was the first year GOED needed to consider how to provide the calculation for two reporting years in the determination letter.

   GOED engaged with the RICs in December 2019 and again in March 2020 to determine a joint interpretation of the statute and administrative code, specifically R357-21-11. Both parties agreed, upon reviewing law and administrative code, that new annual jobs are calculated each year and the baseline resets to the time the investment is made. This interpretation matches new high paying job creation and retention of the job facilitated by an investment under the RJA program.

   In discussion with the Auditor General's staff, GOED implemented recommendation number 2 by quickly providing a determination letter issued on March 31, 2021 which incorporates both tracking of jobs using scenario A and scenario B. In the future GOED's annual reports will include information using both scenarios.

3. We recommend the Legislature consider clarifying the method for counting new annual jobs when two rural investment companies (RICs) invest in the same eligible small business.

   GOED agrees with recommendation number 3 and has already implemented the recommendation.

   GOED in its March 2021 annual determination letter to the RICs reduced the number of new annual jobs prorata for the three joint investments associated with job creation reporting for scenario A and scenario B. RICs have 30 days to respond to the determination letter and we have requested their cooperation to accept this recommendation. Additionally, GOED is a pursuing administrative rule update to make this change moving forward. GOED requests Legislative support to provide clarity.

4. Prior to starting a new or similar tax credit program, we recommend that the Legislature consider the following suggested improvements as they relate to program performance metrics:
   a. Program performance metrics should be directly tied to predefined goals or standards and reflect intended outcomes.
   b. Program performance metrics should be timely and include an end date

   GOED agrees with recommendation number 4.