



Audit of Economic Development

Recruitment & Expansion Follow-Up Review

The City of Denton has adopted a new Economic Development strategic plan based on an economic ecosystem approach. This plan includes strategic growth areas which have been incorporated into the City's business recruitment marketing and incentive evaluation processes. However, reporting on the plan's implementation has recently been stalled due to staff turnover.

In addition, the Economic Development Partnership has implemented a lead tracking system that has improved lead tracking and reporting capabilities.

Similarly, the City has developed a formal business retention and expansion program and has used this lead system to record more detailed information about business assistance services provided.

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Follow-Up at a Glance

Why we did this Follow-Up:

This report is intended to provide information on what changes have been made in response to the Audit of Economic Development: Recruitment & Expansion issued in January 2020. The original audit evaluated the City’s economic development business recruitment and expansion activities framework. This follow-up review was included on the City’s fiscal year 2021-22 Annual Internal Audit Plan as approved by the City Council.

What we Found:

The City of Denton has adopted a new Economic Development strategic plan that includes strategic growth areas. While these have been incorporated into the City’s incentive evaluation processes, staff turnover has stalled reporting on the plan’s implementation. In addition, a lead tracking system has been implemented to facilitate business recruitment lead tracking as well as business assistance services provided by the City. The status of each recommendation is summarized below:

Recommendation	Mgmt. Response	Status
1. Develop an economic development strategic plan based on historical patterns, current circumstances, and emerging trends.	Concur	Implemented
2. Identify high value-added subsectors of target industry sectors to help focus economic development recruitment and incentive activities.	Partially Concur	Implemented
3. Revise the Tax Abatement and Incentives policy to outline clear performance expectations from staff based on the City’s incentive objectives.	TBD	Alt. Solution
4. Verify critical metrics used to determine the incentive package offered to businesses as part of incentive monitoring and reporting to ensure program objectives are met.	Concur	Implemented
5. Require Economic Development and Chamber staff to report the outcomes of their marketing efforts to achieve program objectives as established by the City Council.	Concur	In Progress
6. Develop a system to quantify marketing activities in order to better evaluate marketing event effectiveness.	Concur	Alt. Solution
7. Implement a lead tracking system to promote improved communication, reporting, and monitoring.	Concur	Implemented
8. Consider developing a process to discuss potential economic development projects with the City Council before negotiations begin to facilitate the approval process.	Partially Concur	Implemented
9. Clearly define business retention and expansion targets and objectives to facilitate the evaluation of the program’s performance.	Concur	Implemented
10. Enhance documentation of business retention and expansion visits to facilitate reporting of program results.	Concur	Implemented
11. Consider developing a survey to distribute to small business and those outside of targeted business retention and expansion areas.	Concur	Implemented

Introduction

The Internal Audit Department is responsible for providing: (a) an independent appraisal¹ of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

The Internal Audit Department has completed a follow-up review of the Audit of Economic Development: Recruitment & Expansion issued in January 2020. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Audit Objectives, Scope, and Methodology

This report is intended to provide a progress update on recommendations from the [Audit of Economic Development: Recruitment & Expansion \(January 2020\)](#), which evaluated the City's economic development business recruitment and expansion activities framework.

Audit fieldwork was conducted during August and September 2022. The scope of review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

- Reviewed documentation from the issued audit to develop criteria including industry standards, best practices, policies, and procedures;
- Interviewed Economic Development Department, Economic Development Partnership, and City Attorney's Office staff;

¹ The City of Denton's Internal Audit Department is considered structurally independent as defined by generally accepted government auditing standard 3.56.

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- Reviewed the 2020 Denton Economic Development Strategic Plan, the Business Retention & Expansion Program Outline, economic development activity reports made to the Economic Development Partnership Board since January 2021, and the City's 2020 Economic Development Agreement with the Denton Chamber of Commerce;
- Compared the 2022 Tax Abatement and Chapter 380 policies with the 2018 Policy for Tax Abatement and Incentives, which was reviewed during the original audit;
- Examined an incentive application and respective evaluation using the application process adopted in 2022; and
- Observed the Economic Development Partnership's new lead management system.

Recommendation Status Update

This report summarizes the Audit of Economic Development: Recruitment & Expansion's recommendations, management responses, and the Internal Audit Department's follow-up findings, which describe to what extent City management has implemented Internal Audit's recommendations since the publication of the original report in January 2020.

Incentive Agreements are Adequately Administered

The original audit found that all incentive agreements entered into by the City between 2014 and 2018 were accurately calculated and reimbursement amounts were paid according to the terms of the agreement after compliance with the applicable required conditions. In addition, all the agreements were properly approved by the City Council in compliance with the City's economic development incentive policies. As such, this was not reevaluated as part of this follow-up review.

Unfocused ED Incentive Policy May Obscure Recruitment Targets

- 1. Develop an economic development strategic plan based on historical patterns, current circumstances, and emerging trends. This strategic plan should identify the core industry clusters that drive regional economic growth based on analytical research and clear expectations for program effectiveness. For this purpose, the City will benefit from hiring a qualified consulting firm practicing in this discipline. As of November 2019, the City has hired a consultant to perform this service.**

Management Response: Concur

Economic Development staff requested and received approval for a new comprehensive economic development strategic plan during the FY 19-20 budget process, which was given approval to be funded in FY 18-19. A contract with TIP Strategies has been executed and the final report is anticipated by Summer 2020. Management appreciates the auditor's shared understanding of the value of having such a plan.

Audit Follow-Up Finding: Implemented

An Economic Development strategic plan was adopted by the City Council in January 2021. This plan includes three goals including:

1. Accelerate Recovery – Coordinate short-term economic recovery efforts from the COVID-19 pandemic by aggregating information, collaborating with regional partners, and allocating resources to top priorities.

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2. Foster Growth – Attract long-term economic growth that aligns with community priorities by focusing on four strategic growth areas: connectivity, creativity, sustainability, and competitiveness.
3. Strengthen Community Inclusion – Align economic, workforce, and community development efforts to meet critical community needs and strengthen community inclusion.

This strategic plan utilized an ecosystem building approach to identify the City's strategic growth areas as opposed to a tradition target industry approach as discussed in the original audit report. Under this approach, elements of an ecosystem including anchor institutions, competitions and events, local capital, emerging participants, building blocks, and public awareness are all evaluated in order to identify growth areas.

Based on review of the Environmental Protection Agency's "Framework for Creating a Smart Growth Economic Development Strategy," there are five key steps to developing a smart growth strategy:

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|----------------------------|---|
| A. Select a focus area. | B. Define the context. |
| C. Set goals. | D. Identify existing assets and barriers. |
| E. Select the right tools. | |
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The City's new Economic Development Strategic Plan appears to have identified four strategic growth areas using the recommended five steps, as described below:

- Connectivity – Denton's major employers, interstate access, and planned infrastructure improvements make it a transportation and logistics hub for the DFW Metroplex.
- Creativity – A growing entrepreneurship community, including startups in the tech and arts/culture sectors, contributes to Denton's unique vibe.
- Sustainability – the City's investment in 100 percent renewable resources positions Denton to be a global leader in renewable energy and green technology.
- Competitiveness – Denton's economic competitiveness will continue to improve with planned housing developments, downtown amenities, digital marketing, and infrastructure improvements.

2. **Identify high value-added subsectors of target industry sectors to help focus economic development recruitment and incentive activities. These defined target industries should be based on the analysis conducted by the economic development consulting firm hired by the City.**

Management Response: Partially Concur

Management agrees that more clear guidance regarding the pursuit of targeted sectors for specific incentive programs could be developed, but requests that the development of those targeted sectors be based on a comprehensive analysis of the regional economic ecosystem, the City Council's strategic goals, potential future development possibilities, and an evaluation of tax-base diversification, supply chain needs, workforce development possibilities, and additional factors. The audit relied solely on the use of cluster analysis and location quotients to establish this recommendation. And while this type of analysis can be information, a cluster analysis and location quotient technique only produce a rough descriptive indicator of relative concentrations of industries as compared to a larger area. It forces the user to make assumptions that a given smaller region is significantly similar to a larger geographic region on the whole, and, if the assumptions that are not correct or the economic system is not well understood, produces a value that inaccurately portrays the economic system in which the industry clusters exist. There are also significant challenges in understanding how industries and labor are classified under different systems, which can further destabilize assumptions and lead to faulty conclusions. Management also understands the value of flexibility and the consideration of innovative and unique factors of projects, and that being overly prescriptive can reduce recruitment potential and lead to ineffective, limiting strategies that reduce the City's ability to find creative ways to attract and retain businesses.

Audit Follow-Up Finding: Implemented

While the new strategic plan did not employ traditional economic development target sectors as recommended by the original audit, it did identify strategic growth areas. For each of these strategic growth areas, three-digit North American Industry Classification System codes have been identified to help evaluate if incentive applicants align with these.

Furthermore, the original audit found that the City's target industries and priority considerations were generally very broad and not well defined; however, this issue appears to have been addressed as the updated incentive evaluation matrix contains explanations or definitions of the priority considerations including new "public benefit factors" evaluation considerations.

The City has revised its incentive application and application review process to include an evaluation of applicants' alignment with the City's economic development strategic growth areas, priority considerations, and public benefit factors.

Revisions to Economic Development Incentive Policy May Improve Accountability

- 3. The City Council needs to revise the Tax Abatement and Incentives policy to outline clear performance expectations based on the City's incentive objectives.**

Management Response: None Needed
Not Applicable.

Audit Follow-Up Finding: Alternative Solution

The Economic Development Strategic Plan includes specific objectives and activities that are expected to be completed by the City's Economic Development Department's and the Denton Economic Development Partnership's staff within certain timeframes. This plan allows for evaluation of performance in alignment with the City's new strategic plan, which includes specific objectives and focus areas.

- 4. Verify critical metrics used to determine the incentive package offered to businesses as part of incentive monitoring and report to ensure program objectives are met.**

Management Response: Concur

Management fully agrees that regular and robust monitoring of incentive agreements and associated metrics is a high priority, and as noted in the audit, quality management of the monitoring and compliance process was demonstrated with the finding that incentive agreements were administered appropriate. Also, as noted in the audit, the Economic Development department negotiates agreements and associated performance measures and compliance reporting on a case-by-case basis, based on numerous factors for evaluation. Due to the individualized nature of agreements, the negotiation process, and the variety of metrics that are used to evaluate an incentive request, defining what critical metrics are needed should be based on the individual incentive package being negotiated and the incorporated into the monitoring process based on the outcome. To the extent feasible, staff include basic critical metrics that are relevant and important to the incentive being offered and take great care to ensure that agreements remain in compliance with negotiated terms.

Audit Follow-Up Finding: Implemented

As part of the original audit, we found that the Economic Development Department had a generally effective process to verify that businesses who had executed incentive agreements with the City were meeting their contractual requirements.

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In addition, the 2018 Tax Abatement and Incentives policy reviewed as part of the original audit required companies to meet minimum property value thresholds within the first 24 months of operations to receive their incentive. However, the same type of requirement did not originally exist for job creation, which was a key priority consideration for many incentive applications.

Since the original audit, the 2022 Tax Abatement and Chapter 380 policies now require companies to also meet minimum job creation thresholds unless otherwise specified by contract. In addition, the new incentive application evaluation matrix provides several clearly defined avenues for applicants to show how they will be supporting the City's goal to create quality jobs including:

- Increase high wage jobs whereby an average or significant percentage of jobs will earn at least \$65,000 annually;
- Encourage knowledge base jobs, which require specialized or theoretical knowledge acquired through higher education or specific licensing; and
- Pays a living wage for all new employees based on the Denton County living wage calculator.

This is particularly important as the criteria definitions listed in the 2018 incentive policies were confusing and were grouped together as part of the evaluation process.

Improved Reporting & Monitoring Could Benefit Business Recruitment Efforts

5. Require Economic Development Department and Chamber staff to report the outcomes of their marketing efforts to achieve program objectives as established by the City Council.

Management Response: Concur

Both the City's Economic Development Department and the Chamber economic development staff will be engaged in the strategic planning process, which will include the development of new metrics and performance measures. Management concurs that both City and Chamber staff should report and focus on efforts to meet the goals and outcomes established in that process. In addition, as the Chamber provides a service to the City under a contract, the Chamber should also comply with metrics and performance measures established in that agreement.

Audit Follow-Up Finding: In Progress

The implementation of the Economic Development Partnership's new lead management system facilitates the tracking and reporting of marketing activities and management of economic development contacts. These activities are generally reported to the Economic Development Partnership Board in a briefing at every meeting.

That being said, progress on the Denton Economic Development Strategic Plan has not been presented to the Economic Development Partnership Board since July 2021. Based on discussion with Economic Development Department staff, this is due to limited progress being made on the plan due to staffing turn over. The Department plans to resume work on implementing the strategic plan in the next few months.

6. Develop a system to quantify marketing activities in order to better evaluate marketing event effectiveness.

Management Response: Concur

As part of economic development strategic plan, staff will work with the consultant to evaluate this recommendation and consider options for evaluating the effectiveness of marketing activities.

Audit Follow-Up Finding: Alternative Solution

During the original audit period, the City's agreement with the Denton Chamber of Commerce required the organization to meet specific metrics such as establishing an average of three contacts per marketing event, respond to a certain number of leads, and oversee a certain number of site visits. During the original audit, it was difficult to determine if the Chamber was meeting these metrics due to the way they were tracking lead activity.

Based on review of the City's current agreement with the Denton Chamber of Commerce, the format of this agreement has changed to reflect strategic focus areas and specific work plan items to be completed by the Chamber instead of specific metrics. Based on this new agreement, the Chamber is reporting on its activities in relation to each of these work plan items annually.

In addition, based on discussion with Economic Development Partnership staff, it is difficult to quantify the effectiveness of marketing events as these types of events are intended to help ensure investors and real estate brokers are aware of Denton and what it has to offer. That being said, the Economic Development Partnership does hold quarterly events and invites local business leaders, investors, and real estate brokers to attend. While Economic Development Partnership staff do still attend

some conventions, they stated that their focus now is on these local events and updating marketing materials to reflect Denton's current resources and attract businesses in the City's strategic growth areas.

7. Implement a lead tracking system to promote improved communication, reporting, and monitoring.

Management Response: Concur

While the City currently has a detailed process for tracking and managing its leads and RFIs, Management agrees that these efforts can be better documented and, prior to the audit, had initiated research to find a solution that meets the needs of the City, the department, the Chamber, and businesses. Management is working to implement a more comprehensive reporting program during FY 2019-20 that will provide more meaningful metrics.

Audit Follow-Up Finding: Implemented

The Economic Development Department and Economic Development Partnership staff have jointly implemented a lead tracking system. This lead tracking system allows for lead and project information to easily be shared between both organizations and facilitates reporting of the Economic Development Partnership's activities.

Adherence to Best Practices Could Streamline the Incentive Process

8. Consider developing a process to discuss potential economic development projects with the City Council before negotiations begin to facilitate the approval process. Executive session may be utilized to provide confidentiality to high-profile development projects.

Management Response: Partially Concur

Management partially concurs only insofar as the City Council approves the incentive application and approval procedures as part of the incentive policy. Currently the policy-approved process does not direct staff to bring projects to City Council first, but instead to the Economic Development Partnership Board for review and recommendation. If the City Council wishes to make a change to the process, staff will fully comply with adopted procedures.

Audit Follow-Up Finding: Implemented

Based on discussion with Economic Development Department and City Attorney's Office staff, this appears to be a procedure that the Economic Development Department is currently permitted to implement. Economic Development staff have indicated that they intend to use this process for

more complicated projects when additional strategic direction is needed.

Robust Business Retention and Expansion Efforts Need Comprehensive Reporting

- 9. Clearly define business retention and expansion targets and objectives to facilitate the evaluation of the BRE program's performance. These definitions could be included in an internal policy and procedures manual.**

Management Response: Concur

Prior to the audit, Management reviewed the City's BRE program and has made defining an associated work plan a priority. To accomplish this, staff requested the development of an actionable work plan and metrics for economic development activities, including BRE, in the scope of work for the strategic plan.

Audit Follow-Up Finding: Implemented

The Economic Development Department has created a Business Retention and Expansion Program Outline that establishes the program's purpose, goals, objectives, and qualitative and quantitative performance measures, which was approved by the Economic Development Partnership Board in November 2020.

In addition, results of the Business Retention and Expansion Program from 2021 were presented to the Board in February 2022. According to this report, 47 businesses of varying size were visited by Economic Development staff, which lead to eight local business expansions.

- 10. Enhance documentation of business retention and expansion visits to facilitate reporting of program results.**

Management Response: Concur

Management agrees that business retention and expansion efforts can be better documented and , prior to the audit, had initiated research to find a solution that meets the needs of the City, the department, and businesses. Management is working to implement a more comprehensive reporting program during FY 2019-20.

Audit Follow-Up Finding: Implemented

According to Economic Development staff, businesses are required to complete a pre-visit survey as part of every business retention and expansion visit. This survey includes questions on if the business plans to expand, current space needs, types of training the business performs,

and any challenges or needs that the business is facing that the City may be able to assist with.

In addition, the Economic Development Department receives assistance inquiries from businesses throughout the year . All business assistance requests and resolutions are tracked in the City's HUBSpot system to ensure that there is adequate documentation of what services have been provided. According to Economic Development staff, a business assistance ticket may be opened based on a business retention and expansion visit if needed.

11. Consider developing a survey to distribute to small businesses and those outside of targeted business retention and expansion areas.

Management Response: Concur

As part of the economic development strategic plan, staff will work with the consultant to evaluate this recommendation and determine if a small business survey should be incorporated into the actionable work plan.

Audit Follow-Up Finding: Implemented

The Economic Development Department has developed a small business survey and distributed it to the community. This survey requests information from businesses on planned expansions, resource needs, and current operational challenges. In 2021, the survey received 13 total responses.