
PERFORMANCE AUDIT OF THE ECONOMIC DEVELOPMENT DEPARTMENT'S BUSINESS COOPERATION PROGRAM

The Business Cooperation Program
Should Increase City Revenues by
Targeting Large Construction Projects,
and Improve Internal Controls over
Rebate Payment Processing

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Auditor

City of San Diego



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THE CITY OF SAN DIEGO

September 28, 2017

Honorable Mayor, City Council, and Audit Committee Members
City of San Diego, California

Transmitted herewith is a performance audit report of the Economic Development Department's Business Cooperation Program (BCP). The BCP is a component of the larger Business and Industry Incentive Program (BII), and our audit of the full BII is forthcoming. This report was conducted in accordance with the City Auditor's Fiscal Year 2017 Audit Work Plan, and the report is presented in accordance with City Charter Section 39.2. The Results in Brief are presented on page 1. Audit Objectives, Scope, and Methodology are presented in Appendix B. Management's responses to our audit recommendations are presented after page 47 of this report.

We would like to thank staff from the Economic Development Department for their assistance and cooperation during this audit. All of their valuable time and efforts spent on providing us information is greatly appreciated. The audit staff members responsible for this audit report are Kevin Christensen, Andy Hanau, and Kyle Elser.

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Results In Brief

The City of San Diego (City) has recently experienced budget shortfalls resulting in the potential elimination of City jobs, changes in reserve policies, and cuts to arts funding and other popular City programs. The City also has approximately \$1.3 billion in unfunded infrastructure needs over the next five years. Therefore, it is crucial that the City seek to maximize the effectiveness of revenue-generating programs where opportunities exist.

In 1996, the City Council created the Economic Development Department's (EDD's) Business Cooperation Program (BCP) to capture additional sales and use tax revenues from large research, manufacturing, or construction projects. Since that time, EDD's operation of the BCP has successfully captured more than \$3.9 million in net new sales and use tax revenue for the City. However, since peaking in the mid-2000s, program revenues have declined significantly—only two companies are currently enrolled—and EDD has not taken advantage of the BCP to target large construction projects and maximize the amount of sales and use tax revenues that are deposited in City coffers.

The City is in the midst of a construction boom, with numerous projects of \$50 million or more being constructed in recent years. Given this, the City has likely missed out on additional revenues—potentially hundreds of thousands to more than \$1 million—from additional tax monies that could have been captured in the last two years alone.¹ Instead, these revenues have been distributed to other taxing jurisdictions throughout San Diego County, or another county. We recommend that the Chief Operating Officer direct EDD, or another appropriate department, to utilize the BCP to systematically target large public and private construction projects in order to maximize City revenues from the program.

In addition, because the program relies on voluntary company enrollment, the City has also provided more than \$3 million in tax rebates to companies in order to incentivize participation. In order to ensure that revenue and rebate calculations are accurate, it is critical for EDD to implement an internal control framework to

¹ This is before any rebates or consultant commissions, as discussed in Finding 1.

ensure the accuracy of the revenue the City receives and the rebates paid to the company. Although we did not note any material payment inaccuracies, we found that EDD had not developed a sufficient internal control framework over the BCP, lacked documented procedures for how rebates are calculated, did not establish appropriate segregation of duties between payment processing functions, and did not conduct supervisory review to verify accuracy.² We recommend EDD consult with the Comptroller's Office to design and implement internal controls to ensure accurate calculations and quality control over payments.

We made a total of 4 recommendations to improve BCP program revenues and improve internal controls over rebate payment processing. Management agreed to implement all 4 recommendations.

² As a result of our audit findings, EDD has begun developing documented procedures for calculating rebate, performing supervisory review, and establishing separation of duties between payment processing functions.

Background

Introduction

The City pursues economic development for two reasons: to promote investment in jobs and infrastructure, and to support revenue generation for the City. To that end, the Business Cooperation Program (BCP) was created in 1996 to help the City capture additional tax revenue that would otherwise be distributed Countywide, or to taxing jurisdictions in other counties. The BCP is a component of the Economic Development Department's (EDD) broader Business and Industry Incentives Program (BII). As part of a larger audit of the BII, we evaluated the BCP to:

1. Determine whether opportunities exist to improve the effectiveness of incentives provided by the BCP; and
2. Assess the City's overall control framework related to incentives offered through the BCP.

The BCP Has Helped the City Capture Approximately \$3.9 Million in Additional Tax Revenue Since 1996

The BCP was created to take advantage of tax regulations promulgated by the California State Board of Equalization (BOE) which allow the City to collect additional sales and use taxes on goods sold or purchased by businesses in the City. Specifically, when created by the City Council in 1996, the BCP was intended to target large research, manufacturing, and construction projects, as those projects would generate the greatest return on investment due to the larger tax revenues that would be generated.³

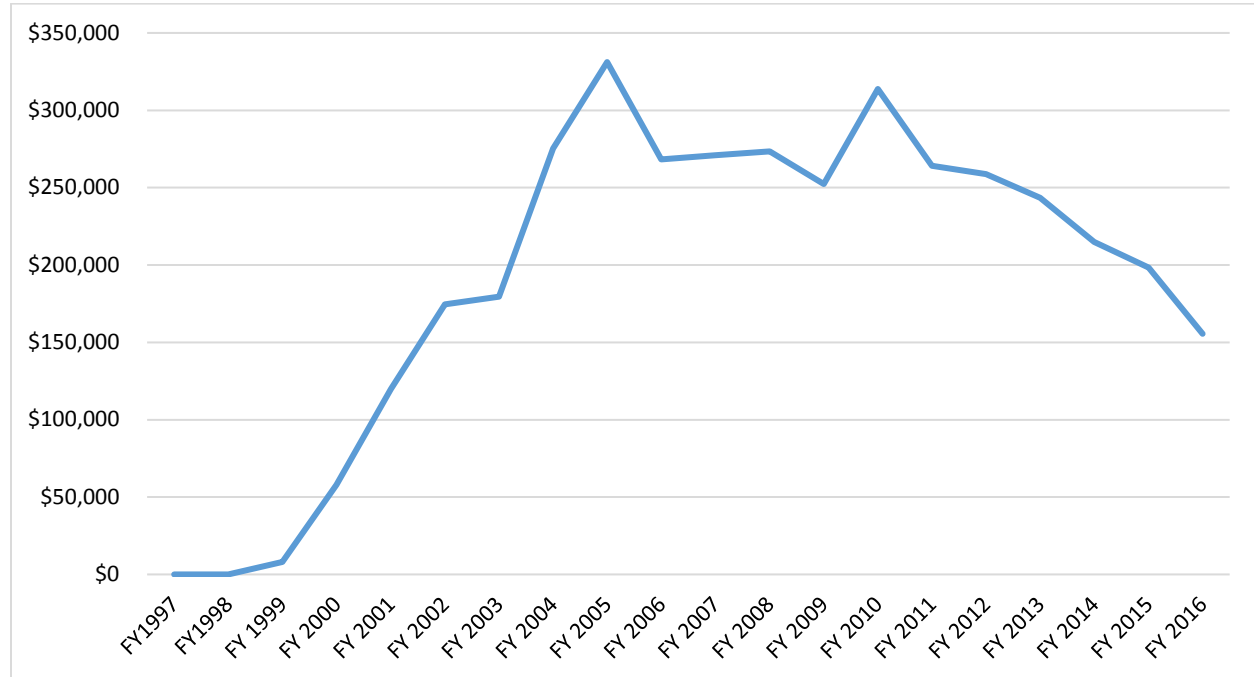
The BCP does not increase taxes on businesses located in the City, but rather, captures certain tax revenues generated by businesses in the City that would otherwise be distributed to other taxing jurisdictions within San Diego County. Since the BCP's inception, the program has generated modest amounts of revenue for the City—\$3.9 million over 20 years, or about \$190,000 annually—and the number of companies enrolled has declined over time.⁴ Currently, only two businesses are participating in the BCP. As shown in Exhibit 1, program revenues have also declined in recent years.

³ Council Resolution R-288034 (attached as Appendix C) and Manager's Report 96-206.

⁴ Since its inception, 15 companies have been enrolled in the BCP. Today, just two companies continue to submit rebate invoices. These companies include Novartis and Intuit.

Exhibit 1:

Business Cooperation Program – Additional Funds Generated for City, FY1997-FY2016



Source: OCA, based on data provided by EDD.

The following sections describe how certain taxes—specifically, Bradley-Burns sales and use tax revenues—are normally distributed, and how the City captures more revenue through the BCP.

The State Collects All Sales Tax Revenue, Then Allocates Monies To Various State and Local Funds

California charges sales and use tax on most sales and purchases within the state. When California retailers sell taxable tangible goods, they generally owe sales tax to the state. The state sales tax applies to a retailer’s sales to most buyers, including individuals, businesses, nonprofit and religious organizations, and California’s state and local governments. State law also requires buyers to pay a use tax on certain purchases of tangible goods, if the buyer does not pay sales tax on those goods. The use tax is imposed at the time that taxable tangible personal property is placed into service (“used”) in California. Most transactions subject to use tax are those involving products shipped into California from outside the state. The combined sales and use tax rate in the City is currently 7.75 percent.

Although portions of the combined sales and use tax revenues are dedicated to local purposes, all revenues are originally collected

**Use Taxes Generated in
the City of San Diego are
Frequently Shared
Between the City and
Other County
Jurisdictions, Even
Though the Taxable Use
of Goods Occurred
Within the City**

by the state BOE. After the BOE collects sales and use tax revenue, the money is allocated for distribution between various state and local funds.⁵

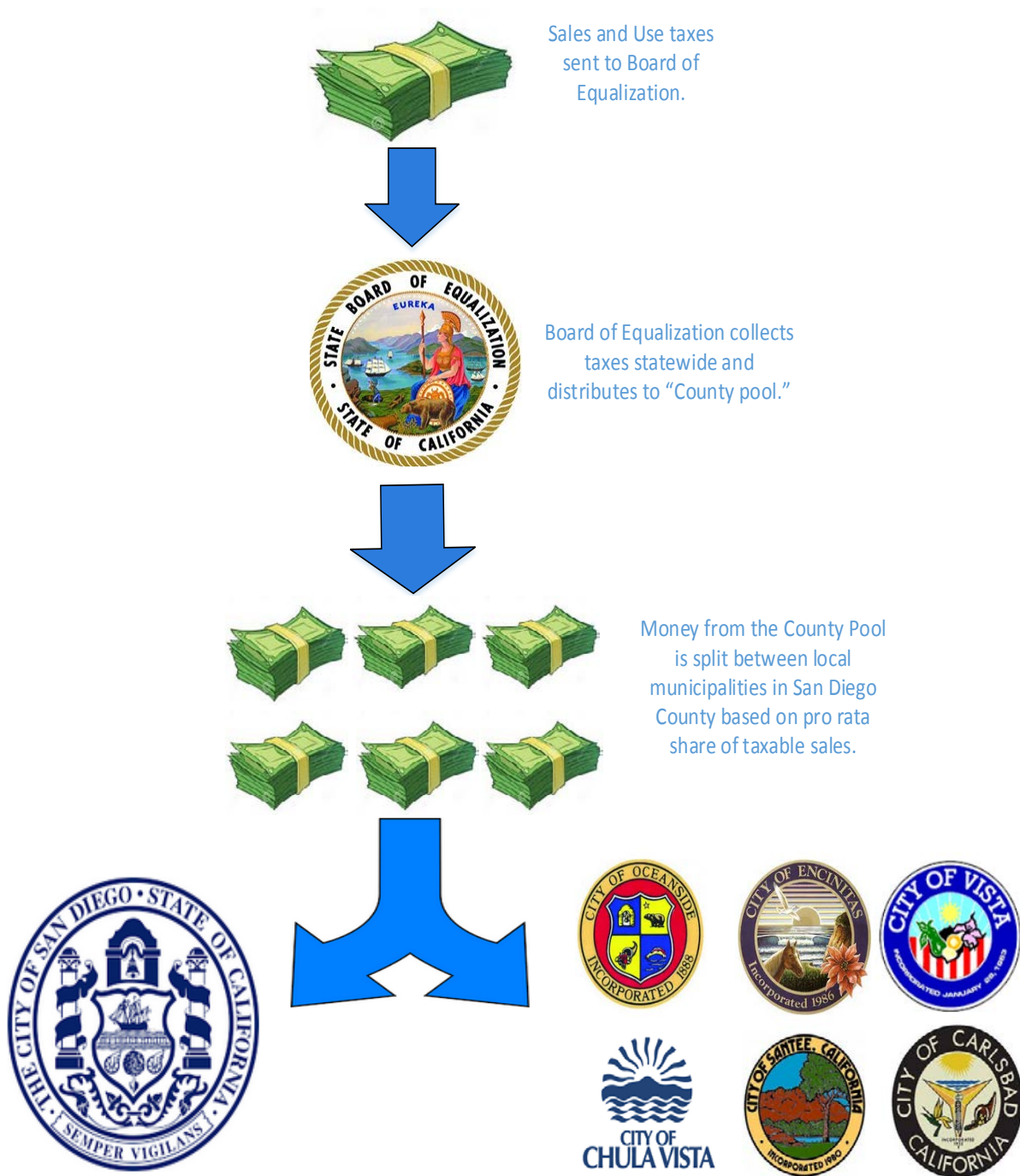
A portion of the total sales or use tax collected by the BOE, known as the Bradley–Burns Uniform Local Sales and Use Tax Rate, is frequently directed into Countywide tax pools in accordance with the City's tax administration contract with the BOE. The Bradley–Burns sales and use tax rate constitutes one percent of the total 7.75 percent sales and use tax rate applied to transactions involving taxpayers in the City (i.e., one cent for every 7.75 cents collected). The County pools are basically an accounting mechanism to collect the funds and distribute them to local municipalities located within counties throughout the state using a formula based on a pro rata share of taxable sales. The City of San Diego receives 48 percent of the funds allocated to the San Diego County pool, even if the revenues derive from business activity located entirely within the City. The remaining 52 percent of the revenues are distributed to other jurisdictions within the County.

For example, as part of its total 7.75 percent sales and use tax bill, a company or project located in the City pays \$100,000 in Bradley–Burns sales and use tax, which is collected by the BOE, which then allocates the \$100,000 to the San Diego County pool. Of the \$100,000, about \$48,000 is directed to the City and the remaining \$52,000 is distributed to other County jurisdictions, even though the taxed consumption of goods (such as manufacturing equipment or construction materials) occurred within the City. A depiction of how Bradley–Burns sales and use taxes are normally allocated can be found in **Exhibit 2**.

⁵ The various funds and percentage of sales and use tax allocations include: State General Fund (4.19 percent); 2011 Realignment (1.06 percent); Bradley–Burns Transportation (0.25 percent); Local Public Safety (0.50 percent); 1991 Realignment (0.50 percent); Transaction and Use Taxes (0.25 percent); and Bradley Burns Sales and Use Taxes (1 percent).

Exhibit 2:

Bradley-Burns Use Tax Revenue Generated from Sales or Consumption of Goods within the City of San Diego are Frequently Placed into the County Pool and Shared with Other County Jurisdictions



Source: OCA, based on interviews with EDD staff and documentation from the State Legislative Analyst.

**BOE Regulations Allow
the City to Partner with
Businesses to Capture All
Bradley-Burns Use Tax
Revenue They Generate
in the City**

While Bradley-Burns use tax revenues are frequently divided amongst jurisdictions in the County, regulations promulgated by the BOE provide a mechanism to allow the City to ensure all Bradley-Burns use tax revenues generated in the City go directly to City coffers, thereby avoiding the split through the County pool.⁶ This typically requires the City to approach a business which generates Bradley-Burns tax revenue, and persuade them to change the way they report their Bradley-Burns use taxes.

This requires extra work on the part of the participating business to change how they report, or cause the reporting of taxable transactions, hence the name "Business Cooperation Program" (BCP). As a result, all of the transactions and related use tax are recorded in the City itself, rather than the County. In return for the business' cooperation, the City Council authorized EDD to rebate the business a portion of the new tax revenue allocated to the City.⁷

In addition, in the past the City used a consultant to help reorganize a business' tax reporting and process refund payments, and the consultant received a portion of the additional revenues for providing this service. The City no longer uses a consultant to perform these functions and performs them in-house.

For example, a company in the City that enrolls in the BCP pays \$100,000 in Bradley-Burns use tax, which is collected by the BOE. As a result of the company's change in reporting and filing transactions subject to the use tax, the BOE sends the \$100,000 directly to the City instead of to the County pool, where the City

⁶ Board of Equalization Regulations secs. 1699.6, 1802, and 1806. *See also: California State Board of Equalization: Publication 9*, March 2016, available at: <https://www.boe.ca.gov/pdf/pub9.pdf>.

⁷ Convincing companies to enroll in the BCP can be a challenge for municipalities because the company must undertake a series of time consuming changes in accounting methodology and tax reporting. Cities can incentivize companies to enroll and undergo the changes in accounting and reporting methodologies by splitting with the company a portion of the new revenue generated through that company's enrollment in the BCP. The City of San Diego provides ongoing tax rebates to participating businesses equal to up to 50 cents for each new dollar of tax revenue reported resulting from the company's enrollment in the BCP. This figure represents about a quarter of the sales/use tax paid. The City has allocated more than \$3.5 million to companies enrolled in the program. There is, however, no requirement that the City split the new revenue, and some jurisdictions do not split new revenue with participating businesses.

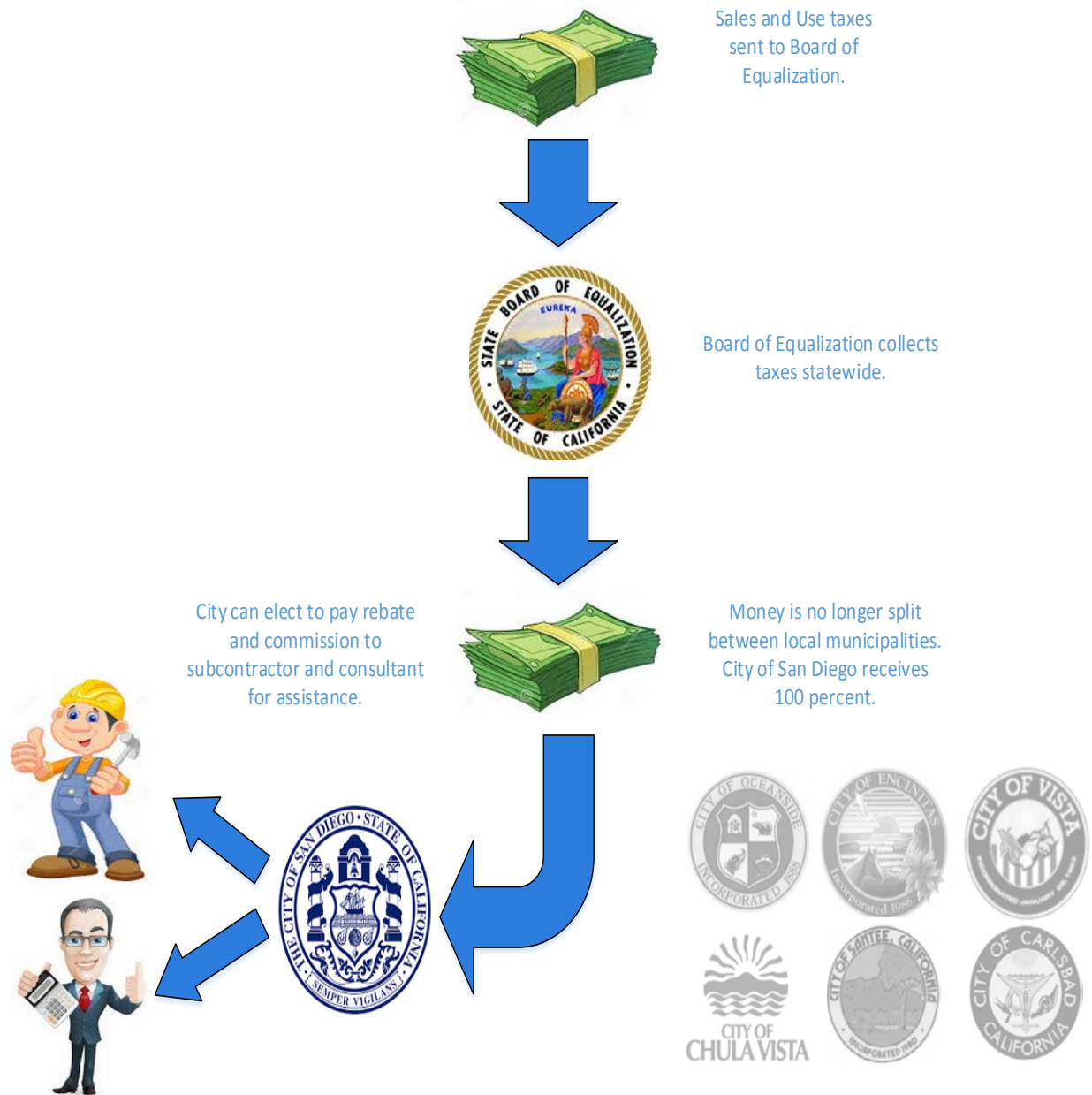
As discussed in Finding 1, large public works construction projects are also good targets for the BCP. For these types of projects, the City can likely require contractors to commit to enrolling in the BCP as part of the bidding and award process. Therefore, it may not be necessary to rebate any of the new revenues to the contractors.

would have only received \$48,000 as described in the previous section. A portion of the new funds may be returned to the participating business, as well as a consultant, if needed.

A depiction of how Bradley-Burns use tax revenues are allocated under the BCP can be found in **Exhibit 3**.

Exhibit 3:

Under the Business Cooperation Program, Bradley-Burns Use Tax Generated in the City of San Diego is Sent Directly to the City, Thereby Avoiding Distribution through the County Pool



Source: OCA, based on interviews with EDD staff and documentation from the State Legislative Analyst.

Audit Results

Finding 1: The Business Cooperation Program Should Target Large Construction Projects in Order to Maximize City Revenues

California State Board of Equalization (BOE) regulations allow the Business Cooperation Program (BCP) to pursue job-site construction contractors in the City, in addition to the manufacturing and research projects that the Economic Development Department (EDD) has typically targeted.⁸ The City Council also directed EDD to utilize the BCP to target construction projects, in addition to research and manufacturing, when the program was initiated in 1996. According to EDD, initial attempts to pursue job-site contractors in the late 1990s were unsuccessful, and since that time EDD has only targeted other industries, and has not used the BCP to target construction.

We found that several other California cities are successfully pursuing large construction projects through their versions of the BCP. Given that the City of San Diego (City) is in the midst of a construction boom, the City has likely missed out on significant revenues by not targeting large construction projects for participation in the BCP—potentially hundreds of thousands to more than \$1 million in the last two years alone. We recommend that the Chief Operating Officer direct EDD, or another appropriate department, to use the BCP to systematically target public and private construction projects, in addition to its current focus on other industries.

⁸ As discussed later in this section, BOE's Regulation 1806 allows job-site contractors to report the tax on taxable materials used at the jobsite to the jurisdiction within which the jobsite is located, if the materials portion of the contract is \$5 million or more. Notably, the California League of Cities is currently promoting legislation to lower this threshold to \$1 million.

**California Cities Are
Successfully Utilizing
Programs Like the BCP to
Capture Additional Use
Tax Revenue from Large
Construction Projects**

Most large construction projects in California require the purchase of significant amounts of materials and equipment—such as glass, steel, and elevators—from out-of-state sources. Such purchases are subject to the Bradley-Burns Uniform Local Sales and Use tax, which is typically distributed Countywide.⁹ Several cities in California have successfully used BOE regulations to capture additional tax revenue on large construction projects by diverting tax away from County pools directly to the jurisdiction where the job site is located.¹⁰ These cities have directed staff to monitor large scale construction projects in their municipality, directed outreach to establish relationships with contractors, and enrolled large subcontractors thereby capturing use tax revenues that would have been lost to other cities.

To successfully use the program, a municipality must proactively identify large construction projects planned within its boundaries, and approach the contractor to try to gain their participation in the BCP. Because most large construction projects are divided amongst several subcontractors, who report their own use taxes on construction materials they procure, subcontractors must be targeted as well. Current BOE regulations only allow this mechanism to be used with subcontractors whose individual contracts are for more than \$5 million. Experts we interviewed agreed that projects with total construction costs exceeding \$50 million are prime targets, as they will likely have several subcontractors with contracts exceeding \$5 million each.

Additionally, according to experts we interviewed, some types of City capital improvement projects which cost \$25 million or more may also be worthwhile to pursue, especially given that when awarding the contract, the City can use the bidding and award process to compel the contractor and subcontractors to participate without having to rebate some of the new proceeds as an incentive.

Once the contractor or subcontractor has been persuaded to enroll, they then file for a permit with the BOE, called a “sub-permit,” which designates the job site at the principal place of

⁹ According to EDD and MuniServices, the City’s tax consultant, there are some cases where companies may already file their taxes in a way that taxes are allocated to the City instead of the County pool. However, according to MuniServices, this is not common.

¹⁰ California State Board of Equalization Regulation 1806.

business for the purpose of tax allocations. The BOE will direct the allocation of use tax to the jurisdiction in which the job site is located rather than an indirect allocation through the Countywide pool. As a result, the City collects the full amount.

Other Cities Have Used a Variety of Strategies to Target Construction Projects Using the BCP

The most notable success stories of cities that have used the program to capture large sums include:

- The City of Santa Clara netted an additional \$1 million in use tax revenue related to the construction of the \$1.3 billion Levi's Stadium.
- The City of Sacramento netted an additional \$420,000 in use tax revenue related to the construction of the \$558 million Golden 1 Arena.

Other cities have employed different techniques to educate contractors and subcontractors to enter this program. As discussed below, some municipalities use the program only for publicly-owned construction projects while others seek to enroll contractors on privately-owned projects. Additionally, one stark difference between programs is some municipalities provide enrolling subcontractors a portion of the newly captured sales and use tax as an incentive to enroll. Other municipalities do not provide a rebate.

The following sections describe how other cities have used the Bradley-Burns tax code to capture additional use tax revenues that would have otherwise been distributed Countywide.

The City of Santa Clara Focuses on Publicly-Owned Projects Without Offering a Rebate for Subcontractor Participation

The City of Santa Clara effectively used the program to capture about \$1 million in additional use tax related to the construction of Levi's Stadium, which had a construction cost of approximately \$1.3 billion. The new stadium was constructed on public land which provided the city more negotiating leverage in its pursuit of subcontractor enrollment.

The City of Santa Clara included language in the contract with the developer that stated the developer would apply its best effort to require subcontractors that meet the threshold to enroll in Santa Clara's BCP. City of Santa Clara officials stated they spent time meeting with contractors submitting bids for the project to explain the purposes of the program. Additionally, the city officials used these meetings to target contractors hiring subcontractors that planned to purchase out of state materials in order to maximize the use tax revenue distribution.

The City of Santa Clara did not offer to pay rebates for subcontractors that enrolled in the program. City of Santa Clara officials stated subcontractors should be willing to enroll in the project as a sign of good corporate citizenship.

**The City of Sacramento
Focuses on Public
Projects or Projects on
Public Land, Awards
Extra Points on Bids and
for Contractors Who
Pledge to Participate,
and Offers Rebates**

The City of Sacramento effectively used the program to capture approximately \$420,000 in additional use tax related to the construction of the Golden 1 Arena, which had a construction cost of approximately \$558 million. The City of Sacramento is also exploring the possibility of using the program for large, public capital improvement projects.

In order to generate subcontractor interest and commitment to enroll in the program, the City of Sacramento and a consultant host meetings with developers when the city is planning a large project on city-owned land to explain the purpose of the use tax cooperation program. The City of Sacramento requests the developers to complete a questionnaire to gather information about the value of the contract, the kind of work to be completed, whether the company has used the program before, and to gauge contractor interest.

For publicly owned development projects, the City of Sacramento includes language in development agreements stating that contractors and subcontractors will report local sales and use taxes directly to the City of Sacramento. The City of Sacramento does not believe the addition of the language to the contracts caused increases in bid amounts.¹¹

The City of Sacramento contracts with a consultant specializing in sales and use tax allocations. The consultant, rather than city staff, works with the contractors and subcontractors on filing necessary documents with the BOE, assists with the accounting methodology changes, and assists with sales and use tax filings. The city also pays the consultant 15 percent of the new tax revenue.

¹¹ See Appendix D for an example of contract language.

**The City of San Jose
Focuses on Enrolling
Private Construction
Projects and Offers
Rebates to Enrollees**

The City of San Jose has used its version of the BCP for both private and public projects, and the program generates on average between \$40,000 to \$70,000 in additional revenue per quarter. According to the City of San Jose, large projects could be targeted as well, but relatively few large projects are currently being constructed. The program is housed in the city's Economic Development Department and staff actively pursues construction projects to identify potential enrollees.

To locate prospective enrollees, representatives of the City of San Jose's Economic Development Department monitor media reports of large projects and the lists of permits filed in the city for development. City of San Jose officials stated one technique that increased success in enrolling companies was incorporating language in agreements and project approval processes with developers to help ensure potential participation. However, enrolling contractors can be difficult due to time constraints of the construction company. The city also seeks to enroll companies into the program as a term of incentive agreements entered into during the course of economic development.

The City of San Jose employs a consultant to assist the company in filing initial paperwork, accounting changes, and different required tax filings. The consultant also oversees the contract between the city and subcontractors. City of San Jose officials stated that consistent and sustained follow-up of leads—one called this process "hand holding"—is critical to achieving success in enrolling companies.

The City of San Jose pays a rebate to subcontractors based on a scaled percentage of the new revenues. In other words, the more revenue generated, the higher the rebate percentage to the subcontractor. The City of San Jose also pays the consultant.

**The City of Long Beach
Focuses on Publicly-
Owned Projects and
Private Projects Without
Offering a Rebate for
Participation**

In an effort to maximize revenue potential, the City of Long Beach actively pursues Use Tax opportunities from both private projects and large construction projects that it owns and bids out. As part of this effort, the city included a contract requirement for all construction projects managed by the city. The requirement states that vendors must cooperate with the city in regards to taxes and tax reporting. This includes filing a Use Direct Payment Permit and the Sellers Permit.

Departments managing construction projects, largely the Public Works Department, are asked to notify the Financial Management Department once the contract is awarded and contractor is selected. Financial Management representatives and the city's sales tax consultant may set up meetings with the contractor to walk them through the permit and tax filing requirements.¹² The consultant may be responsible for working with the contractor and qualifying subcontractors on permit filing and proper tax filing. A notable city—managed project currently going through this process is the City of Long Beach's new Civic Center.

For private projects, the city may be made aware of upcoming projects through the normal development process. However, the city and its sales tax consultant will generally monitor receipts and report any misallocations that may occur.

The city's sales tax consultant is paid out of new revenue collected. The city does not currently have rebate agreements related to Use Tax. The decision to offer a rebate for Use Tax would be on a case-by-case basis per city management recommendation. At this time, no analysis has been conducted on whether rebates would have attracted more participants.

**The City of San Diego is
in the Midst of a
Development Boom,
Which Could Be
Leveraged to Increase
City Revenues**

Because EDD has not used the BCP to target large construction projects, the City has missed potential opportunities to enroll a number of large and high-dollar-value projects. In fact, in 2007, the developer for the Westfield Mall Expansion (a project estimated at approximately \$900 million) submitted a report to the City stating that the City would gain an additional \$1.1 million in tax revenues if the contractors enrolled in the BCP. EDD ultimately did not seek to persuade the contractors to enroll in the BCP, and the project was eventually constructed without participating.

Furthermore, numerous other projects that would be good targets for the BCP have been constructed in recent years. As noted above, projects of \$50 million or more are typically considered prime targets because they will likely have several subcontractors with contracts exceeding the \$5 million state threshold for participation in the BCP. For example, between 2016 and 2017, more than 30 large projects with valuations of \$50

¹² See Appendix E for the PowerPoint presentation that City of Long Beach uses in presentations to contractors.

million or more have been constructed or were being planned, with a total combined construction cost of \$5 billion. Projects that were potentially eligible for the program are shown in **Exhibit 4**.

Exhibit 4:

Large Construction Projects* in the City of San Diego, Calendar Years 2016-2017

Project	Project Cost
Kaiser Permanente San Diego Medical Center	\$585 million
UC San Diego Jacobs Medical Center	\$525 million
Westfield UTC (Phase 2)	\$500 million
The Judicial Council of California, San Diego Central Courthouse	\$452 million
Ballpark Village	\$257 million
San Diego International Airport - Rental Car Center	\$233 million
Intercontinental Hotel	\$219 million
UC San Diego, Altman Clinical and Translational Research Institute	\$173 million
UCSD East Campus Housing	\$172.2 million
Eli Lilly Expansion	\$136 million
Scripps Clinic La Jolla - John R. Anderson Medical Pavilion	\$130 million
SDSU - South Campus Plaza	\$118 million
460-16th Street	\$115 million
Centrum	\$108.9 million
San Diego International Airport Terminal 12	\$99.8 million
Lane Field North	\$94.2 million
SDSU Engineering & Interdisciplinary Sciences	\$90 million
IDEA 1	\$90 million
Blue Sky Apartments	\$86.4 million
One La Jolla Center	\$86 million
The REY	\$84 million
The Alexan	\$82 million
Pendry Hotel	\$81.2 million
UC San Diego, Outpatient Pavillion La Jolla	\$81 million
520 West Ash St.	\$80 million
San Diego Zoo, Africa Rocks Exhibit	\$68 million
The Park at Bankers Hill	\$66 million
Carte Hotel & Suites San Diego	\$62 million
Spectrum II	\$53 million
Torrey Point	\$53 million
San Diego Continuing Education Caesar E. Chavez Campus	\$50 million
Total Value of Large Construction Projects* in City in 2016-2017	\$5 BILLION

Note: Materials for certain non-profit and federal government projects may not be subject to sales and use tax. We did not verify whether each of the projects above are subject to sales and use tax; however, based on the project descriptions, the projects above do not appear to qualify for an exemption.

* Construction costs >\$50 million

Source: OCA, based on the 2016 and 2017 San Diego Book of Lists.

**Even Moderate Levels of
Success Gaining
Contractor Participation
Would Likely Generate
Significant New
Revenues**

According to information provided by tax consultants and other jurisdictions we interviewed, approximately 20 to 33 percent of the cost of large projects of \$50 million or more is made up of out of state purchases of things like glass, steel, and certain mechanical components, which are subject to the Bradley-Burns Uniform Local Sales and Use Tax. While not all contractors and subcontractors may be willing to participate, securing cooperation on just a few large projects could net significant revenues for the City.

For example, downtown's Ballpark Village project, currently under construction, has a projected construction cost of approximately \$257 million. Assuming that about 20 percent of the project cost is comprised of out-of-state materials purchases, the contractor and subcontractors would pay about \$514,000 in Bradley-Burns sales and use tax, of which only \$247,000 would be distributed to the City through the County pool. If the City were successful in securing contractor and subcontractor participation in use tax reporting, the City would receive the full \$514,000 (an increase of \$267,000, before any rebates or commissions that may be paid to contractors or consultants).¹³

Certain public projects that involve the purchase of large amounts of equipment and materials can be good targets as well because the City has control over the bidding process and could require BCP participation as a condition of the contract award, without having to provide rebates to the contractors. For example, the City Council recently approved a large sewer pump station backup generator project. According to the Public Works Department, \$11.2 million of the project cost is the actual acquisition of four substantial backup generators. By compelling the contractor to participate in the BCP, the City could receive the full \$112,000 in use taxes on the generator purchase, rather than the \$54,000 the City would otherwise receive through the County pool. There may be other components of the \$72 million project that would be

¹³ \$257 million construction cost x estimated 20 percent for use taxable materials = \$51.4 million. \$51.4 million materials cost x one percent Bradley-Burns sales and use tax rate = \$514,000. Of the \$514,000, the City would receive \$247,000 (48 percent) from the County pool, unless contractors and subcontractors cooperate to have all \$514,000 in use taxes sent directly to the City.

eligible for the BCP as well, increasing the City's benefit from compelling BCP participation on the project.¹⁴

Overall, if the City had only been successful in recruiting 10 to 20 percent of contractors and subcontractors on large projects in the last two years alone (as shown in the table above), the City would have captured an additional \$523,000 to \$1.05 million in revenue before any rebates or commissions, assuming that 20 percent of project costs were for out-of-state materials.¹⁵ If out of state materials costs were 33 percent and taking into account that about 25 percent of the contractors and subcontractors are located outside of the County, as some consultants forecast, the total the City could have captured is between \$1.1 million and \$2.1 million in the past two years.¹⁶

¹⁴ Public, non-City projects are good targets as well, because the City may be able to work with other public agencies to compel contractor participation in the BCP. For example, the new San Diego International Airport Rental Car Center, owned by the San Diego County Regional Airport Authority, has a projected construction cost of approximately \$233 million. Assuming that about 20 percent of the project cost is comprised of out-of-state materials purchases, the contractor and subcontractors would pay about \$466,000 in Bradley-Burns sales and use tax, of which only \$224,000 would be distributed to the City through the County pool. If the City and Airport Authority were successful in compelling contractor and subcontractor participation in the BCP, the City would receive the full \$466,000.

¹⁵ Total large project construction costs were \$5 billion over the last two years. \$5 billion x estimated 20 percent for use taxable materials = \$1 billion in use taxable materials. \$1 billion x one percent use tax rate = \$10 million in total use taxes paid. 10 percent cooperation conversion rate x \$10 million = \$1 million allocated directly to the City, whereas only \$483,000 (48 percent) would have been received through the County pool. This represents an increase of $(\$1,006,140 - \$482,947) = \$523,192$. 20 percent cooperation conversion rate x \$10 million = \$2.01 million allocated directly to the City, whereas only \$965,900 (48 percent) would have been received through the County pool. This represents an increase of $(\$2,012,280 - \$965,894) = \$1,046,385$.

¹⁶ According to tax consultants, when calculating tax disbursement estimates based on all projects in the City, it is fair to assume that about 25 percent of the contractors on a project are located outside of the County. In these cases, the City would receive none of the tax collected because the business is likely recording its transactions outside the County. It is therefore appropriate to use a 36 percent distribution for the City's collection of the funds through the County Pool (48 percent County pool distribution x 75 percent estimated contractors located in San Diego County = 36 percent of available sales/use tax collected by the City through the County Pool).

Taking these factors in account, and assuming that use taxable materials cost make up 33 percent of total project costs, as some experts estimate, the City could have captured \$1.1 million to \$2.1 million in additional revenues over the past two years, calculated as follows. Total large project construction costs were \$5 billion over the last two years. \$5 billion x estimated 33 percent for use taxable materials = \$1.65 billion in use taxable materials. \$1.65 billion x one percent use tax rate = \$16.5 million in total use taxes paid. 10 percent cooperation conversion rate x \$16.5 million = \$1.65 million allocated directly to the City, whereas only \$594,000 (36 percent) would have been received through the County pool. This represents an increase of $(\$1,650,000 - \$594,000) = \$1,056,000$. 20 percent cooperation conversion rate x \$16.5 million = \$3.3 million allocated directly to the City, whereas only \$1.2 million (36 percent) would have been received through the County pool. This represents an increase of $(\$3,300,000 - \$1,188,000) = \$2,112,000$.

Notably, some cities experienced more success. For example, former City of San Jose officials stated they enrolled subcontractors for 50 percent of the projects targeted.

Smaller Projects Could Also Be Targeted, Pending Potential Regulation Changes

Making the program more attractive for City use, the League of California Cities is considering seeking a sponsor for legislation that would lower the threshold for subcontractor entry from \$5 million to \$1 million. According to past users of the program, the threshold reduction could significantly increase the number and types of projects that can be targeted. As described above, the program is now limited to large projects with construction of more than \$50 million because these projects are more likely to have subcontractor contracts that meet the \$5 million threshold. Should the threshold be reduced, the program's prospective enrollee base could be expanded to include smaller projects, as well as additional capital improvement projects undertaken by the City.

Coordination Between EDD, Public Works, Development Services and Civic San Diego is Needed to Maximize Success

Implementing a strategy to target large projects should include the integration of efforts between staff in the Economic Development Department (EDD)¹⁷, Public Works Department, Development Services Development, and Civic San Diego (which issues permits for projects in the Downtown area). Specifically, staff in Public Works, Development Services, and Civic San Diego can help identify large construction projects—those more than \$50 million, or \$25 million for public projects—early on in the project planning phases and notify staff at EDD. Providing this information early in planning stages can provide EDD staff sufficient lead time to reach out to developers and contractors for outreach and education efforts to enroll subcontractors into the BCP. This will also help identify public projects that are good candidates early on, so that BCP participation can be included as part of bid requirements.

¹⁷ As discussed later in this section, EDD believes this task is best suited for another department. We recommend the COO determine which department, such as the Economic Development Department or the Financial Management Department, has the best ability to manage the portion of the Business Cooperation Program that targets construction activity.

**The City Should Act
Quickly to Take
Advantage of
Continuing High Levels
of Construction Activity**

The City's development boom appears poised to continue in the near future, with several potentially substantial public projects or projects on publicly-owned land contemplated, such as the expansion of the Convention Center and the redevelopment of Seaport Village, Harbor Island, and the Qualcomm Stadium site. The possibility of these types of projects, which have a high chance of enrollment, and the likelihood that additional large private projects will continue to be developed, make it important for the City and EDD act quickly to use the BCP to systematically target large construction projects. The positive return on investment could be substantial, even if an additional staff member or consultant is needed to help operate the program.

According to EDD, it is difficult to persuade contractors to enroll in the BCP because the cost of changing their accounting methods often exceeds the value of the rebate the City provides as an incentive. While this may sometimes be the case, other cities have successfully targeted construction activity, and the City of San Diego could likely be successful as well if it leverages the experiences of other cities and chooses an effective strategy.

Also according to EDD, although the City Council originally directed responsibility for implementing the BCP to EDD, using the BCP to target construction activity is a task that would be best suited for another department, such as Financial Management. In most of the other cities we reviewed—including San Jose, Sacramento, and Santa Clara—this task was typically undertaken by economic development staff or the City Manager's Office, largely because those offices have expertise in forming relationships with private businesses. However, it is possible that other departments have the equivalent expertise and could successfully operate the program. Therefore, in the City of San Diego, the Chief Operating Officer should determine where to best place this function to maximize success.

**Proposition H Affects
How Future BCP
Revenues are Allocated
and Expenses are Paid**

While this report was being completed, the City Attorney's Office issued a memorandum which stated that Bradley-Burns Use Tax revenue generated by new BCP agreements should be reallocated to the Infrastructure Fund, established by voters through the approval of Proposition H, in certain years.¹⁸ Specifically, the reallocation would only occur when total sales and use tax revenues grow faster than the Consumer Price Index in the prior year, based on the City's fiscal year 2016 audited actual revenues and expenditures.

In such years, any new revenues generated from new BCP agreements with construction contractors will be diverted to the Infrastructure Fund *before* any rebate payments or consultant commissions are paid out of the General Fund. In these years, the City will experience a net benefit from BCP agreements with construction contractors, and the Infrastructure Fund will experience positive growth by receiving all new proceeds from the BCP. However, the General Fund may experience a net loss because program expenses such as rebate payments must be paid from the General Fund.

In years where overall sales and use tax revenues do not grow faster than the Consumer Price Index established in the base year, the use tax generated by the construction portion of the BCP is not allocated to the Infrastructure Fund, resulting in a net increase to the General Fund.

Therefore, the COO, in addition to directing staff to use the BCP to pursue construction contractors, should determine how to fund program-related expenditures—such as staff FTEs, consultant commissions, and rebates for certain program participants—during the annual budget process.

¹⁸ Proposition H: San Diego Infrastructure Fund Establishment Amendments, approved by voters in June 2016, amended the City Charter to establish a dedicated Infrastructure Fund to provide for capital improvements and maintenance. Notably, the language included in the City Charter did not specifically call out Bradley-Burns Use Tax as a source of revenue that is required to be reallocated to the Infrastructure Fund. As a result, the City Attorney's Office authored a memorandum stating that the intent of voters in approving Proposition H was to include this tax revenue stream. See **Appendix F** for this memorandum.

In order to maximize opportunities to capitalize on development in the City and capture additional use tax revenues, we recommend:

Recommendation #1

The Chief Operating Officer should determine which department, such as the Economic Development Department or the Financial Management Department, has the best ability to manage the portion of the Business Cooperation Program that targets construction activity. This department should develop a documented process to focus on the systematic identification, recruitment and enrollment of contractors and subcontractors working on large public and private construction projects to capture use taxes before allocation to the County pool.

In addition, the COO should determine how to fund program-related expenditures—such as staff FTEs, consultant commissions, and rebates for certain program participants—during the annual budget process. (Priority 1)

Recommendation #2

The department managing the portion of the Business Cooperation Program targeting construction activity should work with the Public Works Department, the Development Services Department, and Civic San Diego to develop procedures to allow Business Cooperation Program staff to become aware when projects with estimated construction costs of more than \$50 million are being proposed. This should also include notification when City capital improvement projects of more than \$25 million are planned. (Priority 1)

Recommendation #3

The Public Works Department and Business Cooperation Program staff should implement a policy requiring that when Business Cooperation Program staff determine that a City capital improvement project would be eligible for the program and would likely generate significant revenues, participation in the Business Cooperation Program be included in the bid requirements. (Priority 1)

Finding 2: Economic Development Should Document Procedures for Calculating Business Cooperation Program Reimbursements and Establish Appropriate Segregation of Duties Over Reimbursement Processing

The Economic Development Department's (EDD) operation of the Business Cooperation Program (BCP) has successfully captured more than \$3.9 million in net new use tax revenue to the City since its inception in 1996. Because the program relies on voluntary company enrollment, the City has also provided more than \$3.5 million in tax rebates to companies in order to incentivize participation. In order to ensure that revenue and rebate calculations are accurate, it is critical for EDD to implement a comprehensive internal control framework to ensure the accuracy of the revenue the City receives and the rebate paid to the company.

While our review of BCP payments revealed no material discrepancies¹⁹, we found that EDD had not developed a sufficient internal control framework over the BCP, and lacks documented procedures for calculating rebates, supervisory review of rebate payments, and adequate separation of duties.²⁰ In order to ensure payment accuracy and reduce the risk of fraud, we recommend that EDD work with the Comptroller's Office to document BCP rebate processing procedures, assign supervisory review responsibilities, and establish sufficient separation between various payment processing functions.

Additionally, we found that BCP payment processing functions occupy a significant amount of time for a staff member whose primary job function is providing assistance to businesses seeking to locate or expand within the City. As BCP payment processing procedures are reviewed and documented, we recommend that EDD work with the Comptroller's Office to identify other staff who

¹⁹ We reviewed all payments to currently active program users between 2010 and 2016 and identified a small number of immaterial discrepancies that together totaled less than \$2,000.

²⁰ As a result of our audit findings, EDD has begun developing documented procedures for calculating rebates and performing supervisory review, and for establishing separation of duties between payment processing functions.

**A Comprehensive
Internal Control
Framework over the
Business Cooperation
Program Is Important to
Ensure Payment
Accuracy and
Appropriateness**

can process rebate payments, which would allow EDD to better focus on its core missions of promoting investment in jobs and infrastructure, and supporting tax revenue generation for the City.

Guidance published by various authorities such as the United States Government Accountability Office and the California Controller highlight the need for City management to develop appropriate control activities and ensure the implementation of a comprehensive control framework.²¹

Specifically, local governments should establish policies and procedures to implement control activities that achieve management directives and respond to identified operational risks. For the BCP, this means that the methodologies and procedures for calculating rebate amounts and processing rebate payments should be documented. In addition, control activities should include supervisory review on a recurring basis to verify payment accuracy and take corrective actions when necessary.

Furthermore, both the California Controller and the United States Government Accountability Office provide guidance on the proper segregation of duties. Segregation of duties helps prevent fraud, waste, and abuse in the internal control system. For proper segregation of duties, management divides or segregates key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud. This includes separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets so that no one individual controls all key aspects of a transaction or event.

²¹ United States Government Accountability Office Standards for Internal Control in the Federal Government; and California Controller Internal Control Guidelines for California Local Agencies.

EDD had Not Implemented Sufficient Internal Controls Over the BCP

We reviewed all invoices and payments in SAP for the currently active BCP enrollees from 2010 through 2016 and did not note any material discrepancies or errors in tax calculations and rebate distributions.²² However, we found that EDD did not have any documented processes and procedures for operation and oversight of the BCP. Specifically, EDD had not implemented a process narrative providing direction on the proper calculation and allocation methodologies, or established responsibilities and procedures for supervisory review. In fact, because procedures were not documented at the time of our review, EDD management did not understand the rebate calculation process and methodologies, and did not conduct any review of the allocation and rebates to ensure accuracy.

One EDD Staff Member Conducts All Significant Aspects of BCP Rebate Processing

Additionally, EDD does not have internal controls requiring segregation of duties over the calculation and disbursement functions related to the BCP.

While EDD previously used a consultant to calculate and process BCP rebate payments, currently, BCP rebate payment processing functions are almost entirely conducted by one member of EDD staff.²³ During our review, this EDD employee was the only staff member with any knowledge of the rules concerning the sales and use tax calculation and rebate structure. The calculation required the employee to review the company's sales and purchases of taxable goods to determine which specific transactions qualified. The EDD employee receives the tax information, determines the taxable charges, determines the rebates to the company, and issues the rebate check to the company.

²² As discussed in the Background users, the two currently active program users are Novartis and Intuit.

²³ At the BCP's inception, the City relied on a consultant to work with companies on submitting the documentation of taxes paid and calculating the appropriate rebates. The consultant communicated the amount of the rebate to the City, and the City processed the rebate and provided the funds to the company. According to EDD, EDD did not renew the consultant contract as a cost savings measure.

A Lack of Documented Procedures, Supervisory Review, and Separation of Duties Increases the Risk of Inaccurate or Improper Rebate Payments

Without appropriate documentation of rebate processing procedures, assigned responsibilities for supervisory review, and adequate segregation of duties, significant risk of improper payments exists, especially if institutional knowledge is lost. More specifically, without documented procedures and methodologies, managers are unable to verify payment accuracy, and if the one EDD employee overseeing the program leaves City service, there is no one in EDD who can seamlessly absorb these responsibilities.

Following the start of the audit and identification of this issue, EDD management began drafting a process narrative to provide direction on the proper steps in enrolling, calculating and distributing rebates to BCP members. We will report on the status during or normal bi-annual recommendation follow-up process.

The process narrative should utilize the framework established in the United States Government Accountability Office Standards for Internal Control in the Federal Government and separate the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions for accuracy, and handling any related assets so that no one individual controls all key aspects of a transaction or event.

Furthermore, the EDD employee responsible for rebate processing stated that the calculations for rebates is different for each company in the program. The EDD employee noted that this is a very time consuming process. As a result, the EDD employee, who as a Community Development Coordinator is one of EDD's primary representatives assisting businesses with locating and expanding within the City, is spending time processing payments instead of providing assistance to businesses in need. EDD should reassign BCP payment processing duties to other staff, such as clerical staff or analysts, so that the Community Development Coordinator can focus their skills and expertise on their core job responsibilities.

In order to ensure payment accuracy, reduce the risk of fraud, and allow Economic Development Department (EDD) staff expertise to be used towards achieving EDD's core mission, we recommend:

Recommendation #4

The Economic Development Department should work with the City Comptroller to establish and document policies and procedures for issuing payments through the Business Cooperation Program (BCP), including segregating key functions. As these policies and procedures are developed, EDD should reassign BCP payment processing duties from the Community Development Coordinator to other staff, such as clerical staff or analysts, who would normally perform these functions as part of their core job responsibilities. (Priority 2)

Conclusion

The City of San Diego is facing significant financial challenges including approximately \$1.3 billion in unfunded infrastructure needs over the next five years. The City should therefore seek to maximize the effectiveness of revenue-generating programs, such as the Economic Development Department's (EDD's) Business Cooperation Program (BCP), where opportunities exist.

EDD should take advantage of all components of the BCP and target large construction projects to maximize the amount of sales and use tax revenues that are deposited in City coffers. San Diego is in the midst of a construction boom, and if current development levels continue, the BCP could be used to potentially capture hundreds of thousands to more than \$1 million in additional tax monies over the next two years alone.²⁴ We recommend that the Chief Operating Officer direct EDD, or another appropriate department, to utilize the BCP to systematically target large public and private construction projects in order to maximize City revenues from the program.

In addition, because the program relies on voluntary company enrollment, the City has also provided tax rebates to companies in order to incentivize participation. By consulting with the Comptroller's Office to design and implement internal controls over rebate payment processing and establishing appropriate separation of duties, EDD can ensure accurate calculations and quality control over rebate payments made to BCP enrollees.

²⁴ This is before any rebates or consultant commissions, as discussed in Finding 1.

Recommendations

In order to maximize opportunities to capitalize on development in the City and capture additional use tax revenues, we recommend:

Recommendation #1

The Chief Operating Officer should determine which department, such as the Economic Development Department or the Financial Management Department, has the best ability to manage the portion of the Business Cooperation Program that targets construction activity. This department should develop a documented process to focus on the systematic identification, recruitment and enrollment of contractors and subcontractors working on large public and private construction projects to capture use taxes before allocation to the County pool.

In addition, the COO should determine how to fund program-related expenditures—such as staff FTEs, consultant commissions, and rebates for certain program participants—during the annual budget process. (Priority 1)

Recommendation #2

The department managing the portion of the Business Cooperation Program targeting construction activity should work with the Public Works Department, the Development Services Department, and Civic San Diego to develop procedures to allow Business Cooperation Program staff to become aware when projects with estimated construction costs of more than \$50 million are being proposed. This should also include notification when City capital improvement projects of more than \$25 million are planned. (Priority 1)

Recommendation #3

The Public Works Department and Business Cooperation Program staff should implement a policy requiring that when Business Cooperation Program staff determine that a City capital improvement project would be eligible for the program and would likely generate significant revenues, participation in the Business Cooperation Program be included in the bid requirements. (Priority 1)

Recommendation #4

The Economic Development Department should work with the City Comptroller to establish and document policies and procedures for issuing payments through the Business Cooperation Program (BCP), including segregating key functions. As these policies and procedures are developed, EDD should reassign BCP payment processing duties from the Community Development Coordinator to other staff, such as clerical staff or analysts, who would normally perform these functions as part of their core job responsibilities. (Priority 2)

Appendix A: Definition of Audit Recommendation Priorities

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The Office of the City Auditor maintains a priority classification scheme for audit recommendations based on the importance of each recommendation to the City, as described in the table below. While the City Auditor is responsible for providing a priority classification for recommendations, it is the City Administration's responsibility to establish a target date to implement each recommendation taking into considerations its priority. The City Auditor requests that target dates be included in the Administration's official response to the audit findings and recommendations.

Priority Class ²⁵	Description
1	Fraud or serious violations are being committed. Significant fiscal and/or equivalent non-fiscal losses are occurring. Costly and/or detrimental operational inefficiencies are taking place. A significant internal control weakness has been identified.
2	The potential for incurring significant fiscal and/or equivalent non-fiscal losses exists. The potential for costly and/or detrimental operational inefficiencies exists. The potential for strengthening or improving internal controls.
3	Operation or administrative process will be improved.

²⁵ The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher priority.

Appendix B: Objectives, Scope, and Methodology

Objectives In accordance with the Office of the City Auditor's Fiscal Year 2017 Audit Work Plan, we conducted a performance audit of the Economic Development Department's Business and Industry Incentive Program (BII). The Business Cooperation Program (BCP) is a component of the BII. As part of a larger audit of the BII, which is forthcoming, we evaluated the BCP operations from 2010 to 2016 in order to:

1. Determine whether opportunities exist to improve the effectiveness of incentives provided by the BCP; and
2. Assess the City's overall control framework related to incentives offered through the BCP.

Scope and Methodology

Literature and stakeholders In order to arrive at these objectives, we conducted an extensive preliminary review and scoping phase. As part of this process, we reviewed published reports and analyses focusing on economic development programs in California and San Diego, including reports from the California Legislative Analyst's Office, California State Board of Equalization, the academic and think-tank research, as well as City Council and Committee presentations.

We interviewed key City staff within the Economic Development Department (EDD) who manage and review projects within the Business and Industry Incentive Program. We also conducted interviews with cities and consultants in California specializing in establishing and operating economic development programs, in order to gain prospective on issues, rules, and best practices for economic development programs in San Diego, including programs similar to the BCP.

**Economic Development
Department documents
and data reliability
testing**

In our review of the program's project participation data, we utilized an EDD-provided spreadsheet titled, "Business Cooperation Program (BCP) Net Tax Revenue to City." The list provided revenue to the City through the BCP and the rebates paid to enrollees of the program. We scrutinized the reliability of the master data list in several ways:

We pulled all invoices submitted by companies enrolled in the BCP for years 2010 through 2016 from the City's SAP system. We reviewed the information included on the companies' invoices including the tax reported to the City of San Diego, the tax received by the City of San Diego, and the tax rebate paid by the City. For every invoice from 2010 through 2016 for the currently active largest users, we cross-referenced the payments made by the City in the SAP system to the rebated listed on the company invoices. We then compared the amount of the rebates to the rebate calculation formulas in the City's enacting legislation that created the BCP.

Comparison and Context

To understand the effectiveness and the opportunities to improve incentives offered to businesses in the City, we compared the incentives offered to other cities in California, including the City of Sacramento, the City of San Jose, the City of Santa Clara, and the City of Long Beach. We also conducted interviewed representatives of these cities to discuss how the program was formed, how the program was operated, and solicited information about unsuccessful and successful experiences with the program.

To understand opportunities to expand the BCP we reviewed relevant sections of the Bradley-Burns Uniform Local Sales and Use Taxes, and information provided by the California State Board of Equalization and the California Legislative Analyst's Office.

Internal Controls

We limited our testing of the internal control environment over the BCP, we requested any policies and procedures to the BCP's fee reimbursement calculation and payment processing activities, including the accuracy of reimbursement payments made by the BCP from 2010 to 2016, and also evaluated the separation of duties between payment processing functions.

GAGAS 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 reasonable basis for our findings and conclusions based on our audit objectives.

Appendix C: City Council Resolution Creating Business Cooperation Program

(R-97-400)

RESOLUTION NUMBER R- 288034

ADOPTED ON NOV 12 1996

WHEREAS, The City of San Diego currently loses an estimated fourteen to twenty million dollars annually due to the manner in which local business firms report to the State of California Board of Equalization, the local one percent (1%) sales/use tax paid by them on business-to-business sales; and

WHEREAS, the City Council authorized the formation of the Business Cooperation Program ("BCP") in September, 1995, to look at ways to increase City revenues without tax or fee increases; and

WHEREAS, on June 4, 1995, the City Council directed City staff to convene a meeting of local business leaders to develop and recommend incentives for businesses to participate in the BCP; and


WHEREAS, the Economic Development Services' Business Expansion and Retention Team held a meeting on July 19, 1995, of executives from firms engaged in research, manufacturing, and construction, and at this meeting the group developed several incentives that they now recommend to the City Council and which are set out in detail in City Manager's Report No. 96-206, dated October 16, 1996; NOW, THEREFORE,

BE IT RESOLVED, by the Council of The City of San Diego, that it hereby approves the following incentives for participation in the Business Cooperation Program and directs staff to take all actions necessary to implement them:

-PAGE 1 OF 2-

1. A credit, measured by the amount of sales/use tax returned to the City as a result of a company's participation in the BCP, to be applied against future City fees or taxes.
2. A cash rebate of half the amount of sales/use tax returned to the City as a result of a company's participation in the BCP.
3. A deferral of the City's development fees until final inspection, in exchange for the company's participation in the BCP.

APPROVED: JOHN W. WITT, City Attorney

By 
Allisyn L. Thomas
Deputy City Attorney

ALT:lc
10/08/96
Or. Dept. Comm. & Eco. Dev.
Aud. Cert: N/A
R-97-400
Form=r-4.res

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2-288034

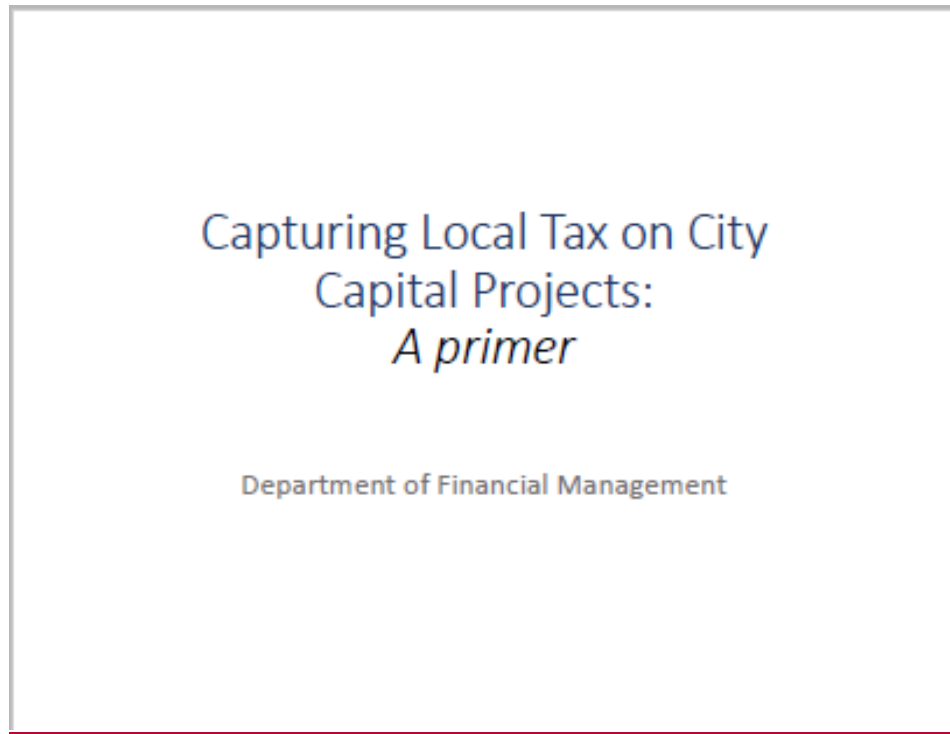
Appendix D: Sample Contract Language

Sales Tax Self-Accrual

Typical Contract Language for Contracts over \$5 Million

1. **Use Tax Requirements.** During the performance of this Agreement, CONTRACTOR, for itself, its assignees and successors in interest, agrees as follows:
 - A. **Use Tax Direct Payment Permit:** For all leases and purchases of materials, equipment, supplies, or other tangible personal property used to perform the Agreement and shipped from outside California, the Contractor and any subcontractors leasing or purchasing such materials, equipment, supplies or other tangible personal property shall obtain a Use Tax Direct Payment Permit from the California State Board of Equalization ("SBE") in accordance with the applicable SBE criteria and requirements.
 - B. **Sellers Permit:** For any construction contract and any construction subcontract in the amount of \$5,000,000 or more, Contractor and the subcontractor(s) shall obtain sellers permits from the SBE and shall register the jobsite as the place of business for the purpose of allocating local sales and use tax to the City. Contractor and its subcontractors shall remit the self-accrued use tax to the SBE, and shall provide a copy of each remittance to the City.
 - C. The above provisions shall apply in all instances unless prohibited by the funding source for the Agreement.

Appendix E: City of Long Beach PowerPoint Presentation



Why are we here?

**Section 19 of your standard
contract language.**

19. TAXES AND TAX REPORTING.

B. Contractor shall cooperate with City in all matters relating to taxation and the collection of taxes, particularly with respect to the self-accrual of use tax. Contractor shall cooperate as follows: (i) for all leases and purchases of materials, equipment, supplies, or other tangible personal property totaling over \$100,000 shipped from outside California, a qualified Contractor shall complete and submit to the appropriate governmental entity the form in Appendix "A" attached hereto; and (ii) for construction contracts and subcontracts totaling \$5,000,000 or more, Contractor shall obtain a sub-permit from the California Board of Equalization for the Work site. "Qualified" means that the Contractor purchased at least \$500,000 in tangible personal property that was subject to sales or use tax in the previous calendar year.

"Sales" vs "Use" Tax

A City may tax the sale of tangible personal property if the City is the place of sale for the tangible personal property. This is known as the "sales" tax since it is on the sales-side of a purchase.

If the sales tax does not apply, then the City may tax the purchase, storage, or consumption of tangible personal property within the City. This is known as the "use" tax, since it applies to the purchaser's use of the property.

"Tangible personal property"

means personal property (i.e. not land) which may be seen, weighed, measured, felt, or touched, or which in any other manner perceptible to the senses. (See e.g. Ca. Rev. & Tax. Code, section 9016)

"Place of Sale"

Generally, a place of sale is a retailer's place of business that participates in the sale. There are a series of regulatory rules that attempt to explain how to determine the place of sale. If you have questions on this, please contact Financial Management. (See. Reg. 1802.)

What Does This Really Mean?

Think about how important it is to you to have your paycheck correct. If there is anything missing from your check, you are going to track it down. These tax-revenue streams are as important to a city's finances as your paycheck is to you. The revenues fund city services. With advance planning, the City can capture more of the tax generated from some city-funded projects. Without that planning, the City suffers a considerable loss.

Dilution of Local Tax

If the tax does not come directly to the City, then it is diluted through either the County Pool or State Pool (ways the state spreads sales tax). A direct payment to the City on \$1M in taxable goods would be \$10,000. Look what happens when it goes through the County Pool or State Pool instead of coming directly to the City:

What if \$10,000 is allocated through the Pools instead of allocated directly to the City?

Long Beach County Pool % is 3.5%
 $\$10,000 \times 3.5\% = \350

Long Beach State Pool % is 0.82%
 $\$10,000 \times 0.82\% = \82

A loss of \$9,650 or \$9,918 per \$10,000 of local tax paid.

How You Can Help?

1 \$5 million

This is the threshold for being able to directly report sales and purchases in construction contracts. If any of the subcontracts (including the general contractor, if the general contractor is performing portions of the work), are worth \$5 million or more, then please flag the project and notify Financial Management immediately so we can work with the contractors to register the jobsite with the State Board of Equalization.

"Construction Contract"

Means a contract to build, alter, repair, a structure or improvement to real property, or to construct many forms of public works, or to pave surfaces. (See 18 CCR Reg. 1521(a)(1) for details.)

[This is the general definition and there are some nuances. Please contact Financial Management if you have any questions.]

2 \$100,000

If a contractor's purchase from an out-of-state vendor will meet this threshold, please notify Financial Management. In our contract language, a contractor that is making a purchase from out of state that meets this threshold and who is a "Qualified Contractor" must apply for a direct-pay permit.

"Qualified Contractor"

the Contractor purchased at least \$100,000 in tangible personal property that was subject to sales or use tax in the previous calendar year.

An Aside—How a Contractor Registers a Jobsite

1 Gather necessary information

Basic information about the business. See the California State Board of Equalization website. <http://www.boe.ca.gov/elecrrv/ings.htm>

2 Register online or in person

Instructions can be found at the SBE website. <https://efile.boe.ca.gov/ereg/index.boe>

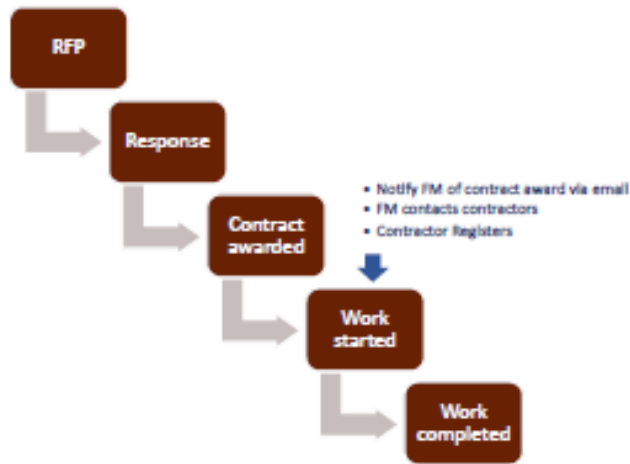
3 Report the tax to the City on its tax returns.

Typically on Schedule C.

"Register a Jobsite"

Means applying for a sub-permit with the State Board of Equalization with the jobsite as the address.

When to Involve Financial Management



An example

Let's walk thru an example together. Imagine you have a project coming up to build a library. Your first number is:

\$5 million

Let's say the general contract is worth \$12 million. So far so good. But let's say there are 10 contractors who will work on the project. One of them has a \$6 million portion of the contract and the remaining nine make up roughly equal shares of the remaining \$6 million. Only the subcontractor with the contract worth \$6 million could register the jobsite. That contract should be reported to Financial Management.

\$100,000

Now, let's assume that one of the other subcontractors is purchasing some espresso machines for the library. (Why not! It's imaginary.) And further assume that the espresso machines will cost \$100,000. That purchase should be reported to Financial Management to pursue a direct-pay permit with the contractor.

Neither

Let's assume that the City is having some paving work done. The contract is for less than \$5 million and the asphalt will be purchased from in-state. In that case, there is no use tax to be allocated since the sales tax will be collected by the seller.*

* Unless the contractor has a buying company in the City. See section 28, para. C.

What should you take away from this Presentation.

This is meant to serve as an overview. An overview always leaves out details and the details can often be important. If you have any questions, please contact Financial Management for additional information or help with the many nuances in local sales and use tax reporting.

Contact Financial Management with any questions

Julissa Jose-Murray 8-6869; julissa.jose-murray@longbeach.gov

Appendix F: Memorandum From the City Attorney's Office

Office of
The City Attorney
City of San Diego

MEMORANDUM
MS59

(619) 533-5800

DATE: September 21, 2017

TO: Honorable Mayor and City Councilmembers

FROM: City Attorney

SUBJECT: Allocation of Use Tax Revenue to the City's Infrastructure Fund under San Diego Charter Section 77.1

INTRODUCTION

Local voters passed Proposition H on June 7, 2016, amending the San Diego Charter (Charter) to add section 77.1 (Section 77.1) entitled "Infrastructure Fund." Commencing with the City's Fiscal Year 2018 budget, Section 77.1 diverts to a new City-administered Infrastructure Fund: (a) 50 percent of the City's growth in property tax revenue and transient occupancy tax revenue over the amount of such revenue received in Fiscal Year 2016, and certain utility franchise fee revenue received by the City, for five years; and (b) 100 percent of the City's growth in sales and use tax revenue over the amount of such revenue received in Fiscal Year 2016 adjusted for the annual change in the statewide Consumer Price Index for California, and certain pension cost reduction amounts, for 25 years.

The City's Business Cooperation Program (BCP) allows the City to offer financial and other incentives to local businesses in an effort to retain well-paying jobs in the City and promote job growth. *See* San Diego Resolution R-288034 (Nov. 12, 1996); Council Policy 900-12. The City Auditor is conducting a performance review of the BCP and, in that context, has asked this Office whether Section 77.1 allocates growth in the City's use tax revenue to the Infrastructure Fund, preventing the City from making any new commitment of such revenue to provide certain incentives authorized in the BCP.

This Office issued a memorandum in 2016 analyzing the impact of Section 77.1 on certain City fiscal activities. City Att'y MS 2016-27 (Sept. 12, 2016). That memorandum addressed the

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Section 77.1 definition of "Exempt Revenues," which are revenues not required to be deposited in the Infrastructure Fund. As applied to the BCP, the conclusion of that memorandum means that Exempt Revenues include only City tax revenues contractually committed as a BCP incentive before July 1, 2017.

QUESTIONS PRESENTED

1. Does the allocation of 100 percent of specified sales tax revenue growth to the Infrastructure Fund under Section 77.1 include the allocation of the corresponding measure of use tax revenue growth?
2. If so, does Section 77.1 limit the funding sources available to the City to pay any new BCP incentives while Section 77.1 is operative?

SHORT ANSWERS

1. Yes. The most reasonable interpretation of Section 77.1 is that the allocation of specified sales tax revenue growth to the Infrastructure Fund includes the allocation of the corresponding measure of use tax revenue growth.
2. Yes. Section 77.1 limits the funding sources available to the City to pay any new BCP incentives, while it is operative, from July 1, 2017, through June 30, 2042.

ANALYSIS

I. SECTION 77.1 REQUIRES THE CITY TO ALLOCATE CERTAIN USE TAX REVENUE GROWTH TO THE INFRASTRUCTURE FUND

Section 77.1 expressly allocates Sales Tax Increment (as defined in Charter § 77.1(a)(1)) revenue to the Infrastructure Fund. Section 77.1 defines "Sales Tax Revenue" as "any unrestricted sales tax revenue received by the City. In the *Base Year* [Fiscal Year 2016], *Sales Tax Revenue* is the Bradley-Bums Sales Tax received by the City including the Triple Flip Property Tax reimbursement." Charter § 77.1(a)(12). Section 77.1 defines "Sales Tax Increment" as the annual change (i.e., growth) in Sales Tax Revenue over the City's Fiscal Year 2016 Sales Tax Revenue adjusted for the annual change in the statewide Consumer Price Index (CPI) for California. Charter § 77.1(a)(11).

"Use tax" is generally defined in California Revenue and Taxation Code section 7203 as a tax upon the storage, use, or other consumption in the City of tangible personal property purchased from any retailer, if such purchase was not subject to sales tax in California. *See also* San Diego Municipal Code (SDMC or Municipal Code) §§ 32.53-32.53.4. The California State Board of Equalization (BOE) explains that, "[g]enerally, if sales tax would apply when you buy physical merchandise in California, use tax applies when you make a similar purchase without tax from a

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business located outside the state."¹ The BOE also provides the following example of the application of use tax:

For instance, if you bought a computer for your business here in California, you would pay sales tax. The same holds true if you bought that same computer from a retailer in New York for your business here in California. If you did not pay any tax to the retailer, you owe the USE tax on the cost of the computer.²

Section 77.1 does not expressly mention, or require the City to allocate, use tax revenue growth (Use Tax Increment)³ to the Infrastructure Fund. The definition of Sales Tax Increment in Section 77.1, though, could be interpreted alternatively as follows: (1) Sales Tax Increment implicitly includes Use Tax Increment; or (2) Sales Tax Increment excludes Use Tax Increment because use tax revenue is not mentioned in the definition of Sales Tax Revenue. While this Office has not found any California case law directly on point, the most reasonable interpretation of Section 77.1 is that Sales Tax Increment implicitly includes Use Tax Increment for the purpose of allocating City revenue to the Infrastructure Fund.

A. Voter Intent Prevails in Interpreting Charter Provisions

The basic rule for interpreting a voter-approved amendment to a city charter is to effectuate the voters' intent in approving the amendment. *People v. Jones*, 5 Cal. 4th 1142, 1146 (1993). It is unlikely that the electorate, in voting to approve Proposition H, discerned any distinction between allocating Sales Tax Increment and Use Tax Increment to the Infrastructure Fund. As explained below, the two sources of revenue are closely intertwined in multiple respects and are treated by the City as a single revenue source.

B. State Law and City Practice Effectively Treat Sales and Use Tax as a Single Revenue Source

Many factors support the treatment of use tax revenue as a component of Sales Tax Revenue for the purposes of Section 77.1. The City's sales and use tax ordinance, Municipal Code sections 32.50-32.59, is subject to the "Bradley-Bums Uniform Local Sales and Use Tax Law," Cal. Rev. & Tax. Code §§ 7200-26 (Bradley-Bums Law). *See* Cal. Rev. & Tax. Code § 7203.2; SDMC § 32.51(a). Use tax is described in the Bradley-Bums Law as a complementary tax to the sales tax and is imposed at exactly the same rate as the sales tax. Cal. Rev. & Tax. Code § 7203; *see also, Wallace Berrie & Co. v. State Bd. of Equalization*, 40 Cal. 3d 60, 66-67 (1985). The City's sales and use tax ordinance is legally required by the Bradley-Bums Law to impose both a sales tax and a use tax. Cal. Rev. & Tax. Code § 7302.2. In other words, the City cannot impose a sales tax without also imposing a complementary use tax. Further, the City's BCP incentives refer to sales tax and use tax as a single revenue source. *See* Resolution R-288034; Council

¹ BOE (Sept. 5, 2017), <https://www.boe.ca.gov/sutax/usetax.htm#Overview>.

² BOE (Sept. 5, 2017), http://www.boe.ca.gov/sutax/pdf/Basic_SUT_Seminar.pdf, page 15.

³ Use Tax Increment refers to any amount of unrestricted use tax revenue received by the City exceeding the amount of use tax revenue received by the City in Fiscal Year 2016 adjusted for the annual CPI increase.

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Policy 900-12. The Office of the City Comptroller has confirmed that the City accounts for sales tax and use tax revenues as a single revenue source, rather than separate revenue sources.

II. SECTION 77.1 LIMITS THE FUNDING SOURCES AVAILABLE TO THE CITY TO PAY ANY NEW BCP INCENTIVES

As discussed in Section I above, the City must allocate all Sales Tax Increment and Use Tax Increment to the Infrastructure Fund during the 25-year operative time period of Section 77.1, from July 1, 2017, through June 30, 2042. Consequently, Sales Tax Increment and Use Tax Increment are not funding sources available to the City to pay any new BCP incentives authorized during this time period.

Before Section 77.1 became operative, the City provided BCP incentives in amounts measured by the sales and use tax revenue growth generated by the incentivized business. The City has not specifically committed sales and use tax revenue to payment of any BCP incentive. Instead, the City has measured the incentive amount as a specified portion of the sales and use tax revenue growth generated by the incentivized business. The City has paid the incentive amount from available funding sources (not necessarily limited to sales and use tax revenue), as determined in the City's discretion during the annual budget process.

During the operative time period of Section 77.1, all of the City's Sales Tax Increment and Use Tax Increment are required to be deposited in the Infrastructure Fund and are not available as a funding source for payment of new BCP incentive commitments. However, under Section 77.1, the "Sales Tax Baseline" amount of City sales and use tax revenue is not required to be deposited in the Infrastructure Fund. This amount is defined as the City's Fiscal Year 2016 Sales Tax Revenue (including use tax revenue) amount adjusted for the annual CPI change. Charter § 77.1(a)(10). In other words, the amount of the City's sales and use tax revenue in a given fiscal year that does not exceed the City's sales and use tax revenue in Fiscal Year 2016 adjusted by the annual CPI change is the only portion of sales and use tax revenue that may be available to the City as a funding source for payment of new BCP incentive commitments.⁴

The City may make new BCP incentive commitments measured by the sales and use tax revenue growth generated by the incentivized business during the operative period of Section 77.1. Payment of any such new BCP incentive amount must come from City funding sources then available for such purpose, which will typically include General Fund revenue, exclusive of Sales Tax Increment or Use Tax Increment required to be deposited in the Infrastructure Fund.⁵

⁴ Any new City commitment of this nature could give rise to additional legal issues that are outside the scope of this Memorandum. For instance, depending on the factual circumstances, providing a BCP incentive measured only by the Sales Tax Baseline amount of use tax revenue could constitute an improper gift of public funds.

⁵ Charter section 77.1(g) provides for suspending deposits into the Infrastructure Fund for all or part of a fiscal year upon request by the Mayor and approval by two-thirds of the City Council, following a public hearing on the request for suspension. The analysis in this Memorandum assumes that Section 77.1 is in effect and not suspended during all fiscal years in which Section 77.1 may be operative.

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CONCLUSION

Section 77.1 requires the City to allocate both Sales Tax Increment and Use Tax Increment to the Infrastructure Fund for its 25-year operative time period commencing July 1, 2017. Consequently, Sales Tax Increment and Use Tax Increment are not funding sources available to the City to pay any new BCP incentives authorized during this time period. However, while Section 77.1 is operative, the City may authorize new BCP incentives measured by the sales and use tax revenue growth generated by the incentivized business that are payable from other City funding sources then available for such purpose.

MARA W. ELLIOTT, CITY ATTORNEY

By Isl Delmar G. Williams
Delmar G. Williams
Deputy City Attorney

DGW:nja

MS-2017-23

Doc. No.: 1553654_6

cc: Eduardo Luna, City Auditor
Scott Chadwick, Chief Operating Officer
David Graham, Deputy Chief Operating Officer, Neighborhood Services
Mary Lewis, Chief Financial Officer
Lakshmi K01mni, Director, Debt Management
Andrea Tevlin, Independent Budget Analyst




THE CITY OF SAN DIEGO

M E M O R A N D U M

DATE: September 26, 2017

TO: Eduardo Luna, City Auditor, Office of the City Auditor

FROM: Erik Caldwell, Director, Economic Development Department
via David Graham, Deputy Chief Operating Officer, Neighborhood Services 

SUBJECT: Management Response to City Audit of Business Cooperation Program

The purpose of this memorandum is to provide the Economic Development Department's response to the Audit Report entitled "Performance Audit of Economic Development Department's Business Cooperation Program." The Audit's primary findings were:

- "The Business Cooperation Program Should Target Large Construction Projects in Order to Maximize City Revenues"
- "Economic Development Should Document Procedures for Calculating Business Cooperation Program Reimbursements and Establish Appropriate Segregation of Duties Over Reimbursement Processing"

The Audit Report provided recommendations for the Business Cooperation Program (BCP) to increase City revenues by targeting large construction programs and improve internal controls over rebate payment processing. Below are the Department's responses to the Audit Recommendations.

Recommendation #1: The Chief Operating Officer (COO) should determine which department, such as the Economic Development Department or the Financial Management Department, has the best ability to manage the portion of the Business Cooperation Program that targets construction activity. This department should develop a documented process to focus on the systematic identification, recruitment and enrollment of contractors and subcontractors working on large public and private construction projects to capture use taxes before allocation to the County pool. In addition, the COO should determine how to fund program-related expenditures - such as staff FTEs, consultant commissions, and rebates for certain program participants - during the annual budget process. (Priority 1)

Management Response: Agree with recommendation.

The COO will determine the appropriate department to manage the portion of the BCP that targets construction activity. The chosen department will need to analyze, during the annual budget process, the resources necessary to develop a documented process to focus on the systematic identification, recruitment and enrollment of contractors and subcontractors working on large public and private construction projects to capture use taxes before allocation to the County pool. This could require additional positions and/or hiring a third-

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party consultant to carry out the continual, labor-intensive, case-by-case identification, outreach, recruitment and enrollment of contractors and subcontractors working on the prime-target, large construction projects in the City. The industry rate for third-party consultant is a 12-20 percent contingency rate. As OCA noted, the City had previously utilized the services of the third-party consultant to engage BCP participants, with limited results and retreading that path could lead to a similar outcome. The department would also need to manage the program and invoice contractors on a quarterly basis. Neither of the two departments identified currently have existing resources to dedicate to this expansion of the BCP. The current program generates an average of \$190,000.

The COO, in conjunction with the assigned department, will determine whether an expansion of the program generates enough revenue to fund program-related expenditures during the annual budget process. This may include staff FTEs, consultant commissions and rebates for certain program participants. The estimated cost per FTE is \$160,000. At this time, it is unknown whether an expansion of the program will be revenue positive or if the necessary resources will be approved through the annual budget process.

Date to be completed: October 1, 2018.

Recommendation #2: The department managing the portion of the Business Cooperation Program targeting construction activity should work with the Public Works Department, the Development Services Department (DSD), and Civic San Diego (Civic SD) to develop procedures to allow Business Cooperation Program staff to become aware when projects with estimated construction costs of more than \$50 million are being proposed. This should also include notification when City capital improvement projects of more than \$25 million are planned. (Priority 1)

Management Response: Agree with recommendation.

The department chosen to manage the portion of the BCP targeting construction activity will work with the Public Works Department (PWD), Development Services Department and Civic San Diego to develop procedures to become more aware of large construction projects (\$50M+ private projects, \$25M+ public projects) as they are proposed. It is important to note that implementing this recommendation is not a guarantee that the City will derive a financial benefit that exceeds the costs of the implementation of this procedure. Additionally, it does not ensure that private parties (those being permitted by DSD and Civic SD) will see enough value in BCP to make it financially viable to participate.

According to the State Board of Equalization (BOE), “[a] construction contractor who enters into a construction contract equal to or greater than \$5 million may elect to obtain a sub-permit for the jobsite for the qualifying contract enabling the contractor to make a direct allocation of tax to the jurisdiction of which the jobsite is located rather than an indirect allocation through the countywide pool.”

Targeting of construction projects at or above \$50M and \$25M stems from the assumption that these projects would likely include contracts and subcontracts valued at or above the BOE threshold of \$5M. Total project cost is not a consistent indicator for materials costs. Materials cost is dependent the type and scope of the project. The use of \$25M or more as a target for public (Capital Improvements Program) projects may be too low of a minimum to capture enough additional revenue for a positive return on investment (ROI) of running, staffing and marketing an expanded BCP.

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EDD's review (below) of the awarded Capital Improvements Program (CIP) projects from FY 2015-2017 shows that just 3 out of 303 total projects exceeded the recommended target award amount of \$25M or more, illustrating a very limited pool of potential recruits. Also, use tax applies on out-of-state purchases of materials and fixtures equal to or greater than \$5M, and most CIP projects do not meet this minimum threshold and therefore would not provide significant ROI through BCP. As a result, the \$25M CIP qualifier target may benefit from a refinement to favor enrollment of CIP projects believed to incur significant (\$5M+) materials costs subject to use tax.

Top 5 Capital Improvements Program Construction Contracts by Awarded Amount (FY2015-17)

FY2015: 91 construction contracts valued at \$270 M				
Contract Number	Contract Name	Award Date	Award Amount	Contractor
15-1245-JOC-3 North of I	Job Order Contract - (JOC) SP15 Street Paving #2 (North of I8)	5/19/2015	\$20,000,000	ATP General Engineering
15-1245-JOC-3 South of I	Job Order Contract - (JOC) SP15 Street Paving #2 (South of I8)	5/19/2015	\$20,000,000	TC Construction Co., Inc.
15-5716-DBB-3	University Avenue Pipeline Replacement	2/20/2015	\$19,354,365	Burtech Pipeline, Inc
15-1319-MAC-3	Catalina 12" Cast Iron Main And Catalina Sewer Main (Task #14)	6/15/2015	\$18,367,000	Orion Construction/Balbo
14-6120-DBB-3	Horton Plaza Improvement Project	8/19/2014	\$14,456,555	Echo Pacific Construction,

FY2016: 127 construction contracts valued at \$482 M				
Contract Number	Contract Name	Award Date	Award Amount	Contractor
16-1311-DBB-3	Miramar Clearwell Improvements	5/25/2016	\$89,915,000	Shimmick Construction Co
16-1306-DBB-3	Pacific Beach Pipeline South	5/26/2016	\$33,758,315	TC Construction Company,
16-1371-MAC-3	Sewer & AC Water Group 778	6/9/2016	\$23,720,000	TC Construction Co., Inc.
15-1346-JOC-3	Job Order Contract (JOC) P15 Right of Way Pipeline for Capital Impr	8/17/2015	\$20,000,000	KTA Construction, Inc.
15-1346-JOC-3-South	Job Order Contract (JOC) P15 Right of Way Pipeline for Capital Impr	8/25/2015	\$20,000,000	Burtech Pipeline, Inc
Contract Number	Contract Name	Award Date	Award Amount	Contractor
16-1335-DB2-3	Chollas Building Design- Build Contract	12/6/2016	\$29,585,997	R.A. Burch
16-6772	Reimbursement and Park Development Agreement - Pardee H	9/6/2016	\$27,236,000	Pardee Homes
16-1233-DB2-3-A	Mission Hills / Hillcrest Library Design - Build Contract	9/29/2016	\$17,794,327	C. W. Driver
16-6779	Amended & Restated Park Development & Reimbursement Ag	11/21/2016	\$15,100,000	Pardee Homes
16-1451-DBB-3	Pacific Breezes, (Cesar Solis) Community Park	8/8/2016	\$14,997,000	3-D Enterprises, Inc.

The assigned department will work with relevant departments to develop a procedure for notification when projects of recommended size and scale are identified. Whether that notification leads to viable participants in the program that generate the revenue to justify the procedure is unknown at this time.

Target implementation date: October 1, 2018.

Recommendation #3: The Public Works Department and Business Cooperation Program staff should implement a policy requiring that when Business Cooperation Program staff determine that a City capital improvement project would be eligible for the program and would likely generate significant revenues, participation in the Business Cooperation Program be included in the bid requirements. (Priority 1)

Management Response: Agree with the recommendation.

Though few CIP projects appear to meet the \$25M+ qualifier, additional contract language stipulating BCP participation could be added to Public Works Department bid requirements provided that it did not significantly increase project costs or exclude qualified contractors.

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September 26, 2017

Eligibility for the program, the process for participation and the overall project objectives will be factors in determining projects that would generate significant revenue through their enrollment in BCP.

Target implementation date: July 1, 2018.

Recommendation #4: The Economic Development Department should work with the City Comptroller to establish and document policies and procedures for issuing payments through the Business Cooperation Program (BCP), including segregating key functions. As these policies and procedures are developed, EDD should reassign BCP payment processing duties from the Community Development Coordinator to other staff, such as clerical staff or analysts, who would normally perform these functions as part of their core job responsibilities. (Priority 2)

Management Response: Agree with recommendation.

EDD will work with the City Comptroller and has already implemented process narrative procedure in FY 2017. The narrative includes job responsibilities and processing duties. The rebate payment process was modified to provide significant checks and balances. The new process for all rebate payments is as follows: a Community Development Specialist II conducts the rebate calculations and generates the invoice; a Community Development Coordinator (supervisor) reviews the calculations and invoices; the Appointing Authority approves all invoices; and the Department's Fiscal Operations Division processes all invoices. In FY 2017, a BCP Process Narrative was approved memorializing policies and procedures.

Target implementation date: Completed



Erik Caldwell
Director, Economic Development Department

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