REPORT OF

THE

STATE AUDITOR

Department of Local Affairs

Enterprise Zone Program
Performance Audit
November 2002

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November 26, 2002

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the Enterprise Zone Program. The audit was conducted pursuant to Section 39-30-103(4)(c)(II), C.R.S., which requires the State Auditor to evaluate the implementation of the Enterprise Zone Program and its effect on six economic indicators and the effectiveness of each zone in achieving its economic objectives, and to report the findings of the evaluation to the General Assembly and to the Governor no less than once every five years.

The report presents our findings, conclusions, and recommendations, and the responses of the Department of Local Affairs and the Department of Revenue.

Joanne Hill

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Performance Audit, November 2002

Authority, Purpose, and Scope

This performance audit was conducted under the authority of Section 39-30-103(4)(c)(II), C.R.S., which requires the State Auditor to evaluate the implementation of the Enterprise Zone Program no less than once every five years. The audit was conducted in accordance with generally accepted auditing standards. As part of the audit, we reviewed documentation, conducted interviews, and analyzed data from the Departments of Labor and Employment, Local Affairs, and Revenue. We also conducted site visits to six enterprise zones. Audit work was conducted from July 2002 through November 2002.

The statutory scope of this audit was to evaluate the implementation of the Enterprise Zone Program and its effect on six economic indicators--employment, unemployment rate, investment, overall growth rate, economic diversity, and per capita income. In addition, statutes mandate that the audit include an evaluation of the effectiveness of each enterprise zone in achieving its measurable objectives, information regarding the amounts of tax credits claimed and allowed under the Program, and recommendations for statutory changes, if any.

We gratefully acknowledge the assistance and cooperation of staff of the Departments of Local Affairs, Revenue, and Labor and Employment as well as the zone administrators and members of the Colorado Economic Development Commission. We would also like to thank Legislative Council staff for their technical support.

Enterprise Zone Program

The Enterprise Zone Program was legislatively created in 1986 "to provide incentives for private enterprise to expand, for new businesses to locate in economically depressed areas, and to provide more job opportunities for residents of the depressed areas." The Program's tax incentives are available to corporations, businesses, and individuals who contribute in various ways to the zones' economies. We estimate that since 1989, Program participants have received nearly $337 million in state income tax reductions through the use of the tax incentives.

Key Findings

- Overall we found that the non-zone areas continue to be more competitive than zone areas in relation to overall employment growth, employment growth by industry, and per capita income. The gap between the zones and nonzones in these three areas has continued since the implementation of the Program in 1986.

- Many of the zones' economic development objectives could not be evaluated because they were unmeasurable, lacked sufficient data to determine their achievement, or were not yet scheduled to be achieved. The Department needs to continue working with the zones and providing ongoing feedback to refine objectives.

- Zone administrators do not maintain complete lists of businesses located within their zone areas for use in identifying and targeting businesses that would be eligible for zone credits. Additionally, businesses located within an enterprise zone are not adequately informed about the Program. Technical assistance and a list of businesses should be provided to the zones.

- Zone administrators are assessing fees for processing the contribution credits without statutory or regulatory authority. The Department of Local Affairs and the Department of Revenue should jointly reassess the need for fees. If the fees are to be continued, the Department of Revenue should pursue changes to statutes or regulations to explicitly authorize the levying of fees and include criteria for determining the reasonableness of such fees.

- Taxpayers do not always comply with income tax filing regulations for enterprise zone tax credits. As a result, controls over eligibility for enterprise zone tax credits need to be improved.

- Due to improvements in reporting and the long-term nature of many of the zones' goals and objectives, the two-year and five-year reviews should be consolidated into one report to occur every five years beginning in 2008.

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	29	Continue working with the zones to refine economic development objectives by providing timely review and feedback as part of the Department's Annual Report preparation process.	Department of Local Affairs	Agree	Ongoing
2	34	Ensure zones' marketing efforts are improved by: a) identifying best practices and providing technical assistance and guidance to the zones in educating businesses about the Program, b) working with the Department of Revenue to establish a list of businesses in each zone, and c) assisting zones in recruiting contribution projects.	Department of Local Affairs	Partially Agree	December 31, 2003
3	37	Work together to determine if fees should be charged on the contribution credit. If it is determined that such fees should be charged, the Department of Revenue should amend its regulations or seek statutory changes to authorize the levying of fees and establish criteria for determining the reasonableness of fees.	Department of Local Affairs Department of Revenue	Disagree Agree	— May 31, 2004
4	38	Work with the zone administrators to ensure contributors are notified of all enterprise zone program fees.	Department of Local Affairs	Agree	July 1, 2003

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
5	41	Improve controls over enterprise zone tax credit eligibility by (a) ensuring that taxpayers are eligible for the credits taken, (b) processing only complete returns or evaluating methods of ensuring that accurate credits are claimed should the taxpayer fail to submit the required certification, and (c) evaluating the cost-benefit of conducting targeted audits of the enterprise zone tax credits.	Department of Revenue	a. Agree b. Partially Agree c. Agree	a. December 31, 2003 b. December 31, 2003 c. February 28, 2003
6	43	The General Assembly should consider a statutory amendment consolidating the Two-Year review of the Department of Local Affairs' Annual Report with the Five-Year Review, beginning in 2008.	--	--	--

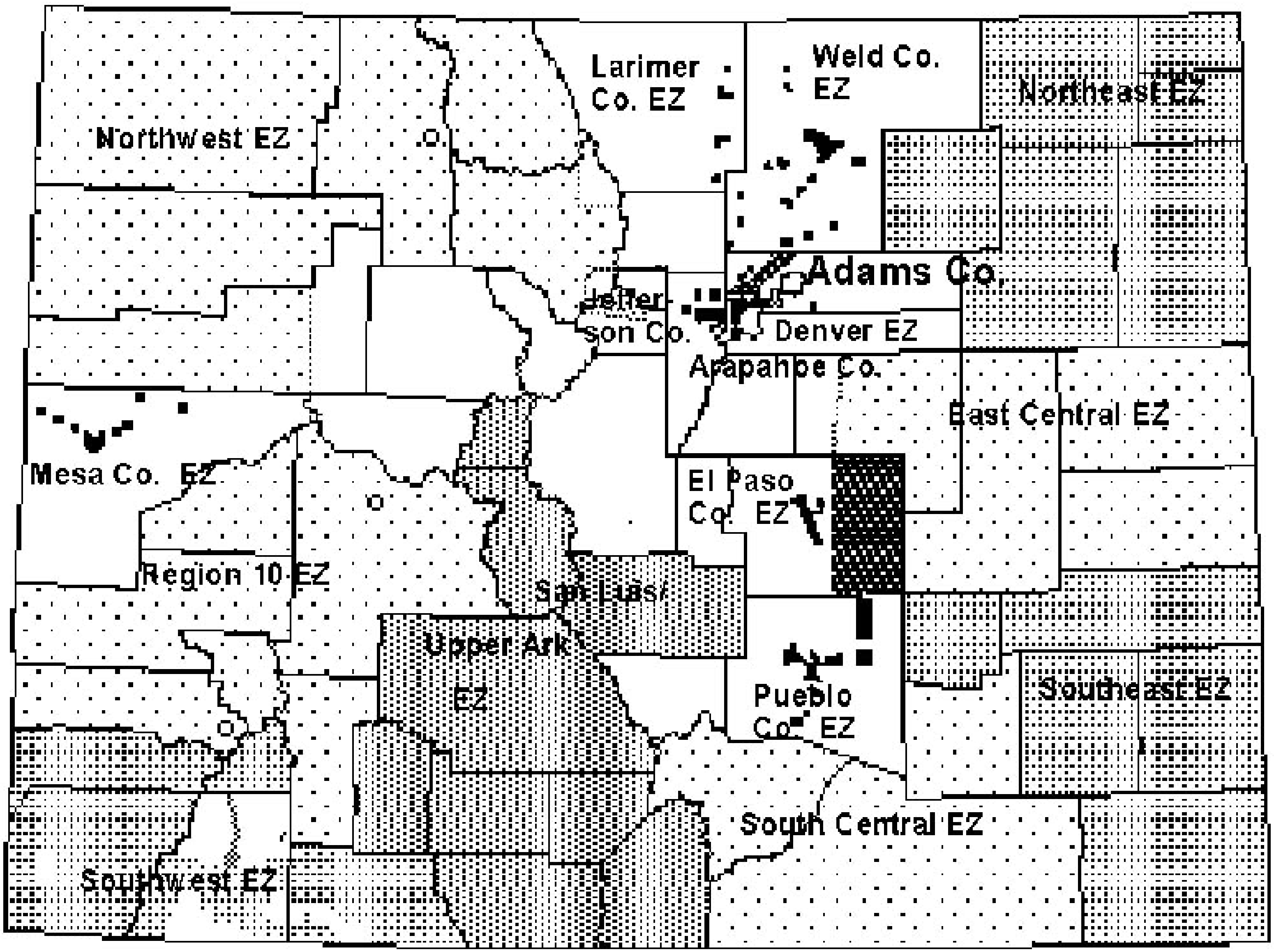
Enterprise Zone Program

Background and Description

The General Assembly created Colorado's Enterprise Zone Program (the Program) in 1986 “to provide incentives for private enterprise to expand and for new businesses to locate in economically depressed areas and to provide more job opportunities for residents of such areas.” By statute, the number of zones is limited to 16. Any municipality, county, or group of contiguous municipalities may propose an area of the municipality, county, or group of municipalities or counties as an enterprise zone. As the shaded portions of the map on the following page illustrate, the existing zones encompass about 70 percent of the State's land area. According to statute, to be designated a zone, an area must have a population of less than 80,000 and meet one of the following criteria:

- An unemployment rate at least 25 percent above the state average.
- A population growth rate less than 25 percent of the state average.
- A per capita income less than 75 percent of the state average.

One-half (eight) of the existing zones were designated in 1986—the year the Program began. The remaining eight zones were designated between 1987 and 1993. Recent changes in legislation increased population limits in some rural zones and established new criteria for enhanced rural enterprise zone designation.



Source: Department of Local Affairs.

Enterprise Zone Tax Incentives

The Program's incentives consist of six different tax credits and one sales and use tax exemption, which are available to corporations, business partnerships, and individuals located within a zone. Enterprise Zone tax credits and exemptions are:

- **Investment Tax Credit.** A 3 percent credit for qualifying equipment investments used exclusively in an enterprise zone. The investment tax credit continues to be the most widely used of the enterprise zone tax credits.

- **Job Training Credit.** This credit is 10 percent of the amount of investment and expenses for qualified job training programs for employees in the zones.

- **Research & Development Credit.** A 3 percent tax credit for any taxpayer increasing research and development expenses in an enterprise zone.

- **Rehabilitation of Vacant Buildings Credit.** Any taxpayer who makes qualified expenditures to rehabilitate an older, unoccupied building in an enterprise zone is eligible for a credit of 25 percent of the qualified rehabilitation expenses.

- **Contributions to Zone Projects Credits.** This is a credit of 25 percent of the monetary or in-kind taxpayer contribution to approved nonprofit or local government projects for the purpose of implementing the enterprise zones' economic development plans.

- **New Business Facility Employee Credits.** For each new employee added by a new or qualifying expanded business facility in an enterprise zone, a $500 credit is available. Additional credits are allowed for new employees covered by employer-sponsored health insurance ($200 per new employee for the first two tax years following the date of qualification) and for businesses that manufacture products from agricultural commodities (an additional $500 per employee).

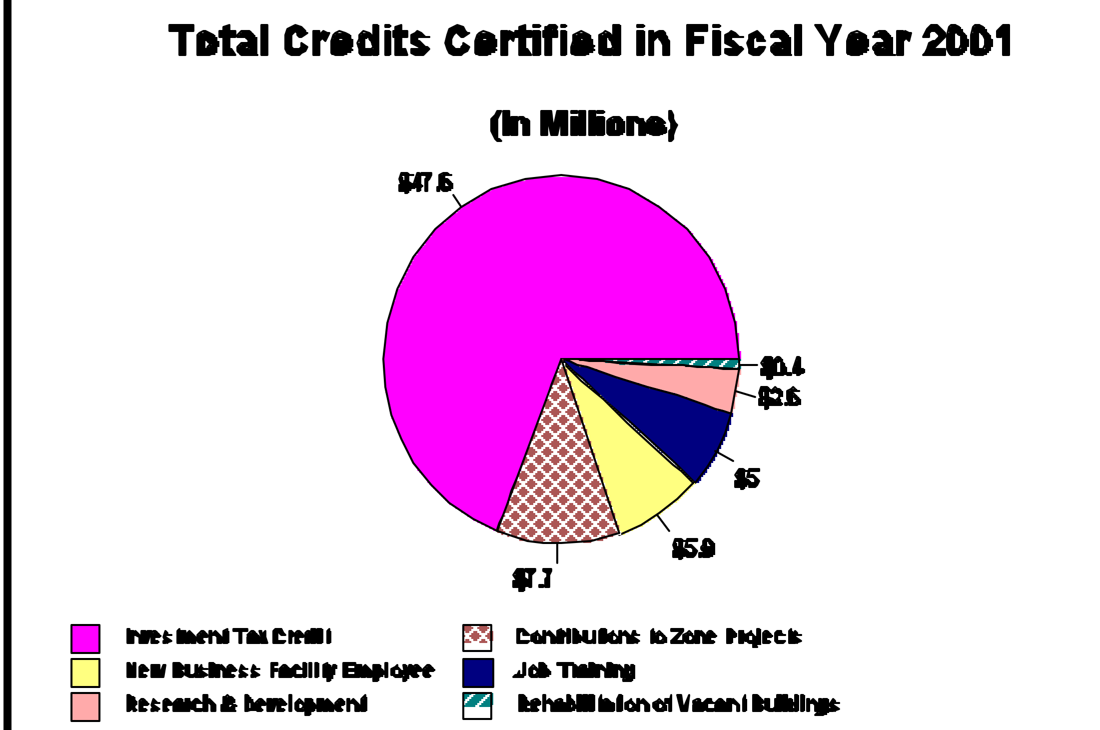
- **Manufacturing and Mining Equipment Sales Tax Exemption.** Purchases of machinery and machine tools used in mining or oil and gas operations in an enterprise zone are exempt from sales and use tax.

Two ways to measure the impact of the Enterprise Zone credits are:

- **Credits Certified.** To receive an Enterprise Zone tax credit, individuals, business partnerships, and corporations must apply for and receive certification from the local zone administrator. The certification allows a business to use a credit to offset state tax liabilities. The amount of credits certified represents the potential amount of credits that may be claimed if all certificates issued are actually claimed on tax returns. For Fiscal Year 2001 the potential tax credit value of certificates issued was $69.2 million.

- **Credits Claimed.** Not all credits certified are actually claimed on state tax forms because participants do not always follow through and take the credits or there is insufficient tax liability in the current year. Therefore, the value of the credits claimed typically will be less than the value of the credits certified. Credits not taken in the current year may be carried forward and used in subsequent years. Tax credits claimed can be described as the actual "cost" to the State in lost tax revenue. The value of total credits claimed for Fiscal Year 2001 was about $62 million.

As the exhibit on the following page shows, the investment tax credit is the most frequently certified credit. In Fiscal Year 2001 the value of the investment tax credits certified represented almost 70 percent ($47.6 million) of the total $69.2 million in credits certified. Between Fiscal Years 1996 and 2001, investment tax credits actually taken (claimed) increased from approximately $17 million to more than $34 million.



Source: Office of the State Auditor's analysis of the Department of Local Affairs' Annual Enterprise Zone Report 2002.
Note: The New Business Facility Employee credit total includes Agriculture Processing and Health Insurance credits.

Purpose and Scope

Section 39-30-103, C.R.S., requires the State Auditor to conduct the following audits of the Enterprise Zone (EZ) Program:

- **Five-year audit.** The purpose of this audit is to evaluate the overall implementation of the program and its effect on the employment, unemployment rate, investment, overall growth rate, economic diversity, and per capita income in each enterprise zone or county containing an enterprise zone. The audit is also to evaluate the effectiveness of each enterprise zone in achieving its measurable objectives. The State Auditor is to report to the Governor and the General Assembly no less than once every five years. Our last five-year audit was released in February 1998. Therefore, our current audit is in response to this statutory mandate and must be completed by February 2003.

- **Two-year review.** Every year, the Executive Director of the Department of Local Affairs (DOLA or the Department) is to submit a report to the General Assembly that summarizes documentation provided by the individual enterprise zones concerning their efforts to achieve their respective economic development objectives. No later than September 1, 2001, and every two years thereafter, the State Auditor is to submit a report to the General Assembly and the Governor that reviews the Department's report. Our last two-year review was completed August 2001. Our current five-year review also includes an evaluation of individual zone objectives, per statutory requirements.

During the 2002 Legislative Session, House Bill 02-1399 repealed the statutory provision that required the creation of a plan establishing criteria, procedures, and a schedule for the termination of enterprise zones, or portions thereof, that no longer meet specified criteria.

Review of the Enterprise Zone Program

Our current Five-Year Review of the Enterprise Zone Program consists of an evaluation of the overall implementation of the Program and its effect on the six economic indicators previously cited. Also, as prescribed in statute, we reviewed the 16 zones' reports on their individual goals and objectives and the zones' documentation of efforts to improve their respective economic conditions. Additionally, we conducted a review of six zones, consisting of on-site visits to the zone administrators' offices and testing of enterprise zone tax credit certificates. In some cases, on the basis of our findings in the six zones, we expanded our review of individual zone activities to include all 16 zones.

Enterprise Zone Program Impacts

Chapter 1

Overview

As previously stated, Section 39-30-103 (4)(c)(II), C.R.S., requires the State Auditor, no less than once every five years, to evaluate the implementation of the Enterprise Zone Program (the Program) and its effect on the employment, unemployment rate, investment, overall growth rate, economic diversity, and per capita income in each enterprise zone or county containing an enterprise zone. Statutes also require the State Auditor to evaluate the effectiveness of each zone in achieving its measurable objectives. To fulfill these statutory requirements, this chapter contains the following:

- An evaluation of the implementation of the Program and its effect on economic conditions within the zones.

- Trend data on each of the six economic indicators referenced in statute.

- An evaluation of the effectiveness of each zone in achieving its enterprise zone objectives.

Measuring Program Effectiveness

Since beginning our audits of the Enterprise Zone Program in 1995, we have reported on the challenges surrounding evaluating the Program's impacts on economic conditions. Not only has it been difficult methodologically to isolate the causes of economic change, but we have encountered the following obstacles:

- Difficulty obtaining comparable, complete, and reliable data.

- Incongruity between the goals of the Program and its structure.

- Changes in zone boundaries and population limits that create a moving target for measurement.

- Zone boundaries and subzone areas that do not necessarily correspond to existing data sources such as census tracts, county lines, or city boundaries.
- Frequent program changes that make it difficult to compare conditions over time.

Other researchers, economic development professionals, and auditors have also found the task of determining the impact of enterprise zone programs challenging. As discussed in our 1998 audit of the Program, the Texas State Auditor's Office determined that it was "neither possible nor cost-effective to assess the success of the Program." California, Florida, Louisiana, and Oregon have all conducted evaluations of their enterprise zone programs and were unable to establish a direct cause-and-effect relationship between the program and changes in economic conditions.

Individual researchers have also faced similar obstacles. For example, one former Director of the Legislative and Urban Policy Staff of the U.S. Department of Housing and Urban Development found that no "evaluation provides conclusive evidence, even on the narrow range of job impacts most have chosen to focus on," that enterprise zones result in changes to the local economy of zone areas. More recently, a 2002 national survey of state enterprise zone programs found that most enterprise zone administrators who responded to the national survey "clearly believe their programs are effective tools to increase jobs and investments in blighted or distressed areas." However, the researchers stated that one of their “distressing observations was that many participating states could not provide the accurate usage statistics necessary to measure the effectiveness of programs.”

Since the start of Colorado's Program in 1986, there have been 16 legislative changes, including the addition of more zones and tax credits and changes to the criteria used to qualify zone areas. For example, a recent bill, House Bill 02-1161 designates certain areas as Enhanced Rural Enterprise Zones. This legislation increases the population limit of rural zones and establishes new criteria for designation as an enhanced zone. Over the years, many legislative changes have reflected the General Assembly's concern for greater accountability, particularly with measuring the effectiveness of the Program. Statutory changes have increased the zones' and the Department of Local Affairs' (DOLA's) responsibilities for compiling and reporting data and for the Office of the State Auditor to evaluate the Program's impacts. As a result of these mandates, we found the following during our current audit, which enhanced our ability to perform the evaluation of the Program in 2002, as compared with previous years:

C Data reported by the zones are more uniform, reliable, and consistent over time.

C Zones have done a better job reporting on achievement of enterprise zone objectives.

- The Department of Local Affairs has implemented several of our past audit recommendations that have mitigated the incongruity between the goals of the Program and its structure.

It is important to note that none of our analyses, including our current one, establish a direct causal relationship between the Enterprise Zone Program and changes in the overall economic conditions in the zones. However, the findings discussed throughout the rest of this chapter begin to explain the correlations that do or do not exist between changes in economic conditions and the implementation of the Enterprise Zone Program.

Enterprise Zones Continue to Be at a Competitive Disadvantage

Although the economy has experienced a downward shift in the past 12 months, the 1990s proved to be a time of economic prosperity for Colorado as a whole. Since our last five-year audit of the Enterprise Zone Program in 1998, economic conditions within the enterprise zones, the nonzone areas of the State, and the State as a whole showed strong, positive growth. On the basis of available data, it appears that the zone and nonzone areas of the State experienced improvements in many economic indicators. For example, economic data for 2000 show that the unemployment rate in the zones was higher than the State's but lower than the nation's. Additionally, between 1996 and 2000 the number of employed individuals in the zones and statewide increased. Further, the investment tax credits taken by businesses in the zones doubled, from $17 million in 1996 to $34 million in 2001. Moreover, both the zone and nonzone counties experienced increases in the number of business establishments, employees, and wages between 1996 and 2000.

In our evaluation of the Program, we used two widely accepted quantitative techniques to evaluate changes in the economic conditions of zone areas over time and to compare those changes with ones observed in nonzone areas during the same period. The two techniques are:

- **Shift Share Analysis** is based upon the assumption that local economic growth can be described by the combined effect of three components: national share, industry mix, and regional shift or competitive share. Thus, one can apply shift share to determine how much each component contributes to local economic growth. In addition, the shift share technique may be used to identify a local or state economy's competitive industries. A competitive industry is one that outperforms its counterpart at the national level.

- **Multiple Regression Analysis** is used to determine the relationship between changes in employment and per capita income and the implementation of the Enterprise Zone Program. Multiple regression analysis is a statistical method for studying the relationship between a single dependent variable (e.g., per capita income) and one or more independent variables (e.g., population, public assistance, ethnicity). The method is commonly used in the social and physical sciences in an attempt to isolate the true causes of a certain observed condition.

A more detailed explanation of the methodology and quantitative techniques used in our evaluation can be found in Appendices B and C.

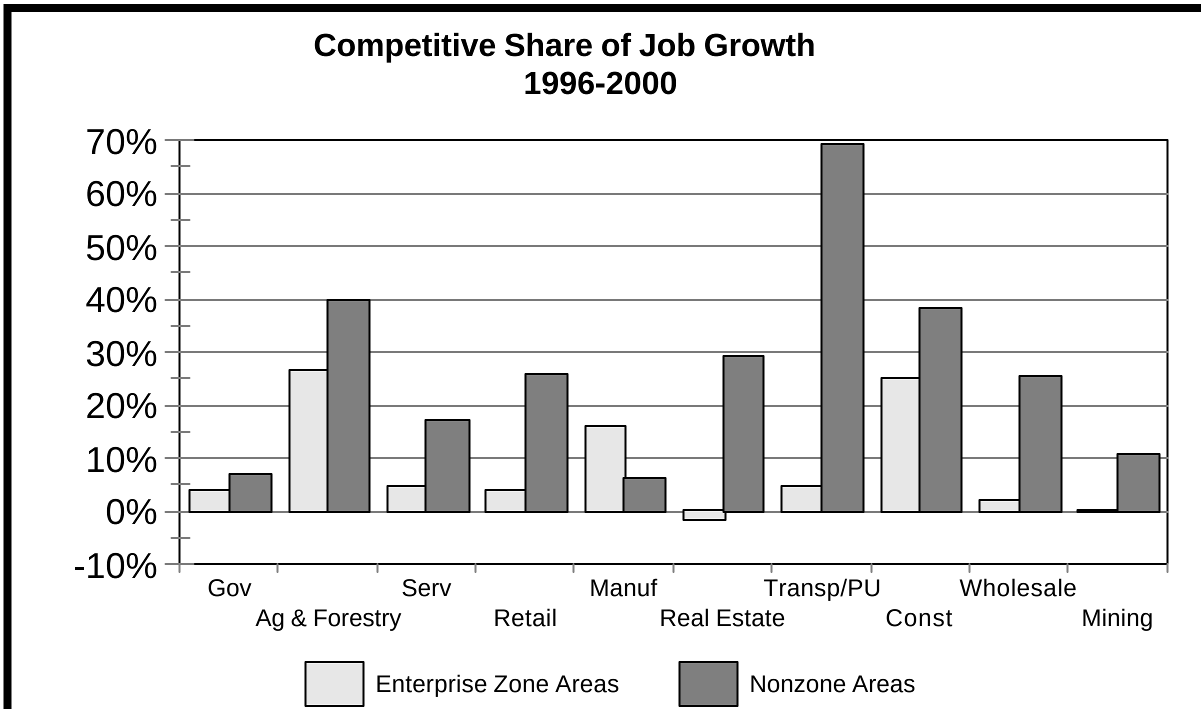
Each of the findings in the following sections support our overall conclusion that the nonzone areas (Boulder, Douglas, Eagle, Gilpin, Park, Pitkin, Summit, and Teller counties) continue to be more competitive than zone areas in relation to three economic indicators:

- Overall Employment Growth
- Employment Growth by Industry
- Per Capita Income

In addition, the gap between the zones and nonzones in these three indicators continued, and, in some cases, widened, after the implementation of the Program in 1986. However, it is important to note that we do not know whether the economic conditions in the zones would have been worse, and the gap even wider, had the Program not been introduced.

Employment Growth Follows National Trends

We used shift share analysis to determine whether enterprise zone areas are more competitive than nonzone areas in attracting jobs. We assessed employment change between 1996 and 2000 in both zone and nonzone areas. The component of most interest to our analysis was the competitive share component, which is graphed in the exhibit on the following page. The competitive share component isolates the effect of growth in the national economy and within each industry and provides the resulting growth directly attributable to the efforts and conditions of the areas under analysis. If a sector's competitive share is positive, then the sector has a local advantage in promoting employment growth. It is important to note that the following graph does not represent the percentage change in employment between 1996 and 2000. Rather, it illustrates the percentage of job growth that can be ***directly attributed*** to either the zone or nonzone areas. For example, the graph indicates that the unique characteristics of the enterprise zone areas were responsible for 4.6 percent of the employment growth in the service industry occurring between 1996 and 2000. However, the conditions in the nonzone areas were responsible for 17.2 percent of the employment growth in the service industry during this same time. Thus, nonzone areas were more competitive in promoting service sector employment growth.



Source: Office of the State Auditor's analysis of employment data from the Colorado Department of Labor and Employment.

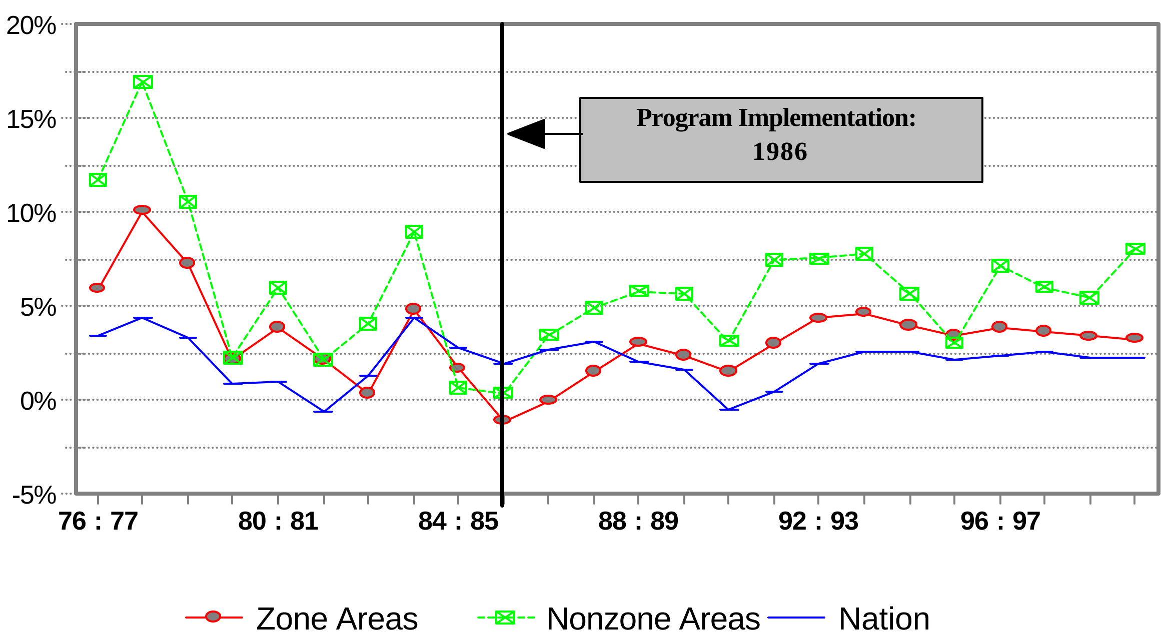
Following are the findings derived from the shift share analysis (the results are illustrated in the graph above):

- **Overall, nonzone areas are more competitive than zone areas in attracting jobs. The results suggest that enterprise zone areas are still at a competitive disadvantage compared with other areas within Colorado.** The only industrial classification in which enterprise zones outperformed nonzone areas was manufacturing. Approximately 16 percent of the employment growth in manufacturing that occurred in enterprise zones can be directly attributed to the conditions and programs of the designated zone areas. This compares with approximately 6 percent of manufacturing employment growth attributed to the conditions present in nonzone areas. Economic development professionals suggest that enterprise zone areas are more competitive in attracting manufacturing facilities and associated jobs because of less expensive and available tracts of land, the presence of incentive programs (such as tax abatements, small business grants, revolving loan funds, and enterprise zone tax credits), and the availability of affordable labor.

- **Enterprise zone areas have a local advantage in promoting employment growth in every one of the 10 industrial classifications except Mining and Finance, Insurance, and Real Estate.** For example, the competitive share component is 0 percent for Mining, and -1.3 percent for Real Estate. Enterprise zones generally grew in employment at a faster rate than both the nation and within each industry between 1996 and 2000. As illustrated by the graph above, the positive competitive share components in the eight other industrial sectors indicate that the zone areas have an advantage in creating jobs. This advantage could be due to local firms' having superior technology, management, or market access, or the local labor force's having higher productivity and/or lower wages.

As the exhibit on the following page shows, changes in employment in zone and nonzone areas closely imitate national trends both before and after program implementation. Broad, macroeconomic forces appear to be driving the fluctuations. For instance, the downturn in Colorado's economy between 1984 and 1986 is explained both by a worldwide drop in the price of oil and gas at a time when the State was heavily dependent on these commodities and by an overbuilding of nonresidential buildings and homes. Resulting layoffs and low employment opportunities in the State caused net migration totals to be negative for five years. The resulting high vacancy rates and foreclosures forced down home prices.

Job Growth—Zones, Nonzones, and Nation 1976-2000



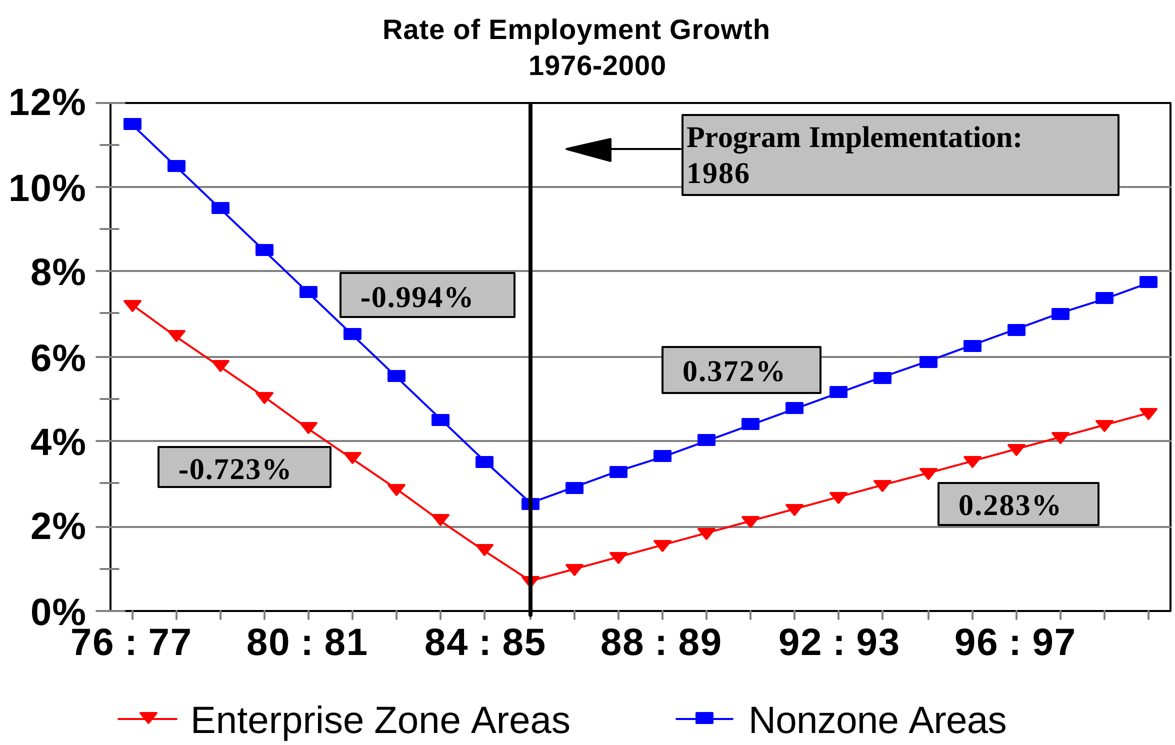
Source: Office of the State Auditor's analysis of employment data from the Colorado Department of Labor and Employment and the United State Department of Commerce, Bureau of Economic Analysis.

Note: The graph illustrates the annual percentage change in total employment beginning in 1976 and ending in the year 2000.

Using the annual percentage change in employment between 1976 and 2000, we also examined the trends in employment growth, using multiple regression analysis to determine differences in the rates of change before and after program implementation in both zone and nonzone areas. Our analyses found the following as shown in the next exhibit:

- **The rate of employment growth for enterprise zones increased directly following program implementation. However, the rate in nonzone areas increased as well.** As the following exhibit shows, the rate of employment growth of zone areas was declining by 0.723 percent per year prior to program implementation. Following 1986, however, the rate of employment growth of zone areas began to increase by 0.283 percent per year. The analysis also shows that the rate of employment growth of nonzone areas was declining at an ***even greater rate*** than zone areas prior to program implementation—a decline of 0.994 percent per year. Following 1986, however, the employment growth of ***nonzone areas began to outpace enterprise zone areas*** by increasing at a rate of 0.372 percent per year.

- **The difference in the rate of annual employment growth between zone and nonzone areas increased after program implementation.** As the exhibit below indicates, the difference in the rate of employment growth between zone and nonzone areas began increasing by a rate of approximately 0.089 percent (0.372% - 0.283% = 0.089%) per year after program implementation. Before program implementation, the gap in employment growth was actually decreasing by a rate of approximately 0.271 percent (0.994% - 0.723% = 0.271%) per year.



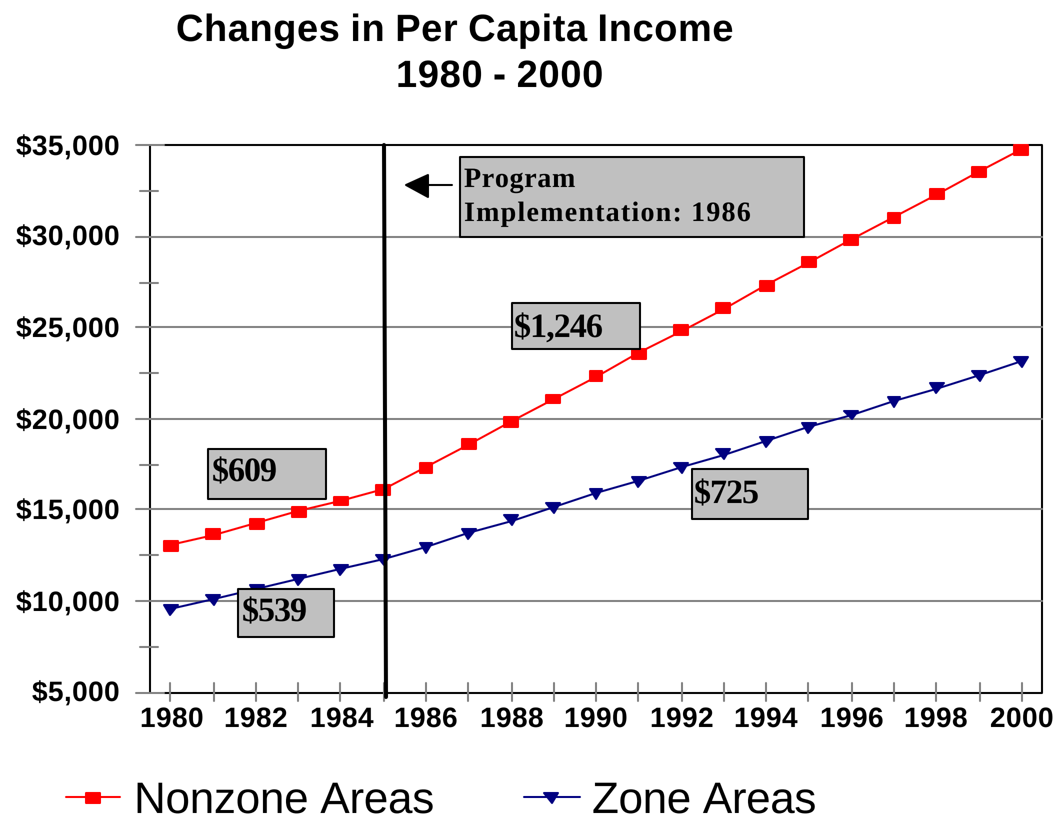
Source: Office of the State Auditor's analysis of employment data from the Colorado Department of Labor and Employment.

Note: The graph illustrates the results of our multiple regression analysis examining the annual percent change in employment (dependent variable) both before and after program implementation. (For additional methodological detail see Appendix B.)

Zone Residents Gain Little in Buying Power

We also analyzed changes in per capita income for both zone and nonzone areas between 1980 and 2000. We found the following:

- **Nonzone areas experienced greater gains in per capita income compared with zone areas following program implementation in 1986.** Prior to 1986, the per capita income in enterprise zone areas was increasing at a rate of $539 per year. Following program implementation, the rate of increase in the per capita income of zone areas rose by approximately $186 per year ($725 - $539 = $186). Comparatively, the per capita income of nonzone areas was increasing by $609 per year prior to 1986. Following program implementation, the rate of growth in the per capita income of nonzone areas rose by $637 per year ($1,246 - $609 = $637). Thus, the gap between zone and nonzone areas in regard to per capita income increased from about $70 per year prior to 1986 ($609 - $539 = $70) to approximately $521 following program implementation ($1,246- $725 = $521). This trend is highlighted in the following exhibit.



Source: Office of the State Auditor's analysis of per capita income data from the Colorado Office of Economic Development & International Trade.

Note: The graph illustrates the results of our multiple regression analysis examining the change in per capita income (dependent variable) both before and after program implementation. (For additional methodological detail see Appendix B.)

Those living in nonzone areas continue to have greater buying power than people residing in enterprise zone areas. We adjusted yearly per capita income data for inflation to examine the actual changes in buying power between zone and nonzone area residents. Between 1980 and 1986, enterprise zone residents had an average, inflation-adjusted, per capita income of $19,745 compared with nonzone area residents who had an average, inflation-adjusted, per capita income of $26,757. Although zone residents experienced an increase in their overall buying power after program implementation (average per capita income increased to $21,688), they were again outpaced by nonzone residents who saw their average, inflation-adjusted, per capita income rise to $31,200 between 1987 and 2000. Thus, zone area residents experienced an average increase in buying power of approximately $1,943 compared with an average increase of $4,443 for nonzone area residents. To determine changes in buying power, we converted the per capita income data for both zone and nonzone areas to 2000 dollars using the consumer price index. See the appendices for a discussion of the methodology and quantitative techniques used in our analyses.

- **The Enterprise Zone Program does not appear to influence changes in the per capita income of zone residents living within urban areas.** We found that there were several areas that could have qualified as enterprise zones in 1990 on the basis of unemployment rate and/or per capita income but were not designated as such. We used these areas to analyze whether the Enterprise Zone Program influenced or led to changes in the per capita income of zone areas. Specifically, with the help of the Department of Local Affairs, we selected 68 census tracts that were comparable on the basis of several socioeconomic factors, the only difference being that one-half (34) were not designated as zones. The results of our analysis revealed that there was no significant difference in the change in per capita income from 1990 to 2000 between the zone and nonzone areas. (Refer to Appendix B for comparison diagnostics regarding the zone and nonzone census tracts and a detailed explanation of the methodology used for the analysis.)

Finally, we analyzed the compound annual average growth rates in per capita income and inflation-adjusted per capita income. The results of this analysis support our findings concerning the differences existing between zone and nonzone areas regarding per capita income. Our analysis of per capita income is detailed in Appendix C.

Review of Six Economic Indicators

In addition to evaluating the overall implementation of the Enterprise Zone Program, statutes require the State Auditor to evaluate the Program's effect on six economic indicators. In the following sections, we discuss our findings relative to the six economic indicators: unemployment rate, per capita income, employment, investment, overall growth rate, and economic diversity. In many cases, we compared zone, nonzone, state, and national data. Our review generally focused on the five-year period from 1996 through 2000. We obtained input from the State Enterprise Zone Coordinator, the zone administrators, the Chief Economist for the Colorado Legislative Council, and others in defining each of the six indicators.

Because complete 2000 census data were not available at the time of the audit, we adapted our analysis accordingly. For example, data on the six economic indicators were not available at the zone level. Thus, the results presented in our analysis only reflect entire county data.

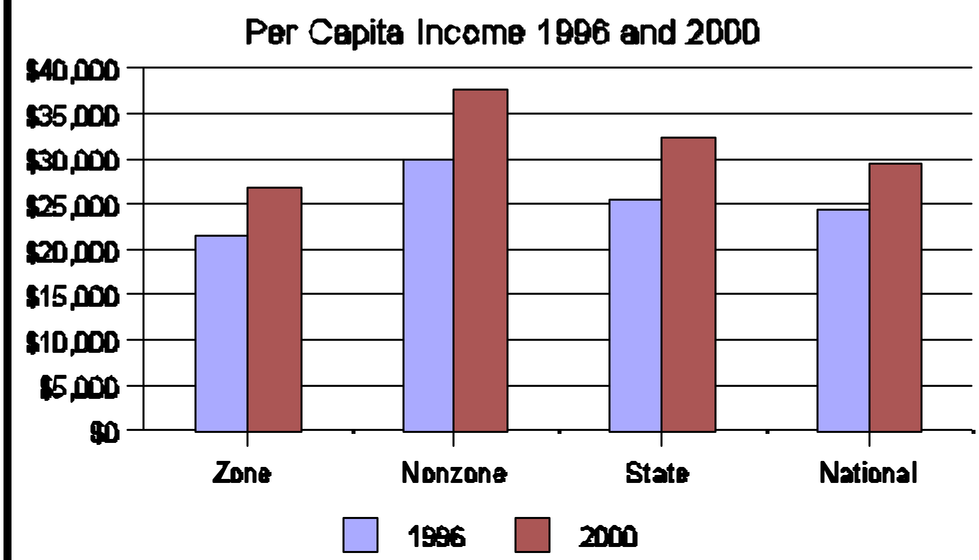
Unemployment Rate—***The total number of unemployed persons expressed as a percentage of the total civilian labor force. That is, the unemployment rate is the percentage of persons who are unemployed and actively seeking employment as compared with the total eligible civilian labor force.***

An unemployment rate 25 percent higher than the state average is the most frequent reason for zone eligibility. For example, 81 percent (13 of 16) of the zones requalified for eligibility in 1996 on the basis of unemployment rate. Although there were significant improvements in the zones' unemployment rates, these rates continued to be higher than the state average. In addition, improvements in the State exceeded improvements at both the zone and national levels. In 1996 the average unemployment rate for the enterprise zones was nearly 5 percent. Fiscal Year 2000 data showed the average unemployment rate for the enterprise zones to be 3.2 percent. During this same period, the State's rate decreased from 4.2 to 2.7 percent. This compares favorably with national rates of 5.4 percent in 1996 and 4 percent in 2000. Additionally, in 2001 the zone's rate had increased to 3.8 percent, while the State's rate increased as well to 3.7 percent.

Per Capita Income—***Per capita personal income is the annual personal income of residents divided by the annual resident population.***

An area may be eligible for zone status if its per capita income is less than 75 percent of the state average. At the time of our audit, the most recent per capita income data available were 2000 data. From 1996 to 2000, per capita income in the zones increased an average of 24 percent, from $21,570 to $26,750.

As the following chart shows, per capita income in the zones was approximately $27,000 in 2000. This is about $10,000 less than the average of $37,500 for the non-zone counties. The state average of $32,434 was approximately $5,000 more than the zone average. The national average of $29,469 was about $2,000 more than the zone average but about $8,000 less than the nonzone average and approximately $3,000 less than the State's average.



Source: Office of the State Auditor Analysis of Per Capita Income data.

Employment—***Employment refers to the number of individuals in the civilian labor force, 16 or older, who are eligible to work and are actually employed. The civilian labor force is defined as the sum of employed and unemployed persons.***

In 1996 there were approximately 1.7 million employed individuals in zone areas. In 2000 the number of employed persons had increased by more than 8 percent to about 1.9 million. For the same period, the number of employed individuals in the State increased from approximately 2 million to 2.2 million, a growth of over 10 percent. The following table depicts these changes.

Number of Employed Persons 1996 and 2000						
	Zone 1996	**Zone 2000**	**Percent Change**	**State 1996**	**State 2000**	**Percent Change**
Employed Individuals	1,713,211	1,856,142	8.3	2,010,284	2,213,044	10.1
Labor Force	1,790,275	1,910,061	6.7	2,098,971	2,275,545	8.4

Source: Office of the State Auditor's analysis of data compiled by the State Department of Labor and Employment.

Investment—***Investment represents the dollar amount of capital investments made by businesses in the zones and is partially reflected by the investment tax credits taken.***

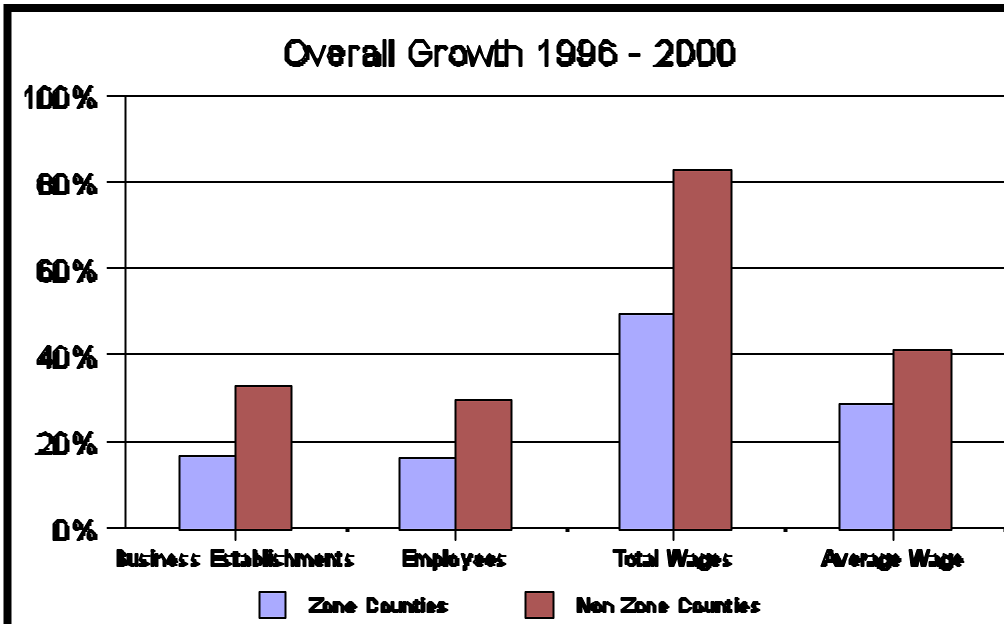
Increases occurred in capital investments and investment tax credits taken. Specifically:

- **From 1987 to 2000, we estimate capital expenditures by manufacturing businesses in the zone counties more than doubled, increasing from $638 million in 1987 to more than $1.4 billion in 2000.** The growth rate nationally was slightly higher, increasing by more than 128 percent. The nonzone rate, however, was the highest, with a growth rate of more than 130 percent. Approximately 80 percent of these expenditures consisted of machinery and equipment purchases, while the remaining 20 percent was attributable to buildings and other structures. It should be noted that information relating to capital expenditures was limited, and as a result, the figures provided are based upon the best estimate available.

- **Investment tax credits taken by Colorado businesses increased from approximately $17 million in Fiscal Year 1996 to more than $34 million in Fiscal Year 2001**. According to tax information obtained from the Department of Revenue, more than $142 million in investment tax credits were taken by participants from Fiscal Years 1996 to 2001. These tax credits represent 3 percent of the total capital expenditures made by the businesses. This translates into more than $4.7 billion spent on items such as machinery, furniture, appliances, and vehicles. Additionally, the number of corporate businesses taking this credit decreased from over 2,000 in 1996 to about 1,610 in 2001, a decrease of 20 percent. Among the nine tax credits available to businesses operating in the zones, the investment tax credit is by far the most utilized credit, accounting for approximately 52 percent of all credits taken by corporations from 1996 to 2000. (Investment tax credit is defined on page 7.)

Overall Growth Rate*—The overall growth rate refers to the changes in the number of business establishments and employees, as well as increases and decreases in wages paid.*

Both the zone and nonzone counties experienced increases in business establishments, employees, and wages from 1996 to 2000. The following exhibit shows the percentage change in each of the categories for the zone and nonzone counties:



Source: Office of the State Auditor analysis of Department of Labor and Employment Data.

Specifically, we observed the following regarding overall growth rate:

- **The mining industry was the only private sector industry to experience a decline in the number of business establishments and employees in the zone counties.** Jobs in this industry, however, paid the highest wages in 1996 as well as in 2000. Since the 1980s, prior to the implementation of the Program, the mining industry, statewide, was experiencing a decline.

- **The construction industry experienced the greatest growth in the zone counties.** The number of business establishments operating in the construction industry rose 30 percent, while the number of employees increased more than 40 percent. Construction also had the largest percentage increase of all sectors statewide.

- **Average wages escalated in all industries.** Average wages in the zone counties increased between 14 and 47 percent for the various industries. Increases in the nonzone counties were higher.

Economic Diversity—*Economic diversity refers to the variety or types of businesses in operation.*

In general, two or three industries represented more than one-half of the business establishments and employees in the zone counties. Among these, the services and retail trade industries represented the largest percentage of business establishments and employees. Compared with other industries such as manufacturing and transportation, communication, and public utilities, however, the retail and services industries paid among the lowest wages in the zone counties during these years. For example, the average annual salary for a manufacturing position was approximately $45,000 in 2000. By contrast, average salaries in the services and retail trades were $36,400 and $19,200, respectively. As the following exhibits show, the top five industries, in terms of the percentage of total business establishments and employees, remained relatively constant in the zone counties.

Top 5 Industries
by Percent of Total Business Establishments
1996 and 2000

Calendar Year 1996					Calendar Year 2000				
	Zone Counties		Nonzone Counties			Zone Counties		Nonzone Counties	
Rank	Industry	Percent	Industry	Percent	Rank	Industry	Percent	Industry	Percent
1.	Services	37	Services	37	1.	Services	36	Services	39
2.	Retail	20	Retail	20	2.	Retail	18	Retail	18
3.	Construct.	11	Construct.	13	3.	Construct.	12	Construct.	14
4.	Finc'l	10	Finc'l	9	4.	Finc'l	11	Finc'l	10
5.	Wholesale	9	Wholesale	7	5.	Wholesale	8	Wholesale	8
	Other	14	Other	12		Other	15	Other	11

Source: State Auditor's Analysis of Employment and Wage Averages Annual Reports for 1996 and 2000.
Note: Other includes Agriculture, Forestry, Fishing; Mining; Construction; Manufacturing; Transportation, Communication, Public Utilities, and Nonclassifiable.
* The sum of the percentages may be more or less than 100% due to rounding.

Top 5 Industries *by Percent of Total Employees* *1996 and 2000*									
Calendar Year 1996					Calendar Year 2000				
	Zone Counties		Nonzone Counties			Zone Counties		Nonzone Counties	
Rank	Industry	Percent	Industry	Percent	Rank	Industry	Percent	Industry	Percent
1	Services	28	Services	33	1	Services	29	Services	33
2	Retail	19	Retail	22	2	Retail	18	Retail	22
3	Gov't	16	Gov't	14	3	Gov't	15	Gov't	12
4	Mfg.	10	Mfg.	14	4	Mfg.	10	Mfg.	11
5	Transp.	7	Construct.	7	5	Construct.	7	Construct.	8
Other [(a)]		20	Other [(b)]	12	Other [(b)]		21	Other [(b)]	13

Source: State Auditor's Analysis of Employment and Wage Averages Annual Reports for 1996 and 2000.
Note: Other (a) and (b) - Derived by ranking all 11 industries identified by the Colorado Department of Labor and Employment. The five highest ranked for each year are identified and the remaining six industries are combined in the "other" category.
(a): Other includes Agriculture, Forestry, Fishing; Mining; Construction; Financial, Insurance, Real Estate; Wholesale Trade; and Nonclassifiable.
(b): Other includes Agriculture, Forestry, Fishing; Mining; Financial, Insurance, Real Estate; Wholesale Trade; Transportation, Communication, Public Utilities, and Nonclassifiable.
***The sum of the percentages may not equal 100% due to rounding.**

Achievement of Zone Objectives

By statute, each enterprise zone is to adopt specific economic development objectives with outcomes that can be measured with specific, verifiable data. Section 39-30-103, C.R.S., requires the State Auditor, as part of the five-year review, to evaluate the effectiveness of each zone in achieving its objectives. The following describes the findings of our current review of the zones' objectives identified in their 2002 annual reports. Of the 97 total objectives identified by the zones, we were unable to evaluate 44 because they were unmeasurable, lacked sufficient data to determine their achievement, or were not yet scheduled to be achieved.

Of the 53 objectives that could be adequately assessed, the zones reported that they were unsuccessful in achieving the majority of them. Specifically:

- Sixty-six percent (35) of the objectives had ***not*** been achieved.

- Thirty-four percent (18) of the objectives had been achieved.

To further understand the relationship between the objectives that were achieved and those that were not, we grouped the 53 measurable objectives into three broad categories: (1) **economic conditions** - objectives aimed at improving the economic conditions of zone areas such as increased per capita income, lower the unemployment rate, and create more jobs; (2) **community conditions** - objectives directed toward improving the community as a whole (e.g., reduce the number of people living below poverty, or increase community well-being); and (3) **administrative actions** - objectives that addressed the administrative actions of the zones (e.g., identify the number of businesses in the zone, increase marketing efforts, and develop new marketing materials).

Overall we found that of the 53 measurable objectives, the vast majority (49) addressed economic conditions, 3 addressed administrative actions, and 1 addressed community conditions. We also found no correlation between the type of objective identified in the zones' annual reports and their success in achieving those objectives:

- Of the 18 objectives that were achieved, 15 addressed economic conditions, 2 addressed administrative actions, and 1 addressed community conditions.

- Of the 35 objectives that were ***not*** achieved, all but one addressed economic conditions.

It is also important to note that just as a direct causal relationship between the Program and changes in the overall economic conditions of zone areas cannot be established, it is not possible to determine whether the Program alone is responsible for the achievement of individual zone objectives. For example, it would be unreasonable to draw the conclusion that the Program was responsible for achieving the goal of a 10 percent increase in the nonresidential assessed valuation of a zone area. There are numerous factors influencing changes in nonresidential assessed valuations. Similarly, the lack of achievement does not necessarily indicate failure of the Program. Using the same example as above, we can assume a zone's failure to achieve a 10 percent increase in nonresidential assessed valuation could be caused by drought, declines in oil and gas prices, federal government subsidy programs, insect infestation, or a host of other possible factors that the Program is not necessarily designed to mitigate. Generally, the objectives that were not achieved were either those that contained aggressive or high benchmarks or those that simply did not experience the improvements in the economic conditions of the areas that the zone was expecting at the time the objectives were adopted.

Continue Refining Objectives

As previously stated, we were unable to evaluate many (44 or 45 percent) of the zones' objectives because they were unmeasurable, lacked sufficient data to determine their achievement, or were not yet scheduled to be achieved. Although the zones have made significant advancements in developing goals and objectives, some problems persist. Most notably, some zones' objectives continue to be unachievable, unmeasurable, or unrealistic. For example an objective such as, "increase capital investment" lacks the necessary measures to determine its achievement. A more appropriate objective that meets statutory requirements would be to "increase capital investment by 1 percent annually by contacting 20 businesses each year that have never been certified for a credit."

In our 2001 review of the Department's Annual Report, we provided a model for developing comprehensive strategic plans containing well-defined goals, work steps, and measurement criteria. It is clear that some of the zones have used the model to structure their own goals. This restructuring and other guidance and efforts by the Department of Local Affairs have resulted in significant improvement in the development of the zones' goals since our first audits of the Program. Program statutes require the Department of Local Affairs to work with the zone administrators to ensure that the zones have specific economic development objectives with outcomes that can be measured with specific, verifiable data. As stated previously we found areas still needing improvement. Therefore, we believe the Department needs to continue working with the zones and provide ongoing feedback to refine objectives and assist zone administrators in making adjustments as economic conditions change, the demographic characteristics of areas evolve, and the local business climate develops.

Recommendation No. 1:

The Department of Local Affairs should continue to work with the zones to refine economic development objectives by providing timely review and feedback as part of the Department's annual report preparation process.

Department of Local Affairs Response:

Agree.

Administrative Issues

Chapter 2

Overview

In addition to our evaluation of Enterprise Zone implementation on the various economic indicators, as discussed in Chapter 1, we selected a sample of enterprise zones and conducted a review of each of these zones' activities. Our review included three urban and three rural enterprise zones. The three urban zones were Greeley/Weld, Larimer, and Pueblo. The three rural zones were East Central/Northeast, San Luis/Upper Arkansas Valley, and Southeast. Our review identified several operational areas in need of improvement. Specifically, we found:

- Zone marketing efforts need improvement.

- Fees charged need to be in compliance with statutes and regulations.

- Eligibility for tax credits needs to be ensured.

Enterprise Zone Marketing

The Economic Development Commission (the Commission) authorizes annual marketing grants to the enterprise zones. The source of the grants derives from general funds. The zones are required to match at least 100 percent of the grant amount either from their own local sources or from partner organizations. Additionally, beginning in 1997, the Commission authorized zones to apply up to 25 percent of these marketing grants to cover the costs for administering the Program. With the exception of the 25 percent administrative allowance, Commission grants are to be used for the marketing and promotion of economic development efforts in the enterprise zones. In 2001 the Commission authorized 16 marketing grants totaling $270,000.

Marketing and Outreach Efforts

The goal of the Enterprise Zone Program is to stimulate economic development. We reviewed the marketing efforts of six zones. We found that zone marketing is conducted in conjunction with overall economic development marketing. Marketing efforts include printing and development of economic development brochures, Web site creation and maintenance, attendance at trade shows, and business retention and expansion efforts. We determined that zone marketing efforts could be improved in three areas:

- **Marketing outreach is limited.** Enterprise zone administrators lack basic information needed to effectively market the Program. Zone administrators do not maintain complete lists of businesses located within their zone areas for use in identifying and targeting businesses that would be eligible for zone credits. We asked each of the six zone administrators in our sample to provide a complete list of all businesses located within their respective zones to determine which businesses had ever been certified and which had never applied for certification. Only one of the six zone administrators was able to provide the list of businesses we requested. We believe the Department of Local Affairs should work with the Department of Revenue to provide a complete list of area businesses to the zones.

- **Businesses located within an enterprise zone are not adequately informed about the Program.** During our audit we contacted 12 businesses that had never been certified for a credit. Four of the businesses reported that they had no knowledge of the Program. Of the eight that were aware of the Program, only one had been notified of the Program by the zone administrator. Additionally, of the businesses that had knowledge of the Program, only two knew about the actual tax credits. Moreover, several of the businesses we contacted had been at their current location for more than 10 years, and all of them had made at least one expenditure that would have qualified for a tax credit. For example:

  - Six of the 12 businesses stated that they had hired new full-time employees within the last three years.

  - Ten of the 12 businesses contacted had purchased some type of investment equipment for their business within the last three years.

  - Three of the businesses stated that, within the last three years, they had purchased machinery for manufacturing.

- **Zones are not actively recruiting contribution projects.** The majority of the zone administrators do not solicit agencies and organizations to become contribution projects. Contribution projects are nonprofit or local government entities located within a zone that have been approved by the Colorado Economic Development Commission to receive monetary or in-kind contributions from taxpayers who, in turn, are eligible for a tax credit of 25 percent of the value of the contribution. One of the zones currently does not have any contribution credit projects. The zone administrator of this zone said that this is due to a lack of interest among potential contribution credit agencies and programs. We believe that the zone administrators should actively pursue contribution projects for the benefit and improvement of the zone. For example, one of the zones uses its marketing funds to solicit projects that meet its zone goals. Projects are then chosen for their appropriateness and fund availability.

Improved Marketing Is Needed

As discussed previously, we believe the Department of Local Affairs and the Department of Revenue should provide zone administrators with a list of zone businesses. After the zone administrator receives the listing, direct mailings could be sent to businesses within the zones. We found one urban zone that has been very successful with direct mailings. This zone contracted with a private firm to obtain a list of local businesses. The zone then used the list for informational mailings to businesses. The following is an example of the mailing the zone sends to businesses.

Model Enterprise Zone Direct Mail Letter

Date

Dear Business Owner,

According to our records your business may fall within the boundaries of the ____________ Enterprise Zone. You may therefore be able to take advantage of tax credits to help strengthen your business. Businesses are eligible for the tax credits if they are located in the Zone and have a state tax liability. The credits that are available in the Zone are the following:

- **New Job credit of $500 for each new employee.**
- **Health Insurance credit of $200 for each employee sponsored on a 50% paid health insurance plan.**
- **Investment tax credit of 3% for all expenditures on business personal property.**
- **Job Training tax credit of 10% for expenditures to train employees.**
- **Exemption from the state sales tax on manufacturing equipment.**
- **Agricultural new jobs credit of $500 for each new employee.**
- **Investment tax credit of 3% on research and development expenditures.**
- **A 25% tax credit for a donation to a zone certified contribution project.**

The process to apply for these credits is simple. Enclosed you will find the Colorado Department of Revenue form to file for the credits. Complete the enclosed from and fax it to our office. Once you receive back the form from our office, enclose it with your tax return to request the credits off your state income tax liability. We look forward to the opportunity to work with you and your company.

Sincerely,
Zone Administrator

Source: Denver Enterprise Zone.

The zone administrator told us that the first year of the mailing resulted in about 75 calls per day from businesses. Additionally, there has been an annual increase in the number of certifications filed. If the Program is to be successful, businesses must first be aware that it exists and that it can be beneficial to them. Without knowledge of the businesses located within the zone area, zone marketing efforts will not be effective in stimulating economic development. The list could be used to determine which businesses and industries should receive increased marketing efforts, and to contact businesses via telephone to discuss the use of the tax credits as part of their business development strategy. The majority of businesses we contacted indicated that the tax credit would influence future business decisions.

Recommendation No. 2:

The Department of Local Affairs should ensure zones' marketing efforts are improved by:

a. Identifying best practices and providing technical assistance and guidance to the zones in educating and informing the businesses in their area about the Program.

b. Working with the Department of Revenue to establish an annual list of businesses in each zone for use by zone administrators in notifying and educating businesses about zone credits.

c. Assisting zones in recruiting contribution projects that are appropriate to their local economic development goals and objectives.

Department of Local Affairs Response:

Partially Agree. The Department believes that each enterprise zone, in cooperation with its local economic development partners, can best set its own priorities at the local and regional level as to the marketing targets and techniques that are most appropriate to their local goals and available resources. This includes deciding whether or not attempting to contact a comprehensive list of businesses would be cost effective as compared with alternatives such as contacting tax preparers; whether mailing lists for a particular area available from the Department of Revenue or commercial sources are sufficiently up-to-date to be of use in a direct mail campaign; and whether contacting existing businesses should be a marketing priority for their area as compared with attempting to attract new businesses.

Likewise, the Department believes that, since the statutory purpose of the enterprise zone contribution tax credit is to assist local zones to implement their economic development plans, local officials can best determine the most effective ways of "recruiting" additional nonprofit organizations, if any, that could potentially assist in such implementation.

Within this framework of local control of marketing,

- The Department will collect and disseminate information describing methods of educating businesses about the Program.
- The Department will request the Department of Revenue to provide a list of businesses within each interested zone, within the constraints of the tax code's confidentiality requirements and that department's resources for generating such lists.
- The Department will continue to provide the zones with guidance as to the types of programs, projects, and organizations that are eligible for the contribution tax credit under the enterprise zone statute and Economic Development Commission policy, and to share information among zones regarding appropriate project activities and sponsoring organizations.

Fees for Contribution Credits

We found that most of the enterprise zones (12 of 16) charge a fee for processing the contribution credit. By statute, businesses or individuals may be certified to receive tax credits for contributions they make to approved programs, projects, or organizations located within a zone. Approved contribution credit projects currently include homeless shelters, job training and economic development centers, hospitals, and children's clinics. For Fiscal Year 2001 self-reported information provided by zone administrators indicates that they collected about $215,500 in revenues from the fees assessed for processing the contributions certifications. However, there is no statutory or regulatory authority for zones to assess a fee related to this particular enterprise zone credit. Rather, authority currently exists for enterprise zones to charge a reasonable fee for certifying all of the other enterprise zone credits (with the exception of the contribution credit). The zones report that the contribution credit is the only credit for which a fee is assessed.

By statute the Department of Revenue is required to promulgate regulations for the implementation of the enterprise zone tax credits. Pursuant to Section 39-30-108, C.R.S., DOR adopted the following regulation 39-30-108:

> The local government with jurisdiction over the enterprise zone shall annually certify to the taxpayer claiming the exemption and credits under section 39-30-104 to 39-30-106 that the taxpayer's place of business is located within the boundaries of the zone. The taxpayer shall file a copy of this certification with the Department of Revenue at the time of the filing of the tax return claiming the exemption and credits. The local government may charge the taxpayer a reasonable fee for certification.

The statutes referred to in the Department of Revenue's regulation, Sections 39-30-104 to 39-30-106, are direct references to the statutory citations for each of the enterprise zone tax credits (e.g. investment tax, new business facility employees, etc.), with the exception of the contributions to zone projects credit. The contribution credit is statutorily authorized at Section 39-30-103.5 C.R.S. As shown above, this section is not cited in DOR's regulation authorizing a fee for certification.

In addition to the lack of authority for charging fees as described above, we identified two other problems with the fee as it is currently applied:

- **Reasonableness of fee(s).** The Department of Revenue's regulation 39-30-108 states that the "local government may charge the taxpayer a reasonable fee for certification." There is a lack of clarity surrounding the term "reasonable" as it applies to the fee amount. Zone administrators told us that the fee covers administrative costs for processing the contribution certifications. We found that the process for certifying the contribution credit is the same as for all of the other credits; however, no fee is assessed for those certifications. Several of the zone administrators also indicated that fee revenues are used to cover the costs for integrating the contribution projects into accounting, bookkeeping, and reporting systems.

  Currently, fee amounts vary among the zones, ranging from $5 per certificate to five percent of the actual contribution made to the project. According to self-reported information from the zone administrators, in Fiscal Year 2001, fee revenue collected ranged from $75 to $66,785. Five of the zones that take a percentage of the actual contribution do not have a limit on the amount of fees collected. To establish a reasonable and appropriate fee, a determination needs to be made as to the purpose for the fee. If the revenues are to cover the costs for processing certificates only, then processing costs need to be determined, and a reasonable fee set per certificate or by type of certificate processed. If, however, the fee is intended to cover other certification-related costs such as compiling, verifying, and reporting credit information, then other costs may need to be determined and included. The Departments of Revenue and Local Affairs should work together to clarify this issue by determining what is a reasonable fee for certification, and whether the fee should be assessed for all certifications. Appropriate rules should then be promulgated and statutory changes recommended, if needed.

- **Fee Notification.** Currently, a majority of taxpayers are not notified that a fee is deducted from their contribution to a zone project. Disclosure of administrative fees is particularly important because administrative overhead has become an issue of concern in recent years. Contributors should be informed that an administrative fee is being assessed by the zone in addition to any administrative overhead incurred by the contribution project. Only two of the twelve zones that assess a fee send notices to taxpayers explaining that a fee was deducted from the amount of the contribution. The remaining ten zones stated that they do not notify taxpayers and did not know if the contribution recipient notifies the taxpayer. Additionally, there is no disclosure of fees on the certificate that describes how contributed funds will be used. We interviewed staff from eight projects that receive contributions to determine if contributors have expressed concerns with the fees or with the donation process. Staff from three of these eight contribution projects stated that contributors have expressed concern with making the check payable to the enterprise zone administrator when the donation was for the authorized project. Procedures for notifying contributors and projects and reconciling fees received are essential controls to reduce the risk of errors and irregularities.

Recommendation No. 3:

The Department of Local Affairs should work with the Department of Revenue to determine if fees should be charged on the contribution credit. If it is determined that such fees should be charged, the Department of Revenue should amend its regulations or seek statutory changes to:

a. Authorize the levying of fees under Section 39-30-103.5, C.R.S., for contributions credits.

b. Establish criteria for determining the reasonableness of such fees.

Department of Local Affairs Response:

Disagree. Department of Revenue Rule 39-30-108 addresses fees charged to *taxpayers* seeking certification for enterprise zone credits. Those enterprise zones that charge fees in connection with contribution projects do *NOT* charge fees to taxpayers. A taxpayer making a cash contribution to an eligible enterprise zone project receives the full 25 percent tax credit allowed by law. Rather, the fees constitute a use of a small part of the amount that has been contributed to assist the zone administrator to cover the costs of promoting, monitoring, state-required reporting, and otherwise administering projects that implement the economic development plan for the enterprise zone, in conjunction with nonprofit organization partners, as provided by statute.

Statutory authority for the use of contributed funds to support the economic development activities of an enterprise zone administrator's office already exists under section 39-30-103.5. These activities "implement the economic development plan for the enterprise zone," and have been approved by the Colorado Economic Development Commission as required by section 39-30-103.5(1)(e).

Therefore, a modification of the Rule or statute is not necessary or appropriate for this purpose.

Department of Revenue Response:

Agree. The Department will work with the Department of Local Affairs to determine whether a fee can, and should, be assessed either on the taxpayer or, alternatively, allow the zone administrator to retain some portion of the contribution to offset the administrator's expense. The Department has made a preliminary review of the statutes and believes the Department does not have statutory authority to authorize the zone administrator to collect a fee from a taxpayer who makes a charitable contribution to enterprise zones. The Department will explore this issue, as well as alternative solutions, with the Department of Local Affairs.

(a) The Department agrees that, if it has statutory authority to assess a fee, it will modify its regulation to implement such authority.

(b) The Department agrees that, if it has statutory authority to assess a fee, it will work with the Department of Local Affairs to develop criteria for determining the reasonableness of such fees.

Recommendation No. 4:

The Department of Local Affairs should work with the zone administrators to ensure contributors are notified of all enterprise zone program fees.

Department of Local Affairs Response:

Agree. The Department will work with those local zones that charge fees in connection with contribution projects to provide notification to contributors that part of a contribution will be retained by the enterprise zone to support the economic development activities of the enterprise zone administrator's office. These activities are eligible purposes for the use of contributions under section 39-30-103.5, and have been approved by the Colorado Economic Development Commission pursuant to section 39-30-103.5(1)(e).

Verification of Tax Credit Information

As part of our five-year review, we intended to match information contained on enterprise zone tax credit certificates with taxpayers' state income tax returns. As described in the following sections, we encountered several problems that hindered our ability to complete this task. Enterprise zone tax credits are significant in terms of lost tax revenues. Since Fiscal Year 1988, taxpayers have claimed nearly $337 million in credits. Because of the problems we identified, we believe greater oversight to ensure compliance with enterprise zone filing regulations is warranted.

We selected a sample of 148 taxpayers who claimed an enterprise zone tax credit in Calendar Year 2000. We reviewed the tax returns filed with the Department of Revenue for these 148 corporate and individual income tax files to determine the number complying with enterprise zone tax credit filing regulations. We found:

- **About 25 percent of the tax returns did not have the required enterprise zone certificate attached (37 of 148 returns).** Department of Revenue regulations require that taxpayers file a copy of their enterprise zone certification with the Department of Revenue at the time of the filing of the tax return claiming the exemption or credits. The certificate attests to the taxpayer's eligibility, as established by the zone administrator, to claim the credit.

- **Errors in calculating the amount of the tax credit occurred in 10 percent of the certificates attached to tax returns (11 of 109 returns).** If the credit amount is calculated incorrectly on the enterprise zone certificate, this erroneous information could be carried over onto the income tax return when the credit is claimed. Because the full value of a credit is not necessarily claimed in a single year and may be carried forward to subsequent years, we were unable to determine whether these calculation errors resulted in taxpayers receiving credits for more or less than they were eligible. We have provided the Department of Revenue with the details of the errors we identified so that staff may address the individual issues appropriately through their audit process.

- **Eight of the certificates attached to the tax returns did not have required sections of the enterprise zone certificate completed.** By statute, companies claiming enterprise zone credits are to provide information needed to evaluate the effectiveness of the zones in accomplishing their measurable economic development objectives. Information such as the number of jobs created, the number of employees trained, and the compensation levels for full-time, part-time, temporary and contract employees, is statutorily required to be collected and reported by the zones and the Department of Local Affairs for all companies claiming enterprise zone credits. Currently, there are no statutes or Department of Revenue regulations requiring zone administrators to verify this type of information at the time of certification. Therefore, verification can only occur at the time the income tax return is processed.

Ensure Eligibility for Credits

We have previously identified weaknesses in ensuring taxpayer eligibility for income tax credits. In our Fiscal Year 2001 Statewide Single Audit, we found controls lacking over the issuance of some credits including the state earned income credit, personal property tax credit, and the rural health care provider credit. As we reported at that time, we found ineligible taxpayers claiming credits for which they were not certified because the Department of Revenue did not verify eligibility. In our current audit DOR staff told us that they process the income tax returns of taxpayers claiming enterprise zone credits whether or not the enterprise zone certificate is attached to the tax return. Staff indicated that they accept tax returns without the enterprise zone certificates to expedite tax return processing. We understand the rationale for expediting the processing of returns. However, the Department's regulations require that documentation supporting eligibility (the enterprise zone certificate) be attached to the income tax return. Also, added assurances about compliance could be achieved by targeting the enterprise zone credits for periodic audits. According to Department of Revenue staff, enterprise zone tax credit participation is not one of the criteria used for selecting businesses or individuals for tax audits. We believe the value of the enterprise zone credits taken each year and the areas of taxpayer noncompliance we identified indicate a possible area for targeting tax audits.

Recommendation No. 5:

The Department of Revenue should improve controls over enterprise zone tax credit eligibility by:

a. Ensuring that taxpayers are eligible for the credits taken.

b. Processing only complete returns or evaluating methods of ensuring that accurate credits are claimed should the taxpayer fail to submit the required certification.

c. Evaluating the cost-benefit of conducting targeted audits of the enterprise zone tax credits.

Department of Revenue Response:

a. Agree. For the 2004 income tax filing season, edits could be incorporated into the existing ones applied to individual, corporate and partnership returns. These edits would identify taxpayers claiming the credit, enabling a tax examiner to review the return and attachments, and specifically determine if a certification form is included. If a certification form is not included, then the credit can be disallowed, and the taxpayer's balance due or refund amount will be automatically adjusted for the disallowed credit amount. The taxpayer would then be obligated to file an amended return, which must include a required certificate, to claim the credit.

b. Partially agree. With the implementation of the edits described above, all returns will be processed. Some, however, will have Department initiated adjustments made to them if a certification is absent. If the certification form is absent, there is no information available to the Department that it could use to assess either the eligibility or the accuracy of the claimed credit, hence the need to disallow it completely in these circumstances.

   The Cash and Document Processing Division has completed a feasibility study for an electronic document imaging system. This system, if implemented, would make it economically feasible to capture data from attachments to tax returns and apply math verification edits to the data contained therein, adding an up-front compliance check to tax returns that currently is not performed and is not feasible using manual procedures. If this system is implemented, the certificates could also be made available in an electronic format to the Department of Local Affairs and zone administrators for program administration and fraud detection.

c. The Department agrees that targeting enterprise zone tax credits for audits may have potential as an identifying characteristic for audit selection purposes. The section proposes to identify taxpayers that have claimed significant enterprise zone tax credits and audit those credits in addition to the other tax liabilities. If the supposition that a large credit claim proves to be an indicator that the taxpayer is non-compliant and if it is determined to be a cost beneficial indicator, the use of a material claim for the enterprise zone tax credit as a marker for audit selection will be expanded and made a part of the program.

Summary: The commitment to carry out the implementation of the recommendations discussed above depends on the availability of resources. As the budget of the Tax Group continues to be reduced, higher priority programs may delay implementation of the changes to a later date.

Effectiveness of Two-Year Review

By statute, the Department of Local Affairs is to submit an annual report to the General Assembly summarizing documentation submitted by the zone administrators regarding the effectiveness of each zone in accomplishing its respective enterprise zone economic development objectives. The documentation submitted by the zones to the Department is to include documentation of efforts to improve conditions in the zones, the results of those efforts, and specific verifiable data that can be used to measure whether the zones have achieved their economic development objectives. In addition, zones are to provide statistical information about various economic indicators such as the number of jobs created in the zone. Every two years, the State Auditor is statutorily required to review the Department's report and then submit a report to the Governor and to the General Assembly. Our last two-year review was submitted in August 2001. Overall, we found that the Department's report generally satisfied statutory requirements regarding the reporting of specific zone statistics and that the zones' reporting of economic development objectives had improved since our prior audits. Because of the improvements noted, along with fact that many of the objectives are of a long-term nature, we are recommending that the two-year and five-year reviews be consolidated into one report to occur every five years beginning in 2008.

Recommendation No. 6:

The General Assembly should consider a statutory amendment consolidating the Two-Year review of the Department of Local Affairs' Annual Report with the Five-Year Review, beginning in 2008.

Appendices

Appendix A

Disposition of 2001 and 1998 Performance Audit Recommendations

Section 39-30-103(4)(c), C.R.S., requires the State Auditor to conduct both a **two-year review** and a **five-year audit** of the Enterprise Zone Program. In February 1998 the Office of the State Auditor issued a report evaluating the impact of the Enterprise Zone Program on six economic indicators: employment, unemployment rate, investment, overall growth rate, economic diversity, and per capita income. Also, the evaluation included a review of the annual report prepared by the Executive Director of the Department of Local Affairs that summarizes documentation provided by the individual enterprise zones concerning efforts to achieve their respective economic development objectives.

The 1998 audit fulfilled the State Auditor's statutory charge in regard to both the two-year review and the five-year audit. In the 1998 audit, we made five recommendations to the Economic Development Commission (EDC) and the Department of Local Affairs for improving the Program. In August 2001 the Office of the State Auditor issued another report detailing the results of the subsequent statutorily required two-year review. The audit again evaluated the Department's annual report and made two recommendations to the Department of Local Affairs for improving its annual Enterprise Zone Program Report.

As the following sections indicate, we found that all of the recommendations made in 1998 have been fully or partially implemented. However, the recommendations made in 2001 have not been fully addressed. The Department should identify the actions needed to implement these recommendations. Notably, the Department needs to implement recommendations related to improving the usefulness of the zones' information on efforts to improve economic conditions.

DEPARTMENT OF LOCAL AFFAIRS/OFFICE OF ECONOMIC DEVELOPMENT AND INTERNATIONAL TRADE AUGUST 2001	
No. 1: The Department of Local Affairs should improve the usefulness of its annual report on the Enterprise Zone Program by (a) fulfilling statutory requirements related to the summarization of individual zone documentation on efforts to improve conditions in areas designated as enterprise zones and the results of those efforts; (b) ensuring greater uniformity and consistency in the ways in which zones present their statutorily required information; (c) ensuring that documentation can be used to measure and verify conditions in the zones; and (d) providing analysis that can be used to determine if the enterprise zones or portions thereof are achieving their specific economic development objectives. **Department of Local Affairs Response:** **a) Partially Agree b) Partially Agree c) Partially Agree d) Partially Agree** **Implementation Date: May 2002**	
Agency Update	**State Auditor Evaluation**
a) Overall summary and summaries of each zone's update report have been prepared. b) Checklist and model format for summary of zones' information were distributed. However, differences among zones limit the amount of uniformity possible. c) Zones have been instructed to provide such documentation. Most reports provide this, although there is still room for improvement. d) The Department issued its Annual Report in February 2002 containing a summary of annual documentation from the zones.	a) **Partially Implemented.** Department staff provided an analysis of enterprise zone tax credit activity and included information as to the type of objectives used by each zone in its annual report. Zone documentation on efforts to improve conditions in areas designated as zones and the results of those efforts was not included. b) **Partially Implemented.** Although Department staff provided greater uniformity in reporting statutorily required information, inconsistencies continued to exist in the summarization of the zones' economic development objectives and the reporting of efforts to improve conditions within designated zone areas. c) **Partially Implemented.** Department staff did not include adequate information in their annual report to measure and verify conditions in the zones. d) **Not Implemented.** Department staff failed to ensure that the information provided in their report could be used to determine the status and achievement of the zones' specific economic development objectives.

DEPARTMENT OF LOCAL AFFAIRS/OFFICE OF ECONOMIC DEVELOPMENT AND INTERNATIONAL TRADE AUGUST 2001	
No. 2: The Department should ensure that enterprise zones develop, implement, and measure economic development objectives and outcomes in keeping with statutory requirements by (a) assisting in the development of objectives through training and workshops; (b) providing adequate and timely feedback to the zones on the status of their objectives and the measurement of outcomes; (c) reviewing documentation provided by the zones on their efforts to improve economic conditions and the results of those efforts; and (d) ensuring that the zones' annual reports contain all of the statutorily required data and documentation. **Department of Local Affairs Response:** **a) Partially Agree b) Partially Agree c) Partially Agree d) Partially Agree** **Implementation Date: May 2002**	
Agency Update	**State Auditor Evaluation**
The Office held a training workshop for all zones on October 1, 2001, and distributed copies of the 2001 audit report as well as checklists and model formats for improving the zones' annual documentation. Feedback based on review of the documentation provided, and possible revision of some of zone's documentation, is currently ongoing.	a) **Implemented.** b) **Partially Implemented.** Inaccuracies and deficiencies continue to be found in several of the zones' reports. c) **Implemented.** d) **Partially Implemented.** Although the individual zones improved overall in providing statutorily required data and documentation in their annual reports, recurring problems such as data inaccuracies and insufficient documentation continue to persist in several of the reports. The Department should continue working with the zones and provide ongoing feedback to refine economic objectives.

DEPARTMENT OF LOCAL AFFAIRS/OFFICE OF ECONOMIC DEVELOPMENT AND INTERNATIONAL TRADE FEBRUARY 1998	
No. 1: The Economic Development Commission, together with the Department of Local Affairs, should make recommendations to the General Assembly, prior to the start of the 1999 Legislative Session, for redesigning the Enterprise Zone Program with regard to eligibility criteria, goals, and goals measurement by (a) limiting zone boundaries to existing towns, municipalities, and counties, ensuring zone boundaries correspond with existing data sources, and eliminating subzone areas where no data are available for establishing eligibility and evaluating outcomes; (b) eliminating population as a criterion for eligibility; (c) matching eligibility criteria with the conditions and relevant economic indicators that can be measured in the discrete zone; (d) ensuring the goals for each zone mirror the goals or criteria used to establish them as zones; and (e) establishing a timetable for zone designation, termination, and evaluation, and restricting changes to zone boundaries to this timetable. **Department of Local Affairs Response: Partially Agree** **Economic Development Commission Response: Partially Agree**	
Agency Update	**State Auditor Evaluation**
The Department and Economic Development Commission have assisted legislators in drafting several proposals to modify the enterprise zone statute. • The Audit Committee bill, SB 99-33, addressed goal setting, measurement, and reporting issues. • In 1999, the Office worked with Senator Hillman, sponsor of SB 99-77, to target enterprise zone credits to certain rural areas. The bill did not pass. • In his State of the State message in 2000, Governor Owens called on the General Assembly "to reform the enterprise zone program so that we can better target tax incentives." The Office worked with the Governor's staff, but no bill was introduced. • In the 2002 session, the Office worked with Representative Young and Senator Hillman, sponsors of HB 02-1161. The bill was enacted and will target enterprise zone tax credits to "enhanced rural enterprise zones." • The Department of Local Affairs has by policy disallowed slow population growth as a qualifying criterion in urban areas.	**Implemented.**

DEPARTMENT OF LOCAL AFFAIRS/OFFICE OF ECONOMIC DEVELOPMENT AND INTERNATIONAL TRADE
FEBRUARY 1998

No. 2: The Department of Local Affairs should resolve issues related to data accuracy, reliability, and usefulness, before the start of the 1999 Legislative Session, by (a) ensuring that information sources needed for determining zone eligibility, designation, and termination are as current as possible and are consistent with zone boundaries; (b) developing standard policies and procedures for use by zone administrators in collecting and compiling data; (c) instituting a process for reviewing self-reported information; and (d) proposing statutory changes, where needed.

Department of Local Affairs Response:
- **Partially Agree**

Agency Update	State Auditor Evaluation
The Office has conducted training sessions and prepared standardized formats for zone administrators to collect and compile data. Collection of data on business tax credit certifications is based on a standard electronic format. Because a number of enterprise zones' boundaries do not cover entire counties, appropriate data do not always exist covering geographic areas consistent with zone boundaries.	**Implemented.**

No. 3: The Colorado Economic Development Commission, in conjunction with the Department of Local Affairs, should make recommendations to the General Assembly prior to the 1999 Legislative Session to reassess current Enterprise Zone tax incentives to ensure that future tax incentive(s) allowed under the Program specifically address the economic condition(s) needing improvement.

Department of Local Affairs Response: Partially Agree
Economic Development Commission Response: Partially Agree

Agency Update	State Auditor Evaluation
See February 1998, Recommendation No 1. for agency update.	**Implemented.**

DEPARTMENT OF LOCAL AFFAIRS/OFFICE OF ECONOMIC DEVELOPMENT AND INTERNATIONAL TRADE FEBRUARY 1998	
No. 4: The Department of Local Affairs should, before July 1998, ensure greater accountability and oversight for the Program by strengthening its methods for ensuring compliance with existing statutes and policies and by making or proposing changes, where needed. This should include adopting procedures for communicating the expectations for accountability on the part of Program participants. **Department of Local Affairs Response:** • **Partially Agree**	
Agency Update	**State Auditor Evaluation**
The Department of Local Affairs has conducted training sessions and prepared standardized formats for zone administrators to collect and compile data.	**Partially Implemented.** Although progress has been made toward implementing this recommendation, Department staff continue to face difficulties with program oversight and zone accountability. This is evidenced by persistent reporting problems such as data inaccuracies and inadequate documentation on efforts undertaken by zones to improve conditions in designated zone areas.

DEPARTMENT OF LOCAL AFFAIRS/OFFICE OF ECONOMIC DEVELOPMENT AND INTERNATIONAL TRADE FEBRUARY 1998	
No. 5: The Colorado Economic Development Commission should make recommendations to the General Assembly, before the start of the 1999 Legislative Session, to clearly define the role of the Enterprise Zone Program within the State's overall economic development strategy. This should include consideration of the ways the Program should be coordinated with local economic development initiatives. **Economic Development Commission Response:** • **Partially Agree**	
Agency Update	**State Auditor Evaluation**
The Colorado Economic Development Strategic Planning Study, which was delivered by the EDC to the General Assembly in March 1997, provided policy options for legislators who might be interested in redesigning the Enterprise Zone Program. Prior to the 2002 session, the Department of Local Affairs worked with Senator Linkhart, who was considering proposing legislation to implement a local-option type of tax incentive, along the lines proposed in the 1997 Study. After consultation with stakeholder groups, he decided not to proceed with the proposal. The declaration of legislative intent in the Enterprise Zone Statute defines the role of the Enterprise Zone Program. The General Assembly, in HB 02-1161, reaffirmed the declaration of intent with further emphasis on the special needs of lagging rural areas. The criteria set forth in Section 39-30-103.5, C.R.S., for the enterprise zone contributions tax credit further define the role of local initiatives in the Enterprise Zone Program, and the EDC has adopted guidelines to implement these. The Office of Economic Development and International Trade and the EDC do not believe that additional legislative authority is needed to define this further.	**Implemented.**

Appendix B

Methodology

To ascertain the effect of the Enterprise Zone Program on the economic health of designated zone areas, the Auditor's Office attempted to answer the question: How do enterprise zones compare with nonzone areas in terms of employment growth and per capita income both before and after program implementation? Employment growth and per capita income were used as the primary economic indicators in our analyses for the following reasons:

- First, the objective most common to Enterprise Zone Programs nationally is job creation. Further, the job growth is intended to attract high-paying jobs that increase the earnings or per capita income of zone residents. Similarly, Section 39-30-102, C.R.S., establishes employment growth and job creation as the primary objectives for Colorado's Enterprise Zones.

- Second, employment growth and per capita income act as indicators of change in other economic conditions such as business relocations, investment, overall growth, and general economic vitality. Thus, employment growth indirectly relates to multiple variables integral to our overall evaluation.

- Third, sufficient, reliable data were available for both zone and nonzone areas to allow for a thorough evaluation of the effects of the Program on these indicators.

To isolate the effects of the Program, it was necessary to compare changes in employment growth and per capita income of enterprise zones to that of nonzone areas both before and after program implementation. The overall evaluation is based on a nonequivalent control group research design that uses enterprise zone areas as the experimental group and nonzone areas as the comparison or control group. The evaluation is considered quasi-experimental because the participants in the experimental and comparison groups were not randomly selected. The following visually depicts the nonequivalent control group research design:

Experimental Group (Zone Areas):	O^1	X	O^2
Comparison Group (Nonzone Areas):	O^1		O^2

Key: O^1 = Observations of changes in the employment and per capita income prior to program implementation.

X = Implementation of the Enterprise Zone Program in 1986.

O^2 = Observations of changes in the employment and per capita income after program implementation.

To support the findings and bolster the inherent weaknesses with quasi-experimental research, we also conducted parts of the evaluation using a before-and-after research design. In this instance, our analyses of changes in employment and per capita income were solely directed at enterprise zone areas. The key difference between the before-and-after and nonequivalent control group designs is the presence or lack of a comparison group. Using the before-and-after research design, we looked at changes in the employment and per capita income of zone areas both prior to and after program implementation. Although one cannot establish a causal relationship with this research design, the findings derived from the analyses can be used in combination with the results from the nonequivalent control group research design to form convincing conclusions. The following visually depicts the before-and-after research design:

Experimental Group (Zone Areas): O^1 X O^2

Key: O^1 = Observations of changes in the employment and per capita income prior to program implementation.
X = Implementation of the Enterprise Zone Program in 1986.
O^2 = Observations of changes in the employment and per capita income after program implementation.

Assumptions

All research and evaluations contain assumptions necessary to make informed decisions on the results. Underlying our analyses are the following assumptions:

- Following program implementation, the employment growth and per capita income of zone areas should improve. This assumption does not indicate that employment growth and per capita income must increase in zone areas for it to be considered an improvement. In fact, we would consider zone areas to have improved simply if the rate of decline in either employment growth or per capita income slowed after program implementation.

- Also, the zone areas should improve, relative to nonzone areas, in both economic indicators after 1986. Again, this assumption does not require increases in either indicator for the Program to be considered successful. Simply, zones must show signs that they are closing the gap in the economic conditions that qualified them as enterprise zones compared with those areas that did not qualify.

Cases

Annual data on employment and per capita income were only available on a countywide basis at the time of the audit. To compare zone areas to nonzone areas, we had to designate multi-site zone counties as enterprise zone areas. As a result, we were unable to isolate the zone areas from the nonzone areas in the nine urban, multi-site zones. Consequently, the nonzone areas in our analyses comprise eight Colorado counties not containing any portion of an enterprise zone (i.e., Boulder, Douglas, Eagle, Gilpin, Park, Pitkin, Summit, and Teller counties). The remaining Colorado counties were designated as enterprise zone areas in our evaluation. Including the entire population in our analyses not only allows for generalizing the results to the entire State but also adds to the accuracy of our findings.

Research Note 1 - Analysis: Rate of Employment Growth and Changes in Per Capita Income

Rate of Employment Growth

The graph in Chapter 1, page 8, illustrates the results from our multiple regression analysis examining the annual percentage change in employment (dependent variable) both before and after program implementation. The two independent variables are Time and Program. Time is the variable accounting for any trend in the data and is equal to 1,2,3,4,5...... numbered from the first period under analysis (1976-1977) to the last (1999-2000). Program is the countervariable and is equal to 0 prior to the Program and 1,2,3,4,5..... after program implementation. The program variable is used to assess any long-term changes in the slope of the trend. The following are the results:

Nonzones
R Square = 0.415, Adjusted R Square = 0.359, F = 7.449
Coefficients: Constant = 12.476, Time = -0.994 (t = -3.857), Program = 1.366 (t = 3.683)

Zones
R Square = 0.541, Adjusted R Square = 0.497, F = 12.354
Coefficients: Constant = 7.928, Time = -0.723 (t = -4.956), Program = 1.006 (t = 4.793)

The points on the graph illustrate the ***predicted values*** representing the rates of employment change both before and after program implementation.

Changes in Per Capita Income

The graph in Chapter 1, page 9, illustrates the results from our multiple regression analysis examining the change in per capita income (dependent variable) both before and after program implementation. The two independent variables are Time and Program. Time is the variable accounting for any trend in the data and is equal to 1,2,3,4,5...... numbered from the first year under analysis (1980) to the last (2000). Program is the countervariable and is equal to 0 prior to the program and 1,2,3,4,5..... after program implementation. The program variable is used to assess any long-term changes in the slope of the trend. The following are the results:

Nonzones
R Square = 0.987, Adjusted R Square = 0.986, F = 710.227
Coefficients: Constant = 12445.515, Time = 609.291 (t = 4.030), Program = 637.019 (t = 3.575)

Zones
R Square = 0.991, Adjusted R Square = 0.990, F = 1009.502
Coefficients: Constant = 9009.237, Time = 538.522 (t = 6.993), Program = 186.911 (t = 2.059)

The points on the graph illustrate the ***predicted values*** representing the rates of change in per capita income both before and after program implementation.

Research Note 2 - Analysis of Per Capita Income by Census Tract

As part of our overall evaluation of the Enterprise Zone Program, we analyzed the effect that zone designation has on the per capita income of enterprise zone areas within Colorado, using census tract data. This evaluation is also based on a nonequivalent control group research design that uses enterprise zone areas as the experimental group and nonzone areas as the comparison or control group. The analysis is quasi-experimental because the two groups were not randomly selected. The visual depiction of the nonequivalent control group research design listed above is applicable to this analysis as well.

This analysis differs from those above, however, in terms of the cases selected. In this instance, we used a sample of 68 census tracts or groups of census tracts that are evenly divided into enterprise zone areas and nonzone areas. Thus, we used 34 ***zone*** census tracts or groups of census tracts and 34 ***nonzone*** census tracts or groups of census tracts for our cases. An inherent weakness with evaluating enterprise zones is the fact that nonzone areas often differ in their socioeconomic conditions with regard to zone areas, thus making comparison between the two groups challenging. To avoid this problem, we selected cases based on how well they compare over a range of socioeconomic criteria.

We paired the cases by first developing a list of every census tract in Colorado identified by the United States Census Bureau in 1990. The census tracts were then sorted by county and whether they were located in a zone or nonzone area. Using information provided by the Colorado Demographer's Office, we compared the unemployment rate, per capita income, and population for each census tract in 1990. Next, we eliminated the census tracts that would not have individually met the enterprise zone designation criteria in 1990. Further, we eliminated every census tract that had a population of 1,000 people or less and that could not be matched with a census tract in 2000 (i.e., some of the census tracts from 1990 were combined, divided, or completely eliminated in 2000). We determined that the remaining census tracts were comparable based on the fact that each could have individually qualified as an enterprise zone in 1990. The primary difference between the two groups is that the nonzone areas were not selected for designation and did not directly benefit from the Program's tax credits.

Realizing that census tracts often differ more so than is apparent on paper, we provided the list of remaining census tracts to the Department of Local Affairs to provide us a list of at least 32 matched pairs of census tracts based on the staff's knowledge of the local areas. After receiving the recommendations from the Department, we were able to establish 34 comparable matches. The exhibit below illustrates the comparability of our sample over a variety of socioeconomic indicators.

Comparability of Cases Used in Evaluating Per Capita Income						
	1990 Per Capita Income	**1990 Unemploymen t Rate**	**1990 Population**	**1990 Percent With Bachelor's Degree or Higher**	**1990 Percen t Non-White**	**1990 Percent Receiving Public Assistance**
Zone	$ 9,155	10.73%	3612	11.39%	28.40%	11.35%
Nonzone	$10,690	9.69%	3654	12.77%	26.09%	9.12%
Differenc e	$ 1,534	1.04%	42	1.38%	2.31%	2.23%
Source: Office of the State Auditor's analysis of data from the United States Census Bureau.						

The census tracts used in the analysis represent 10 counties (i.e., Adams, Boulder, Chaffee, Denver, El Paso, Logan, Mesa, Park, Pueblo, and Weld counties). Only 4 of the 68 census tracts included in the analysis are categorized as rural. Thus, we feel that it is only appropriate to generalize the results of the analysis on the changes in per capita income to urban areas within the State. We were able to isolate the zone areas from the nonzone areas in the nine urban, multi-site zones. Using multiple regression analysis, we then analyzed the percentage change in the per capita income of the 68 cases between 1990 and 2000. Our independent variables included zone designation (dummy), beginning unemployment rate (1990), percentage with a bachelor's degree or higher, percentage receiving public assistance income, beginning population (1990), and percentage non-white.

The model summary and coefficients derived from the multiple regression analysis are as follows:

Model	**Coefficients (B)**	**t**	**Significance**
(constant)	44.922	4.080	0.000
Zone Designation (dummy)	5.138	1.113	0.270*
Percent of Population With Bachelor's Degree or Higher	0.529	1.470	0.147*
Percent of Population Categorized as Non-White	-5.909	-0.550	0.584*
Percent of Population Receiving Public Assistance	-3.961	-0.080	0.937*
1990 Unemployment Rate	0.834	1.107	0.272*
1990 Population	-2.492	-0.190	0.850*
Source: Office of the State Auditor's analysis of per capita income and socioeconomic data from the United States Census Bureau and Colorado Demography Section. *None of the independent variables reached statistical significance at the 0.10 level (t = 1.96). **Note:** R Square = 0.069, Adjusted R Square = -0.023, F = 0.751			

It is important to note that little of the variation in the dependent variable (1990 to 2000 percentage change in per capita income) is explained by the regression model. After conferring with staff from the Legislative Council, we determined that the low values for R Square and Adjusted R Square are most likely due to the fact that other independent variables exist that were not included in the model but have a significant impact on the changes that occurred in per capita income between 1990 and 2000. Legislative Council staff explained that broad macroeconomic conditions, most of which cannot be captured by such analysis, often have a strong influence on changes in the per capita income of the State's residents. After careful consideration, it was determined that the results of the analysis are significant for two reasons:

1. Even with the current model, if a strong enough relationship existed between zone designation and changes in per capita income, the variable (zone designation) would have reached statistical significance at the 0.10 level ($t = 1.96$). Because the zone designation (dummy) variable did not reach statistical significance, it is concluded that the Program does not influence changes in the per capita income of people residing in urban areas.

2. The results from the regression model and the explanations of our efforts in finding comparable zone and nonzone census tracts highlight the difficulties that exist in evaluating the Enterprise Zone Program. Our work will hopefully pave the way for even better evaluations of the Program in the future.

Appendix C

Per Capita Income Analysis

We computed the compound average annual growth rates in per capita income and inflation-adjusted per capita income for both zone and nonzone areas before and after program implementation. The results from this analysis support our findings that are outlined in the main body of the report. The following are the results from our analysis of compound average annual growth rates:

Compound Average Annual Growth Rates Per Capita Income		
	Prior to Program Implementation 1980 - 1986	**After Program Implementation 1986 - 2000**
Enterprise Zone Areas	5.20%	4.11%
Nonzone Areas	5.92%	5.10%
Difference	0.72%	0.99%

Source: Office of the State Auditor's analysis of per capita income data from the Colorado Office of Economic Development & International Trade.
Note: The compound average annual growth rate for zone areas between 1980 and 2000 was 4.56% compared with 5.41% for nonzone areas. The difference in growth rates is 0.85%.

Compound Average Annual Growth Rates Inflation-Adjusted Per Capita Income		
	Prior to Program Implementation 1980 - 1986	**After Program Implementation 1986 - 2000**
Enterprise Zone Areas	0.63%	1.02%
Nonzone Areas	1.32%	1.99%
Difference	0.69%	0.97%

Source: Office of the State Auditor's analysis of per capita income data from the Colorado Office of Economic Development & International Trade.
Note: The compound average annual growth rate (inflation-adjusted) for zone areas between 1980 and 2000 was 0.95% compared with 1.77% for nonzone areas. The difference in growth rates is 0.82%.

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