



STATE OF NORTH CAROLINA

PERFORMANCE AUDIT

Economic Development Studies

MAY 2007

OFFICE OF THE STATE AUDITOR
LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

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May 2, 2007

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Mr. Jim Fain, Secretary, North Carolina Department of Commerce

Ladies and Gentlemen:

We are pleased to submit this performance audit entitled *Economic Development Studies*. The audit objective was to assess the implementation status of several significant recommendations made in studies commissioned on North Carolina's economic development system. Mr. Jim Fain reviewed a draft copy of this report. His written comments are included in the appendix to the report.

We wish to express our appreciation to the staff of the Department of Commerce for the courtesy, cooperation, and assistance provided us during the audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Leslie W. Merritt, Jr.".

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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SUMMARY

North Carolina is continually faced with the challenge of how to increase economic development throughout the State. That challenge is especially linked with having strong leadership, Statewide coordination of activities, and monitoring of those activities for the best results.

As part of North Carolina's efforts to improve, consultants were hired by the State or related organizations to report on the State's economic development operations and provide recommendations for improvement. During our review of these studies, we found that they presented similar findings, although they were performed at different times by different consultants. The findings seemed to be grouped within three important areas: leadership, planning and coordination, and monitoring. The focus of our audit was to examine the Department of Commerce's actions relative to key recommendations from the consultants' studies.

RESULTS IN BRIEF

The Department of Commerce does not function as the lead agency for economic development activities in the State. The Department and the regional commissions/partnerships independently set their agendas to market the State or their regions. Commerce officials state they are powerless to implement needed changes because they lack clear legislative authority. North Carolina's economic development objectives, roles, and vision are not clear to many in the economic development community. A Statewide marketing plan inclusive of all the economic development players has not been developed.

The Governor plays a key role in determining the economic plan for North Carolina. However, results from surveys of North Carolina's economic development players suggest that the Governor's visibility and leadership could be enhanced by more involvement with the local economic development community.

The monitoring of the regional partnerships by the Department has not been comprehensive. Monitoring efforts do not focus on comparing actual accomplishments to specific goals and performance measures for the partnerships.

DEPARTMENT'S RESPONSE

The Department's response is included in the appendix to the report.

INTRODUCTION

BACKGROUND

Economic development is defined by the North Carolina Economic Development Association¹ “as activities and programs aimed at improving local, regional, State, and national economies by attracting or creating investment to expand the tax base; and by increasing jobs, wages, and personal incomes.” These activities are performed by local, regional, and State level professionals and organizations. The Department of Commerce is a very important member of North Carolina’s economic development picture, while the North Carolina Economic Development Board is the economic development advisor to the Governor, General Assembly, and Department of Commerce. Encompassing designated regions in North Carolina are the regional economic development non-profit partnerships and/or commissions. Each economic development participant plays a key role in carrying out North Carolina’s economic development program.

Department of Commerce

The mission of Department of Commerce is “to improve the economic well being and quality of life for all North Carolinians.” Department of Commerce’s declaration of policy stated in *North Carolina General Statute 143B-428*, specific to economic development, is “...to assure throughout State government, the coordination of North Carolina’s economic development efforts.” Regional Department of Commerce representatives assist the State and provide guidance and incentive information to clients interested in locating within their designated regions. Also, Department of Commerce is administratively responsible for providing and monitoring pass-through funds budgeted for the economic development partnerships/commissions and other non-profit entities.

North Carolina Economic Development Board

The North Carolina Economic Development Board is appointed by the Governor and General Assembly. The Board is responsible for recommending economic and community development policy for the State to the Secretary of Department of Commerce, the General Assembly, and the Governor. It develops and updates annually a comprehensive strategic economic development plan as required by North Carolina General Statute 143B-434.

Regional Partnerships/Commissions

North Carolina, organized into seven regions, contains a not-for-profit economic development partnership and/or commission in each region. The seven partnerships/commissions (hereafter jointly referred to as partnerships) promote through marketing strategies economic development opportunities in North Carolina’s 100 counties. The partnership offices are located in Fletcher, Charlotte, Greensboro, RDU International Airport, Elizabethtown, Kinston, and Edenton. North Carolina’s partnerships enable regions to compete for new investment and devise economic

¹ The statewide association for professional economic developers and their allies that has existed for more than 30 years.

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development strategies based on regional opportunities and advantages. The partnerships receive state and private funding.

Local Economic Development

Local economic developers are members of town, city, or county governments, public or private local organizations or commissions, or any other combination of public, quasi-public, private, or non-profit local economic development associations. Focusing on marketing their own areas, local economic development participants strive to increase economic development opportunities within their own boundaries. Locals are important participants in the economic development community as they are a key source of information critical to prospective clients about their areas.

Other Economic Development Participants

When it comes to economic development, the list of players is vast, because any activity that improves an economy by attracting or creating investment is considered economic development. Therefore, North Carolina's community colleges and universities, its State Ports Authority, the Economic Investment Committee over the Job Development Investment Grant, and school systems would be included as other economic development players. Economic development players in the private sector would include banks, electric utilities, natural gas companies, railroads, to list a few.

Economic Development Studies

North Carolina undertook several significant economic development studies over the years, the most recent dated February 2005. The studies, all from different professional organizations, made many recommendations on how North Carolina could improve its economic development system:

1. *Priorities for Enhancing the North Carolina Economic Delivery System*, Ticknor & Associates, February 2005.

The purpose of the Ticknor & Associates study was to identify ways to enhance the State economic development delivery system. This study was requested by the North Carolina Economic Development Board. Ticknor & Associates is an economic development consulting firm that focuses on evaluating economic development performance, impacts and opportunities.

2. *Improving North Carolina's Economic Development Delivery System, a Report to the North Carolina General Assembly*, Michael Luger and Leslie Stewart (Kenan Institute), March 2003.

The Kenan Institute study was commissioned by the General Assembly to assess how Department of Commerce and the seven regional partnerships could improve coordination and communication in their activities and how appropriate measures could be developed and implemented to track and improve the effectiveness of economic development activities in the State. The Office of Economic Development at the Kenan Institute, an arm of the University of North Carolina at Chapel Hill Business School, partners with government and others to translate the latest knowledge in areas of economic competitiveness into practical solutions.

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3. *Observations and Recommendations - North Carolina Economic Development*, KPMG, August 2002.

The State commissioned KPMG to conduct a best practice study comparing and contrasting economic development efforts in North Carolina with those of competitor states. KPMG is a global network of professional firms providing audit, tax, and advisory services.

4. *North Carolina Regional Partnerships for Economic Development*, Market Street Services, Inc., July 1999.

Requested by the North Carolina Partnership for Economic Development, Market Street Services, Inc. prepared the research and facilitated the strategic planning process in preparation for the development of a strategic economic development plan to assess the operations of the seven regional partnerships. Market Street Services, Inc. is an Atlanta-based economic and community development consulting firm that provides comprehensive development strategies for government, corporations and others.

Results of Studies

The studies made several similar recommendations that centered in three major areas. These areas were planning and coordination, statewide economic development leadership, and monitoring. Some of the key recommendations we identified under each area were:

Planning and Coordination of Economic Development Activities

- Department of Commerce should be the lead agency for Statewide economic development (ref. Kenan Institute, KPMG).
- A Statewide economic vision should be developed for principals of all state and regional organizations involved in economic development. Details in the plan should include clearly defined processes, roles, and tasks (ref. Ticknor & Associates, Kenan Institute, KPMG).
- A statewide marketing plan should be developed that would provide a framework for coordination with the regional partnerships (ref. Ticknor & Associates, Kenan Institute, KPMG, Market Street Services).
- The North Carolina Economic Development Board should be recognized as the lead agency for strategic planning (ref. Kenan Institute).

Economic Development Leadership

- The Governor should play a key and visible role in determining and communicating the economic development plan for North Carolina (ref. Kenan Institute, KPMG).

Monitoring Economic Development Activities

- Relevant partnership performance metrics and reporting requirements that are consistent with the partnerships' role in statewide goals and objectives should be developed (ref. Ticknor & Associates, Kenan Institute).

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- An annual review process should be implemented to determine whether partnership goals and objectives were consistent with statewide goals and objectives. The annual review process would also judge whether partnership functions and objectives duplicate efforts of other organizations (ref. Ticknor & Associates, Kenan Institute).

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objective was to assess the implementation status of several significant recommendations made on North Carolina's economic development system in the four studies listed in the background to this report. These recommendations are listed under the three major areas listed in the "Results of Studies" section in the background.

The scope of this audit encompassed the operations associated with economic development within the Department of Commerce. Our audit covered primarily the period from July 1, 2005, to June 30, 2006.

To accomplish our objectives, we interviewed members of the General Assembly, personnel from the Governor's staff, economic development agencies, the Department of Commerce, and the author of one of the studies. We reviewed the *North Carolina General Statutes*, the Administrative Code, and the Department's policies and procedures. We performed compliance testing and examined records and documentation as related to the audit objective. We also surveyed 42 entities identified by the Department of Commerce as North Carolina economic development organizations. Of the 42 entities surveyed, we received information from 30 respondents.

This report contains the results of the audit including conclusions and recommendations. Specific recommendations related to our audit objective are reported. Because of the test nature and other inherent limitations of an audit, together with the limitations of any system of internal and management controls, this audit would not necessarily disclose all weaknesses in the systems or lack of compliance.

We conducted the fieldwork from July to September 2006. We conducted this audit under the authority vested in the State Auditor of North Carolina by Section 147-64.6 of *North Carolina General Statutes* and according to generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

1. OBJECTIVES, ROLES, AND VISION ARE NOT CLEAR TO MANY IN THE ECONOMIC DEVELOPMENT COMMUNITY

Department of Commerce does not function as the lead agency for economic development activities in the State. Legislation appears to appoint Commerce as the lead agency; however, other legislation appears to deny it authority as the lead agency in key areas. Commerce officials state they are powerless to implement needed changes because they lack clear legislative authority. A consequence of this is North Carolina's economic development objectives, roles, and vision are not clear to many in the economic development community.

This lack of clarity demonstrates itself in several different ways. For example, there is no agreement regarding the handling of recruiting prospects. The regional partnerships have the option, not the requirement, of passing prospects to the Department for assistance after the prospect has expressed serious interest in locating or expanding in North Carolina. The Department and the partnerships set their agendas independently: the Department to market the State, the regional partnerships to market their regions. The North Carolina Economic Development Board is responsible for providing economic and community development planning for the State; however, there is minimal reference to the regional partnerships in North Carolina's Comprehensive Strategic Economic Development Plan.² Roles and responsibilities in the strategic plan are not always clearly defined nor is there a formal agreement with the economic development partners acknowledging roles and responsibilities. Decisions on attendance at worldwide trade shows, events to provide support and placement of advertisements are also independently determined by each entity. And a serious shortcoming: Commerce has a marketing plan³ but it does not include all of North Carolina's economic development partners.

Without a Statewide marketing plan and better coordination of activities and more clearly defined roles among all the players in economic development, there is confusion in the economic development community. This situation increases the risk of client confusion and lost prospects and creates a greater risk that marketing and recruitment efforts will be duplicated. Commerce management states that the Department does not have authority over the economic development partners and, therefore, it does not develop a Statewide marketing plan. Also, management states the Department does not formally review and evaluate the regional partnerships' actions and activities because of its lack of authority.

Our survey of the economic development players has verified this confusion. Results from our survey disclose a significant percentage of the economic development community believe clear direction is lacking in North Carolina:

² A plan created by the North Carolina Economic Development Board to outline the State's economic development challenges and opportunities, the long-term strategic goals, the priority objectives and the specific action steps to provide economic and community development for the State.

³ A blueprint for North Carolina's economic development partners that outlines specific actions for communicating the value of the State's resources to potential clients and persuading these customers to invest in North Carolina.

FINDINGS AND RECOMMENDATIONS

- 65% of the respondents state they do not clearly understand the State’s economic development vision;
- 64% do not believe Statewide goals and objectives are well understood by economic development constituents;
- 36% do not believe the North Carolina Economic Development Board is the lead agency for strategic planning; and
- 58% do not believe the roles and responsibilities of the Department, regional partnerships, and local developers are clearly defined.

North Carolina General Statute 143B-428 describes one of the Department’s responsibilities as assuring throughout State government the coordination of North Carolina’s economic development activities. However, *North Carolina General Statutes 158-8.1* through *158-8.3* state that the regional economic development commissions shall exercise their statutory powers and duties independently of the Department of Commerce.

All four studies offered recommendations in this subject area in one way or another:

- A. The 2005 Ticknor study stated, *“Although North Carolina is much studied at the regional and state levels, planning has not led to a unified statewide vision and close coordination of organizational synergies at the Statewide level.”*
- B. A key recommendation of the 2002 KPMG and 2003 Kenan Institute studies was that the Department of Commerce should be the lead economic development agency for the State. The Kenan Institute study continues:
 - *“Commerce should be recognized as the lead agency in recruitment, using its web portal, economic development specialists on enterprise teams and mega-projects, and its regional personnel to assist counties.”*
 - *“Through its Policy and Research Division, Commerce should develop appropriate sectoral targets that are appropriate for North Carolina and its regions.”*
 - *“Commerce should also convene and coordinate efforts by Commerce, the local developers, SBTDC [Small Business Technology Development Center], industrial extension, and community colleges in business expansion and retention.”*
 - *“Commerce, through the Commerce Finance Center, should continue to play the central role in the state’s financial incentives.”*
- C. The KPMG and Kenan Institute studies identify the lack of clarity of roles and responsibilities between the State and the regional partnerships as an area that needs to be addressed. The Kenan Institute study recommends commitments be obtained from the economic development partners as a method to clarify roles and responsibilities.

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- D. All four studies recommend that the State develop a comprehensive Statewide economic development marketing, retention, and expansion plan incorporating all key players for better coordination and leverage of public and private dollars.

Recommendations: The Department, as the agency that is responsible for the coordination of the State's economic development activities, should request clarification from the General Assembly on its responsibilities and authority regarding the partnerships and other economic development entities.

The Department should coordinate economic activities with the partnerships and other economic development entities. The Department should take the lead and develop a statewide marketing plan that is comprehensive of all the major partners. The marketing plan should be coordinated with the participants involved. Although flexibility should be available to each economic development partner, the Department should have final approval of the plan and be designated as the lead agency.

The Department should enter into agreements with its economic development partners that clearly define roles and responsibilities. To reinforce the strategic plan and to help reduce confusion, it might be helpful to have this information on the Department's website so all will know the responsibilities for each entity. A direct link to the State's vision and strategic plan would help to reduce communication problems on the direction for the State's economic development program.

2. THE GOVERNOR PLAYS A KEY ROLE IN DETERMINING THE ECONOMIC DEVELOPMENT PLAN FOR NORTH CAROLINA, ALTHOUGH SOME SUGGEST LOCAL VISIBILITY IS MISSING

The Governor plays a key role in determining the economic development landscape for North Carolina, although our survey results suggest local visibility is missing. The Governor has played an important leadership role in his strong support for obtaining funding sources for companies investing in North Carolina. Table 1 describes some of these funding instruments and the anticipated economic development rewards to the State. However, the survey results from economic development organizations suggest that the Governor lacks visibility in the promotion of economic development at the local level. Of the survey respondents, 43% believe that the Governor does not play a key and visible role. When we followed up with respondents to determine the basis for this belief, some of the comments we received included:

- *"The Governor routinely does not show up for important economic development events and key meetings."*
- *"We as economic developers would like the Governor to play an even more visible role and involve himself in the sales portion of the economic development field."*
- *"I feel he would serve the State better by being very visible as a cheerleader for economic development and make it seem as if it is one of his greatest priorities."*

FINDINGS AND RECOMMENDATIONS

A representative of the Governor's office stated that the Governor is involved with local economic developers through corporate groundbreaking ceremonies and announcements. This representative also stated that the Governor chooses the best opportunity to get involved after discussions with his economic development advisers, that he serves best as the "closer of the deal," and that he has continuous contact with the Secretary of Department of Commerce on current economic development projects.

The Kenan Institute and KPMG studies suggest that the Governor play a key role in determining and communicating the State's economic development plan, as well as be a visible cheerleader, and he should provide strong leadership to reinforce responsibilities among the various players.

Recommendations: Two of the consultant studies recommended a more active role by the Governor in economic development, a view echoed by economic developers in our survey results. The concerns of the economic development community should be recognized and addressed.

FINDINGS AND RECOMMENDATIONS

Table 1 Economic Development Investment Funds As of June 30, 2006				
Fund/Grant	Purpose	Awards	Potential Jobs	Potential Investment From Companies
One North Carolina Fund	Provides grants through local governments to attract business projects. Grants are contingent on local match. Governor approves funds.	\$37.9 million awarded to 181 companies since 2001.	24,462	\$3.7 billion
Job Development Investment Grant	Grants to new and expanding businesses measured against a percentage of withholding taxes paid by new employees. First grant awarded in 2003.	\$188.5 million awarded to 42 companies since 2003. Fund begun in 2003.	15,940	\$2 billion
Industrial Development Fund	Grants and loans that may be accessed by local government applicants.	\$6.7 million awarded to 31 municipal governments since 2001.	2,443	Not Available - awards to local governments
One North Carolina Small Business Fund	Grants that enable North Carolina's small businesses to conduct innovative research and develop technology in an effort to bring new products to the marketplace.	\$1.1 million awarded to 24 companies since January 2006. Fund begun in 2006.	Not Available - research is main purpose for fund	Not Available - research is main purpose for fund
Source: North Carolina Department of Commerce (unaudited)				

3. MONITORING OF ECONOMIC DEVELOPMENT PARTNERSHIPS' OPERATIONS IS WEAK

The Department's monitoring of the regional economic development partnerships' operations has been weak. The Department's monitoring process consisted of informing grantees of their reporting responsibilities, documenting receipt of information and funds disbursements, and reviewing annual audited financial statements and activities/accomplishments reports for unusual expenditures. With closer monitoring activities, the partnerships' actions and their use of funds may be better structured to increase effectiveness in providing economic development for North Carolina.

Title 9 of the North Carolina Administrative Code requires grantors to monitor grant-supported activities to assure compliance requirements are being met and performance goals are being achieved. In addition, two of the studies made recommendations regarding monitoring, as described in Table 2. A comparison of actual accomplishments with measurable objectives or outcomes established for the grant should be performed.

FINDINGS AND RECOMMENDATIONS

Table 2 Consultants' Recommendations	
Process	Source
<ul style="list-style-type: none"> • Institute strong performance measures • Communicate measures to regional partnerships • Issue an annual report tying measures to Department strategies 	Ticknor & Associates
<ul style="list-style-type: none"> • Perform annual review process: <ul style="list-style-type: none"> ○ to assess whether goals and objectives are consistent with statewide goals and objectives ○ to diminish duplication of the partnerships' activities 	Kenan Institute

Management stated that the monitoring deficiencies were due to lack of resources. In July 2006, the General Assembly provided the Department one position to monitor all non-state entities receiving funds through the Department.

Recommendations: The Department should establish a more comprehensive monitoring program consistent with the requirements. The Department should meet with the regional partnerships prior to the performance period and agree to quantifiable performance measures. Monitoring should be on going during the performance period, with an emphasis placed on achievement of goals consistent with performance standards. At the end of the period, achievements should be compared with goals.

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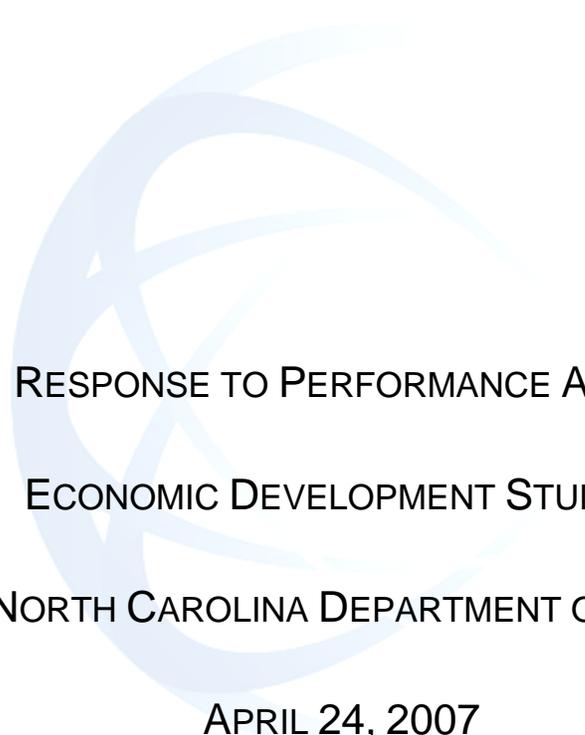
Reports Used In Development of Objectives

1. Ticknor, Tom, and Miles Friedman, February 22, 2005. *Priorities for Enhancing the North Carolina Economic Development Delivery System*
2. Lugar, Ph.D., Michael I., and Leslie S. Stewart, The Frank Hawkins Kenan Institute of Private Enterprise, March 2003. *Improving North Carolina's Economic Delivery System, a Report to the North Carolina General Assembly*
3. KPMG, LLP, Charlotte, N.C., August 27, 2002. *Observations and Recommendations - North Carolina Economic Development*
4. Market Street Services, Inc., July 1999. *North Carolina Regional Partnerships for Economic Development*

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North Carolina Economic Development Organizations

1. Advantage West - North Carolina
2. Beaufort County Economic Development Commission
3. Cabarrus County Economic Development
4. Carolinas Gateway Partnership (Edgecombe & Nash Counties)
5. Catawba County Economic Development Corporation
6. Charlotte Regional Partnership
7. Cleveland County Economic Development
8. Columbus County Economic Development Commission
9. Council for Entrepreneurial Development
10. Economic Development Mooresville, NC
11. Fayetteville Area Economic Development Corporation
12. Forward Greensboro Economic Development Partnership
13. Franklin County Economic Development
14. Gaston County Economic Development Commission
15. Greater Statesville Development Corporation
16. Harnett County Economic Development Commission
17. High Point Economic Development Corporation
18. Institute for Emerging Issues
19. Johnston County Economic Development
20. Jones County Economic Development Commission
21. Lincoln Economic Development Association
22. Martin County Economic Development Corporation
23. NC Citizens for Business and Industry
24. North Carolina Biotechnology Center
25. North Carolina Economic Developers Association
26. North Carolina Electronics & Information Technologies Association
27. North Carolina Global TransPark Authority
28. North Carolina's Northeast Partnership
29. North Carolina's Southeast Economic Development Organization
30. Piedmont Triad Partnership
31. Research Triangle Regional Partnership
32. Richmond County Economic Development
33. Robeson County Economic Development
34. Rutherford County Economic Development Commission
35. Salisbury - Rowan Economic Development Commission
36. Small Business and Technology Development Center
37. Stanly County Economic Development Commission
38. Stokes County Economic Development
39. Surry County Economic Development Partnership, Inc
40. Wilkes Economic Development Corporation
41. Wilmington Industrial Development
42. World Trade Center North Carolina



RESPONSE TO PERFORMANCE AUDIT

ECONOMIC DEVELOPMENT STUDIES

BY THE NORTH CAROLINA DEPARTMENT OF COMMERCE

APRIL 24, 2007

NORTH CAROLINA
the state of minds

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DEPARTMENT OF COMMERCE RESPONSE TO THE OFFICE OF THE STATE AUDITOR REPORT

The Department of Commerce (Commerce or the Department) welcomes the opportunity to provide its response to the March 2007 Economic Development Studies Performance Audit (the Audit). The Office of the State Auditor provided the Department with the opportunity to communicate about the subject matter and listened to our thoughts on the various issues involved.

We agree that coordination, monitoring and leadership of economic development activities are important matters. We disagree, however, with some of the Audit's findings and judgments, and we believe that other findings or judgments would benefit from being placed in a proper context and evaluated more comprehensively.⁴

North Carolina's current system of economic development agencies reflects past choices made by the General Assembly and others about the organization and funding of the State's economic development apparatus. We view this Audit, within that context, as a constructive opportunity to refine further our ongoing efforts to integrate economic development marketing activities and minimize redundancy, duplication and inefficiency.

RESPONSE TO INTRODUCTION/BACKGROUND

The Department of Commerce is the lead agency for economic development in North Carolina. However, the economic development system, as it has evolved, is a fragmented one.

As the Audit correctly notes, the system consists of independent local economic development councils and chambers representing cities and counties, numerous niche-focused nonprofits, allied businesses like public utilities and banks, independent state agencies like the UNC and Community College Systems, and the seven regional partnerships.

Some of these organizations, such as city and county economic development agencies and many private nonprofits, exist entirely outside the orbit of state control. Others, like the various State agencies, the university system, and the regional partnerships, are either created or funded by the General Assembly.

Commerce unquestionably functions as the lead agency for economic development in North Carolina. No other organization in the State is positioned to perform this job, and we invest considerable time and resources leading and coordinating this broad network.

⁴ We have also previously expressed to the Office of the Auditor our belief that the design of the auditors' survey of the state's economic development community was not adequately defined and that the sample surveyed was too small to yield representative results.

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Unlike other economic development organizations in the state, our statutory responsibility is quite broad, as is our definition of economic development. The Department focuses on implementing the goals set by the North Carolina Economic Development Board in its comprehensive strategic plan to develop the State's capacity for economic growth and strength.⁵ North Carolina's ability to recruit and retain good jobs and spur private investment ultimately depends on making it an attractive place to live, work and invest.

The Department, perhaps more than its counterparts in other states, integrates under one roof specific divisions that enable it to address the span of the Economic Development Board's priorities. Our divisions focus variously on:

- Recruiting, retention and expansion, and the provision of business services, including international trade assistance.
- Promoting tourism, film making and sports.
- Providing community development assistance.
- Establishing and supporting workforce policy development and implementation.
- Granting funds for infrastructure development and incentives to induce job creation and investment.
- Marketing our State as a business location and as an attractive place to visit and retire.
- Evaluating and supporting State investments in science and technology.

North Carolina's regional and local economic development organizations have more limited roles in economic development. Many focus primarily on marketing their specific geographic areas to grow jobs and investment in those areas.

In view of the many diverse and independent participants involved in economic development activities, we take seriously the charge given us in G.S. §143B-428 "to assure throughout State government, the coordination of North Carolina's economic development efforts." Fulfilling that charge, however, occasionally requires patience, diplomacy and determination. While we do not operate with the statutory authority and resource control necessary to dictate coordination among the many economic development players, we nonetheless work collaboratively with the many different agencies, using relationships, suasion, operating agreements and understandings, and reliance on a shared sense of vision and purpose to encourage coordination and optimize our state's economic development efforts.

⁵ *The plan's key strategies are:*

- *Investing in education and training a globally competitive workforce.*
- *Developing communities that are prepared for economic success.*
- *Building and maintaining an integrated, modern infrastructure for business.*
- *Nurturing innovation and the commercialization of ideas through investment in science, technology and university outreach.*
- *Maintaining an exceptional business climate with affordable costs and providing programs and services for businesses to attract new companies to North Carolina, support the growth and success of existing businesses – large and small – and encouraging entrepreneurial startups.*
- *Fostering a high quality of life and developing our cultural, natural and heritage assets.*

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RESPONSE TO INDIVIDUAL FINDINGS AND RECOMMENDATIONS

Finding No. 1: Objectives, Roles and Vision Are Not Clear

The Audit's assertion that the Department does not function as the lead agency for economic development activities in North Carolina is puzzling and, as noted above, incorrect. Notwithstanding the absence of statutory authority to control and direct the economic development efforts of the many players in the current system, the Department functions as the only Statewide coordinator and integrator of many different aspects of economic development undertaken by numerous partners.

We routinely work with the North Carolina community college and university systems and their constituent institutions, the Small Business Technology Development Center, the N.C. Biotechnology Center, the N.C. Rural Economic Development Center, private sector allies, and regional and local economic development agencies.

The Audit focuses primarily on a single aspect of the state's economic development structure – the relationship between the Department and the seven regional partnerships.⁶

The partnerships consist of both private, non-profit agencies and legislatively-established commissions, all of which are directed by independently appointed boards of directors. This structure does not preclude regular and productive collaboration between the Department and these seven agencies, although integrating activities and avoiding redundancy is, of course, more of a challenge than if all were part of a single State agency.

The current relationship between the Department and the partnerships represents a policy choice made by the General Assembly. There are three ways the state could choose to organize the process of regional economic development:

- As a “top down” system in which both Statewide and regional economic development activities are directed by a single State department that would control regional budgets.
- As a collaborative relationship between a state-directed and funded commerce department and “bottom up” regional organizations that are organized voluntarily at the local level by constituent counties, funded by regional resources, and directed by regionally-based boards of directors.
- As a dual system created and funded at the state level, in which regional organizations, run by boards of directors, operate independently of a state-level department.

The General Assembly has elected to implement the third choice. It has established, maintained and provided funding for this structure since 1993 and appears committed to it.

Such a structure is not without certain advantages. It provides, particularly to less prosperous parts of the State, State resources that augment local funding to ensure effective and

⁶ It is useful to bear in mind that this relationship, which primarily involves the process of marketing and industry recruitment, is but one part of the Department's larger responsibility to develop the state's economy.

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competent regional economic development activities. Because the partnerships are directed by boards composed of regional leaders, this structure offers a sense of regional control over regional economic development destiny. This structure also mitigates concerns within a region that a single state-level department might not be even-handed in handling prospects and in marketing focus. Regionally led organizations are uniquely positioned to address region-specific opportunities and challenges, and they provide opportunities to achieve scale benefits for constituent counties that could not be achieved by individual counties alone.

The trade-off for the State's present approach is a heightened possibility of redundancy and inefficient use of State resources because of the absence of a mechanism to impose "top down" State-level direction and a uniform accountability system for use of State resources.

In the face of this choice or trade-off, North Carolina has opted to seek the benefits outlined above, accepting some risk of redundancy and sub-optimization. The Department acknowledges this choice and, within the given framework, works to achieve integration of activity and minimize overlap and inefficiency.

As noted in the audit, the Department does have a state marketing plan and also works to coordinate marketing activities at the tactical level with the regional partnerships. We do this through the Marketing Council, a forum convened by Commerce and composed of the marketing officers of the Department and the seven partnerships. Each organization charts its marketing activities by month and type of activity and includes them in a master calendar. This tracking system facilitates communication, joint planning and execution of activities among the various organizations where shared interests exist. The master calendar includes the Commerce schedule of major marketing events, including meetings and events with national site selection consultants and receptions for client businesses. Regional and local organizations are encouraged to participate in those events and share in the cost of the activities. This practice provides a platform on which regional and local agencies may make contacts and promote their areas, using the "drawing power" of the North Carolina "brand name" and the Department's national and international contacts.

The regional organizations, of course, have their own unique set of marketing interests and objectives, and each participates to varying degrees in the Department's events and programs. Their marketing preferences reflect regional differences, opportunities and leadership, making any comprehensively integrated statewide program a challenging and dynamic objective. Within that framework, the Department leads development of North Carolina's marketing coordination and planning and will lead the ongoing refinement of a "state-wide marketing plan."

At the April 2007 meeting of the Marketing Council, this group agreed to increase communication among members, step up its schedule of meetings, increase partnership input into the Department's calendar of marketing events and agree on the form and content of the overall State marketing plan. Commerce committed to develop its statewide schedule of events and activities on a timetable that facilitates, as much as possible, planning and coordination of activities by the regional partnerships.

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The marketing officers of the seven partnerships have noted they are well-served by the access the Department provides them to prospective business clients and to the consultants who assist them in locating projects. In recent years, Commerce has relied on marketing support from the Friends of North Carolina, a non-profit 501(c)(6) membership organization primarily funded by private sector allies, which has provided vital resources to organize statewide marketing events during the state's more challenging budget times. The importance that regional partnership officers place on the Department's ability to arrange Statewide marketing opportunities demonstrates the critical need for adequate advertising and public relations funding to the Department at the state level to create activities that promote the State as a whole as a business destination.

One of the challenges of the State's economic development organizational structure is the allocation of budget resources to the Department and partnerships. We have always operated under the assumption that the process by which the legislature funds the Department and the seven partnerships is not a "zero sum" game. However, and particularly in hard times, this process has the potential to create "turf" behavior over funding and responsibility. For this reason, it is vital that the roles and objectives of all the players be well understood by all parties (including the legislative budget writers) and appropriate performance and accountability measures be set to reflect each organization's specific mission and function.

With regard to roles, we believe a three-tiered system of State, regional and local economic development agencies is appropriate. At each level the players should undertake those tasks for which they are best suited, achieving scale benefits, enabling flexibility where possible and creating the opportunity to tap into local knowledge. The Department of Commerce should be responsible for all client-handling, to ensure that the businesses are exposed to the entire State, and not just a single region, and regional partnerships should be leaders for marketing the merits of their particular geographic area.

We believe regional organizations should have the flexibility needed to address each region's unique challenges and opportunities, even though such a system may be less efficient than a top-down, "one size fits all" approach. To that end, we have worked to educate the players in our economic development system about the proper roles of state, regional and local players.

Finally, results of the Auditor's survey, which purports to find confusion about economic development roles, vision and State-wide goals and objectives, are puzzling. The State's economic development vision and long-term strategies could not be clearer. They are outlined on the fourth page of the Department's annual report, a copy of which is attached. North Carolina's strategic plan for economic development is available for all to view at the Economic Development Board's website. Members of this Board, which creates the plan, include, by law, local economic developers and an N.C. Economic Developers Association representative.

Governor Easley could not have made clearer his vision and commitment to support economic development success by investing in education, workforce development, infrastructure and innovation. Repeatedly he has spoken of his determination that North Carolina would differentiate itself in the global competition for jobs based on the quality of our workforce.

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His education and workforce development agenda has been supported, even during hard times, by the General Assembly. Therefore, to the extent that the survey findings accurately reflect the feelings of the economic development community, Commerce must conclude that any confusion must be about tactical plans and activities rather than the strategic vision and direction of the State. And, again, to enhance understanding and consensus at the tactical level, Commerce is committed to extensive communication and joint planning activities to achieve agreement about state-wide marketing.

Finally, referencing Item B on page seven (7) of the report, Commerce successfully and actively discharges the activities described in the Kenan Institute study.

Finding No. 2: The Role of the Governor

The audit findings regarding the Governor's role in economic development are inconsistent with the audit's stated purpose. The audit purports to examine whether "resources are being used economically, efficiently, and effectively," yet it fails to examine the role of the Governor in this context. The audit's findings focus on whether superficial appearances are maintained. The Governor, on the other hand, concerns himself with actually getting economic development done.

This finding and the recommendations on this point reveal a fundamental lack of understanding of the Governor's role in the economic development process, and they are based on surveys that are over three to four years old conducted of people who are not in positions to judge the Governor's performance or efficacy.

It is not the highest and best use of a governor's time, nor the proper role of the office, to perform the tasks of local economic developers and to engage in meetings that are not strategic and not directly focused on job creation. The suggestion that the Governor, rather than focus on building the best Statewide business climate possible, should instead use his energy and resources to be a "cheerleader" defies reason.

In recommending superficial activity by the state's chief executive, the audit ignores economic data, policy history, key trade magazines, and the opinions of business leaders in the best position to evaluate the Governor's participation in economic development. It gives a misleading impression and blatantly disregards testimony about the Governor's strong level of participation and concern for economic development. The audit, for example, fails to recognize:

- That North Carolina is now ranked among the nation's leaders by respected economic development magazines including *Site Selection*, *Southern Business & Development*, and *Forbes*. Governor Easley was named as one of the "Ten People Making a Difference" by *Southern Business and Development*.
- That the Governor's primary role is to develop public policies that result in the creation of quality jobs and capital investment, which Governor Easley has accomplished through an increased One North Carolina Fund, the Job Development Investment Grant program, and reforms of the State's economic development tax credits. The Auditor's own charts

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(Table 1) show the success of these initiatives. Updating the numbers through April 20, 2007, shows that the potential jobs and investment induced by the One North Carolina Fund now total 28,100 and \$3.8 billion respectively. The current numbers for the Job Development Investment grant are 21,700 and \$3.25 billion.

- That the role of a governor is to work with decision makers on the boards and in the CEO offices of companies that consider North Carolina as a place to locate or expand their facilities and offices. The Governor often closes deals with these key business leaders, who did not have their opinions solicited for the cited reports on economic development.
- That the Governor's clear and consistent approach to economic development is to provide the highest-quality workforce based on knowledge, talent and skill; the most competitive costs of business; and targeted, transparent incentives that are performance-based.
- That North Carolina has in fact outpaced every other state east of the Mississippi in the rate of job growth in the last 12 months and that the our State's unemployment rate is currently at its lowest level in six years.

The jobs and investment results have been achieved in the face of an unparalleled set of economic challenges for our state, including:

- Residual budget and economic effects of natural disasters.
- The "dot.com bust."
- A bear market and its impact on capital gains and tax revenues.
- A manufacturing-led recession.
- Changes in trade policy disproportionately affecting North Carolina's legacy manufacturing.
- The psychological and economic impact of September 11.

During these challenges in the first part of the decade, the Governor insisted on continuing our State's 200-plus year commitment to invest in education, meeting the changing needs of our workforce and demonstrating that North Carolina "walks the talk" in education. The Governor's determination, supported by the General Assembly, helped the State overcome the loss of 195,000 jobs in manufacturing and prepared us to move ahead when the economy turned. Accordingly, during the twelve months through February 2007, North Carolina added 90,000 net new jobs.

The Governor, in making his budgets and allocating his time, has demonstrated his understanding that in economic development, everything counts. In balancing his time to focus on a comprehensive agenda including emphasis on high school graduation rates and access to higher education, clean air and a sound environment, health care, State parks and recreation assets, and enhancing our arts and cultural resources, he has worked to ensure that North Carolina is able to create the climate for economic development success.

Finding No. 3: Monitoring of the Economic Development Partnerships

The Audit's observation that monitoring of the regional partnership's operation has been "weak" and its recommendation that the Department undertake a more comprehensive oversight responsibility does not provide four facts necessary to a proper understanding of the issue:

1. Until 2005, the Department of Commerce (along with all other State agencies) lacked statutory authority to conduct the type of review of non-State agencies the Audit suggests is needed.
2. The General Assembly has given partnership boards authority over their goals, not the Department of Commerce.
3. The Department has at all times complied with the oversight requirements set by the General Assembly and the Office of State Budget & Management.
4. The Department lacks key staff positions that would be necessary to play a larger role in overseeing and coordinating the activities of the seven independent regional organizations.

To read the audit findings on this point, one might get the impression that the Department's oversight of the regional partnerships' operations has suffered from benign neglect. That is not the case. Prior to 2005, State agencies that were directed by the General Assembly to provide pass-through funding to non-State agencies or nonprofits were significantly limited in the type of review and oversight they could undertake. The oversight system placed ultimate power to conduct such reviews in the hands of the General Assembly and State Auditor. State agencies, which were not involved in setting the goals or responsibilities of these organizations and often not involved in decisions to fund them, were limited to collecting reports on their activities and verifying that certain statutorily required documents, such as conflicts of interest policies and annual financial statements, were current and in place. Not surprisingly, the level of staff and resources allocated to agencies by the General Assembly for this function was similarly limited.

In 2005, in response to abuses that had occurred in some non-state agencies, the legislature expanded the oversight role accorded to state agencies that receive legislative appropriations to pass through to non-State entities. In the year that followed, the Office of State Budget & Management (OSBM) developed and implemented a set of comprehensive rules to administer the new law, set out in Title 9 of the Administrative Code.

To fulfill these new responsibilities, the Department of Commerce received funding in 2006 to hire a single auditor who would be responsible for the oversight and monitoring of 36 independent non-State agencies, all having their own unique goals and internal systems, that receive together over \$70 million annually in State funds. The regional partnerships represent seven of these 36 agencies.

The audit does not suggest, nor would it be accurate to claim, that the Department's fiscal staff has failed to discharge its statutory duties. At all times, the Department's staff has done

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its job to the full extent required by law and to the fullest extent possible given the resources provided for this purpose. The recommendations offered in the Audit were being implemented by the Department before the Audit was prepared - not in response to the Audit, but because they are the very actions contemplated under the General Assembly's new oversight laws and the new rules and processes developed by the Office of State Budget and Management.

To put this third finding in further perspective, it should be noted that the Department's responsibility, and that of the new auditor position provided to it for this purpose, is limited to the monitoring and oversight of partnership activity. State agencies that deliver pass through funding to non-State entities have no role in setting the goals or objectives of those entities. For the regional partnerships, for example, that responsibility is the sole province of each partnership's governing board. The Department's new, enhanced oversight role enables it to offer after-the-fact assessments and recommendations to the General Assembly about the partnerships' effectiveness in enhancing economic development in the State, but gives it no authority to set the goals to be measured.

If it is the State's intent to keep direction of the regional organizations in the hands of their boards, this new protocol can provide broader monitoring and assessment of partnership success. Better alignment of partnership activities with broad State goals will still depend, however, on dialogue between the Department and the partnerships and mutual efforts to reach consensus on goals.

In this current structure, the Department continues to believe additional accounting and auditing resources are required to do the job assigned to it in the most effective fashion. Further, the Department has proposed on several occasions that the General Assembly fund a senior executive position to serve as full-time liaison to the partnership boards and their CEO's to promote better alignment of State and regional economic development activities.

Finally, although the audit does not address this issue, it bears mentioning that the seven regional organizations are each organized quite differently. Three are purely nonprofit organizations; one is a local government entity; three are State commissions; and one represents four counties in South Carolina in addition to its North Carolina region.

This diversity of structure renders it impossible, at the present time, to devise uniform accounting, personnel, purchasing and ethics policies for all seven organizations – a fact which renders the Department's task of auditing and monitoring them more challenging. We have encouraged the partnerships to request that the legislature clarify their structures in such a fashion as to eliminate any uncertainty about the scope of their authority, to ensure they possess the necessary flexibility to do their jobs, and to enable them to adopt more uniform and transparent accountability features.

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AUDITOR'S RESPONSE

As stated on page five of this report, our audit objectives were to “assess the implementation status of several significant recommendations made on North Carolina’s economic development system in the four studies listed in the background of this report.” The findings and recommendations documented in those reports were developed by experts in the field of economic development; experts who were engaged to perform those studies by State entities such as the North Carolina General Assembly, North Carolina Economic Development Board, and North Carolina Partnership for Economic Development.

Our findings and recommendations are not based solely on, and are therefore not limited to, our understanding of North Carolina’s economic development system. To ensure an accurate understanding of current conditions and practices, we solicited the opinions and perspectives of regional and county economic development leaders. The entities we contacted are identified on the Department of Commerce’s website as “North Carolina Economic Development Organizations.” We believe that the viewpoint of local economic developers on North Carolina’s economic development system, in conjunction with our other audit procedures, provide a reasonable basis for our conclusions and recommendations.

Our report should not be considered a criticism of North Carolina’s economic development system, the Department of Commerce, or the Governor. We recognize and applaud the efforts that have been made to improve North Carolina’s economy and attract new business to our State. We have listed some of those efforts on page ten of this report. The economic development experts and professionals cited in this report, however, have identified areas where they believe there is room for improvement. We sincerely hope that our report will be a catalyst to begin discussions and take action in those areas where improvement is possible and appropriate.

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