



GARLAND

INTERNAL AUDIT

**Kraft Economic Development
Agreement Audit**

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Report 201501

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Authorization

Internal Audit (IA) conducted an audit of the Kraft Second Amended Economic Development Agreement. This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Garland City Council.

Objective

Ensure compliance with the Kraft Second Amended Economic Agreement regarding Kraft's employment of 215 full-time employees between September 1, 2013 and August 31, 2014.

Scope and Methodology

IA conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. IA believes that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The audit period covered September 1, 2013 through August 31, 2014. To adequately address the audit objective, IA:

- Reviewed the Kraft Second Amended Economic Development Agreement for compliance requirements.
- Obtained and reviewed the definition of full-time according to the Texas Workforce Commission ⁽¹⁾, the Texas Enterprise Zone Act ⁽²⁾ and the Affordable Care Act ⁽³⁾ in order to determine the number of hours considered full-time.
- Contacted the City Attorney's office to determine appropriate criteria to use for full-time employment.
- Received and reviewed the required Certificate of Compliance certifying that the company employed at least 215 full-time employees in the period from September 1, 2013 through August 31, 2014.
- Obtained a list of employees from Kraft to evaluate the number of full-time employees during the audit period.
- Developed an interval sample to verify the number of full-time employees throughout the period (See Exhibit A – Sampling Methodology).
- Obtained and reviewed payroll and time card reports from Kraft to verify employment of the sample population.
- Personally met a sample of Kraft employees to ensure there were no fictitious employees (See Exhibit A – Sampling Methodology).

To verify the reliability of the data provided by Kraft, IA reviewed documentation, interviewed the Controller and Finance team and met a sample of employees listed in the documentation. As a result of our review, we believe that the information provided by Kraft was reliable.

- (1) Texas Workforce Commission - http://www.twc.state.tx.us/news/efte/part_time_full_time.html
- (2) Texas Enterprise Zone Act - <http://www.statutes.legis.state.tx.us/Docs/GV/htm/GV.2303.htm>
- (3) Affordable Care Act - <http://www.hhs.gov/healthcare/rights/law/patient-protection.pdf>

Overall Conclusion

The Kraft Manufacturing facility in Garland was immensely cooperative with our requests. Based on the information provided and the definition of the term “full-time” in accordance with the Affordable Care Act (1,560 hours/year), this audit provides a reasonable assurance that Kraft is in compliance with the Second Amended Economic Development Agreement dated June 25, 2014. However, due to the fact that the agreement does not clearly define the term “full-time”, and various government agencies define this term differently, City management should consider amending the contract to clarify the term “full-time” to prevent any future disagreements with Kraft.

Background



“Kraft Foods Group is one of the largest consumer packaged food and beverage companies in North America and worldwide, with net revenues of \$18.2 billion and earnings from continuing operations before income taxes of \$4.1 billion in 2013. Kraft manufactures and markets food and beverage products, including refrigerated meals, refreshment beverages, coffee, cheese, and other grocery products, primarily in the United States and Canada, under a host of iconic brands. Kraft’s product categories span breakfast, lunch, and dinner meal occasions, both at home and in foodservice locations. At December 28, 2013, Kraft had assets of \$23.1 billion and is listed on the NASDAQ Stock Market and included in the Standard & Poor’s 500 Index.

“Kraft’s diverse brand portfolio consists of many of the most popular food brands in North America, including two brands with annual net revenues exceeding \$1 billion each— *Kraft* cheeses, dinners, and dressings and *Oscar Mayer* meats—plus over 25

brands with annual net revenues between \$100 million and \$1 billion each. In the United States, based on dollar share in 2013, Kraft holds the number one or number two branded market share position in 16 of their top 17 product categories. Kraft has 12 product categories with the number one branded share position that contributed in the aggregate approximately 60% of our 2013 U.S. retail net revenues, while our top 17 product categories contributed in the aggregate more than approximately 80% of our 2013 U.S. retail net revenues.

“Kraft was initially organized as a Delaware corporation in 1980. In March 2012, Kraft redomesticated to Virginia and changed their name from “Kraft Foods Global, Inc.” to “Kraft Foods Group, Inc.” On October 1, 2012, Mondelēz International, Inc. (“Mondelēz International”) spun-off Kraft Foods Group to Mondelēz International’s shareholders (the “Spin-Off”). Kraft is a wholly owned subsidiary of Mondelēz International prior to the Spin-Off. To effect the Spin-Off, Mondelēz International distributed all of the shares of Kraft Foods Group common stock owned by Mondelēz International to its shareholders on October 1, 2012 (the “Distribution”). As a result of the Spin-Off, Kraft began operating as an independent, publicly traded company on October 1, 2012.”⁽¹⁾

⁽¹⁾ Kraft Foods Groups, Inc. Annual Report dated February 21, 2014.

Opportunities for Improvement

During our audit we identified certain areas for improvement. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Opportunities for Improvement section presented in this report may not be all-inclusive of areas where improvement might be needed.

Finding #1

Condition (The way it is)

IA's review of the Kraft Second Economic Development Agreement revealed that the term "full-time" is not defined. As a result, IA researched other possible criteria to define "full-time" and they are as follows:

- The State of Texas and Federal Laws leave the definition of full-time up to business organizations.
- The Texas Workforce Commission, full-time can be defined as 40 hours per week or 2,080 hours annually.
- The Texas Enterprise Zone Act's definition of full-time which is based on 35 hours per week or 1,820 hours annually.
- The Affordable Care Act defined full-time as 30 hours per week or 1,560 hours annually.

Since there were various criteria identified, IA consulted with the City Attorney's office to determine which criteria to use for testing. The Attorney's office advised us to use the Affordable Care Act's criteria of 30 hours per week or 1,560 hours annually.

Criteria (The way it should be)

The Second Amended Economic Development Agreement should define the meaning of "full-time" in order to appropriately clarify the expectations of both parties.

Effect (So what?)

Disagreements of the definition of "full-time" could occur between parties resulting in non-compliance.

Cause (Difference between condition & criteria)

A definition of "full-time" was not considered at the inception of the original contract.

Recommendation

Management should consider ensuring that the term "full-time" is appropriately defined in the agreement between the City and Kraft. The criteria should include the total number and type of hours worked annually.

Management Response

Management concurs with recommendation.

Action Plan

The term "full-time" employee should be defined and the agreement between the City and Kraft be amended to reflect said definition.

Implementation Date

April 2015.

Exhibit A - Sampling Methodology

Kraft provided a list of all employees totaling 245 hourly and salaried individuals. IA developed three different samples from the data as follows:

- **Sample 1** - IA identified hourly employees, eliminated those individuals who had been selected in the previous two audits and any terminated employees which left 170 hourly employees for selection. Of the remaining 170, IA divided 170 by 23 and determined an interval of 7. Another auditor provided a random number between 1 and 7 and selected the number 7 as a starting point. IA selected every 7th person which resulted in a sample of 24.
- **Sample 2** – IA identified salaried employees, eliminating those who had been selected in the previous two audits and any terminated employees which left 25 salaried employees for selection. IA divided 25 by 7 and determined an interval of 3. IA requested another random start between 1 and 3 and another auditor selected 2. IA selected every 2nd person which resulted in a sample of 7.
- **Sample 3** – IA eliminated any employee that was previously selected for Samples 1 & 2, previous years' selections and who worked on shifts 1 & 3. The resulting population was 39. IA then selected every other person, starting at the beginning of the list. The method resulted in a sample of 20.

IA chose the interval method for two of the samples to ensure randomness and provide each employee an equal opportunity for selection. Because the third sample was smaller, IA selected every other individual starting from the first name on the list in order to obtain a sufficient sample size and ensure equal opportunity for selection.

IA believes the results can be projected to the population.