



**GARLAND**

**INTERNAL AUDIT**

# **Kraft Retention Agreement**

*December 16, 2015*

*Report 201601*

***City Auditor:***

*Jed Johnson, CIA, CGAP*

***Major Contributor:***

*Jonna Murphy  
Staff Auditor*

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## Overall Conclusion

The staff at the Kraft Heinz facility in Garland were very cooperative with all requests from Internal Audit. Based on the information provided, this audit provides a reasonable assurance that Kraft is in compliance with the Second Amended Economic Development Agreement dated June 25, 2014. However recommendations made last year for defining "full-time" in the agreement have not been implemented. Additionally, the contract provides criteria which fall after the date of review and reimbursement. Therefore City management should consider amending the contract: 1) to include a definition of "full-time" and 2) to ensure that the deadline for meeting employment requirements corresponds with the time periods for grant payments. This will prevent any future disagreements with Kraft.

## Authorization

We have conducted an audit of the Kraft Retention 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

The objective of this audit is to ensure compliance with the Economic Development Agreement regarding Kraft's employment of 215 full-time employees through December 31, 2014, and 352 full-time employees by December 31, 2015.

## 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The audit period covered September 1, 2014 through August 31, 2015.

To adequately address the audit objective and to describe the scope of our work on internal controls, IA performed the following:

- Reviewed the Kraft Second Amended Economic Development Agreement and Tax Abatement Agreement for compliance requirements.
- Consult with the City Secretary's Office to determine if the agreement has been updated and recommendations from last year were implemented.
- Obtained and reviewed the Certificate of Compliance certifying that the company employed at least 215 full-time employees and is on track to employ 352 full-time employees by December 31, 2015.

- Contacted the City Attorney's office and Economic Development to determine appropriate criteria to use for full-time employment and hours worked.
- Obtained a list of employees from Kraft to evaluate the number of full-time employees during the audit period.
- Compared the list obtained this year for September 2014 employees to the list provided last year for August 2014 employees to determine data reliability.
- Developed an interval sample to verify the number of full-time employees throughout the audit period.
- Obtained and reviewed payroll and time card reports from Kraft to verify employment of the sample population.
- Compared summary payroll data with detailed payroll data to determine data reliability.
- Personally met a sample of Kraft employees to ensure there were no fictitious employees.
- Met with Kraft Financial Analysts to determine causes of payroll reporting discrepancies in the Kraft system.

To verify the reliability of the data provided by Kraft, IA reviewed documentation, interviewed the Controller and two Financial Analysts for Kraft-Heinz, and met a sample of employees listed in the documentation. As a result of our review, we believe the information provided by Kraft was sufficiently reliable for the purposes of this engagement.

## Background

"The Kraft-Heinz Company is the third-largest food and beverage company in North America and the fifth-largest food and beverage company in the world, with eight \$1 billion+ brands. A globally trusted producer of delicious foods, The Kraft-Heinz Company provides high quality, great taste and nutrition for all eating occasions whether at home, in restaurants or on the go. The Company's iconic brands include *Kraft*, *Heinz*, *ABC*, *Capri Sun*, *Classico*, *Jell-O*, *Kool-Aid*, *Lunchables*, *Maxwell House*, *Ore-Ida*, *Oscar Mayer*, *Philadelphia*, *Planters*, *Plasmon*, *Quero*, *Weight Watchers Smart Ones* and *Velveeta*. The Kraft-Heinz Company is dedicated to the sustainable health of [their] people, [their] planet and [their] Company." <sup>(1)</sup>

The Garland Kraft plant opened in 1949, covering more than 675,000 square feet, and producing such varied products as mustard, margarine, chocolate candies, caramels, marshmallows, and mayonnaise.<sup>(2)</sup>

In Spring of 2015, the H.J. Heinz Co. purchased Kraft Foods, creating a company with an annual revenue of about \$28 billion, in a deal Warren Buffett stated would "unit[e] two world-class organizations and deliver shareholder value."<sup>(3)</sup>

In June 2015, the Garland plant began expanding to include four Lunchables production lines, which are expected to bring an additional 400-500 jobs to Garland.<sup>(4)</sup> Two of these lines are already in production, and Kraft-Heinz hopes to have the other two in production by

Spring 2016, hitting 750 employees by January of that year.<sup>(5)</sup> This will reaffirm Kraft-Heinz as one of Garland's largest employers.<sup>(6)</sup>

In addition to jobs and revenue, Kraft-Heinz also believes in giving back to the community. The company provides \$2 billion to feed hungry children worldwide,<sup>(7)</sup> a portion of which remains in Garland. In 2015, Kraft-Heinz contributed to the City's Summer Nutrition Program by providing healthy snacks for children free of charge.<sup>(8)</sup>

Source:

1. Kraft-Heinz, <http://ir.kraftheinzcompany.com/overview.cfm>
2. Garland Economic Development Partnership, <http://www.garlandedp.com/garland-story/kraft.html>
3. CBSDFW, <http://dfw.cbslocal.com/2015/03/25/heinz-buying-kraft-to-create-28-billion-food-giant/>
4. United States Conference of Mayors <http://www.uscmwdc.org/workforce-solutions-greater-dallas/>
5. Greg Larson, Controller for Kraft-Heinz Garland
6. Garland Business Profile and Targeted Industries, [https://www.garlandtx.gov/gov/eg/economic\\_development/business/business\\_profile\\_and\\_targeted\\_industries.asp](https://www.garlandtx.gov/gov/eg/economic_development/business/business_profile_and_targeted_industries.asp)
7. Kraft-Heinz Fact Sheet, [http://www.kraftheinzcompany.com/KraftHeinzCompany\\_FactSheet.pdf](http://www.kraftheinzcompany.com/KraftHeinzCompany_FactSheet.pdf)
8. Garland News Updates, <http://www.nmls.lib.tx.us/news/displaynews.asp?NewsID=873&TargetID=15>

## Management Accomplishments\*

The Economic Development Process is developing an annual certification process for all of our existing and future agreements. This will involve working toward establishing a consistent, uniform reporting period for companies to certify compliance. Deliverables will be clearly identified.

\*Please note that "Management Accomplishments" are written by the audited entity and that Internal Audit did not audit or verify its accuracy.

# 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.

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## FINDING # 1

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### CONDITION (THE WAY IT IS)

1. Review of the Kraft Second Economic Development Agreement demonstrated the contract has not been updated to include a definition of "full-time employee" as recommended last year.
2. The deadline for Kraft to reach the required number of full-time employees does not match the deadline for grant payments. According to the Second Amended Economic Development Agreement, Kraft is required to reach 352 full-time employees by December 31, 2015; however verification must be done in order to issue grant payment for the period of September 1, 2014 to August 31, 2015, with "payment made [to Kraft] on or before October 30 (or within 30 days of Kraft providing the City with the [Certification of Compliance]."

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### CRITERIA (THE WAY IT SHOULD BE)

1. The Second Amended Economic Development Agreement should define the meaning of "full-time" in order to appropriately clarify the expectations of both parties.
2. The dates of the employment requirement and issuance of grant payment should align to ensure requirements have been met before issuing the grant payment.

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### EFFECT (SO WHAT?)

1. Disagreements of the definition of "full-time" could occur between parties, resulting in non-compliance.
  2. Kraft is not required to reach 352 full-time employees during the time period in which employment is verified and the grant payment is issued. Therefore a grant payment could be issued when Kraft was not compliant.
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<p style="text-align: center;"><b>CAUSE (DIFFERENCE BETWEEN CONDITION &amp; CRITERIA)</b></p>	<p>1 &amp; 2. Amendments have been added to the contract numerous times, and the inconsistencies were not noted.</p>
<p style="text-align: center;"><b>RECOMMENDATION</b></p>	<ol style="list-style-type: none"> <li>1. The Second Amended Economic Development Agreement should be amended to define "full-time," including total number and type of hours worked annually.</li> <li>2. The Second Amended Economic Development Agreement should be amended so that the employment minimum requirement deadline corresponds with the deadline for grant payments for utility usage.</li> </ol>
<p style="text-align: center;"><b>MANAGEMENT RESPONSE</b></p>	<ol style="list-style-type: none"> <li>1. Management agrees that the meaning of "full time" needs to be defined and that a clarification in this regard is necessary between the parties.</li> <li>2. Management also agrees that it would be preferred if the employment minimum requirement deadline corresponded with the deadline for grant payments for utility usage.</li> </ol>
<p style="text-align: center;"><b>ACTION PLAN</b></p>	<ol style="list-style-type: none"> <li>1. In regards to the "full-time" item, Management agrees to pursue an Amendment of the contract to use the definition of "full-time" employment as defined by the Affordable Care Act (ACA) which is an employee that works 30 hours per week, per month on average. Without a more strict definition of full-time employees in the Kraft agreement, the City will side of the most flexible and reasonable definition of "full-time" worker.</li> <li>2. In regards to the coordinating deadlines, Management agrees to pursue an Amendment of the contract to match employment requirements with the deadline for utility usage. The contract's employment requirements should reflect the grant term in section 2 i.e. September 1<sup>st</sup> of each calendar year to August 31<sup>st</sup> of each calendar year.</li> </ol>
<p style="text-align: center;"><b>IMPLEMENTATION DATE</b></p>	<p>Management will immediately coordinate with City Legal Department to get an amendment assigned to the contract. Estimated timeline for the full implementation of this amended contract is 8 to 10 weeks.</p>

## Exhibit A – Sampling Methodology

For the audit, three samples were selected from the list of employees provided by Kraft. For all samples, individuals that had been terminated from Kraft, selected within the previous two audits, or hired in September 2015 (which was outside the scope of this audit) were removed from the sample pool. Interval samples were used to give each individual an equal chance of being selected. The interval was selected based on the number of individuals desired to reach a sample size of at least 10%. Results can be projected to the entire population.

Hourly Employees: The original list of hourly employees was 462 individuals. When the terminated and previously sampled employees were removed, a pool of 357 remained. A sample of 52 (11% of population) was selected.

Salaried Employees: The original list of salaried employees included 64 individuals. When terminated and previously sampled employees were removed, a pool of 47 remained. A sample of 10 (16% of population) was selected.

In-Person Interviews: In addition to removing individuals from the pool as noted above, individuals working shift 3 were removed from the pool for this test because no interviews would be conducted during that time. Individuals selected for the hourly and salaried samples described above were similarly removed. The resulting pool contained 236 individuals. Of these, 60 individuals (11% of the total population of 526) were sampled over two site visits, based on job duty and shift.