



LIMITED-SCOPE PERFORMANCE AUDIT REPORT

Department of Commerce: Evaluating the Department's Compliance with Statutory Caps for the PEAK Program

AUDIT ABSTRACT

The Department of Commerce administers the Promoting Employment Across Kansas (PEAK) program, which allows eligible businesses to retain some of their employees' state income tax withholdings. Our 2013 audit found that the department had exceeded statutory limits on the amount of benefits that could be given to expanding businesses. In 2014, the Legislature clarified the law, creating more specific limits for both expanding businesses and retaining jobs in Kansas. We reviewed PEAK benefit records to determine compliance with statutory benefit limits. We found PEAK benefits paid to expanding businesses have stayed within the statutory limits. Benefits paid to retain existing jobs exceeded the statutory cap slightly in fiscal year 2015, but remained within the cap in other years. Finally, the Department of Commerce has authorized benefits for job retention to be paid in fiscal year 2019 – beyond the date currently allowed by state law.

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
April 2017**

From the Legislative Post Auditor:

This limited-scope audit was authorized by the Legislative Post Audit Committee at its March 8 meeting. It addresses the following question: Has the Department of Commerce adhered to the new Promoting Employment Across Kansas (PEAK) caps outlined in the 2014 law?

To answer this question, we interviewed officials at the Departments of Commerce and Revenue, and reviewed state statutes, agreements, financial documents, and reports related to the PEAK program to evaluate whether the Department of Commerce had stayed within statutorily allowed benefit limits for job retention and business expansion within Kansas.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Overall, we believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit standards require that we report on any work we did related to internal controls, but a review of internal controls was not part of the scope of the audit as approved by the Legislative Post Audit Committee.

This audit was requested by Senator Jim Denning and conducted by Daniel McCarville. Justin Stowe was the audit manager. If you need any additional information about the audit's findings, please contact Daniel at (785) 296-5552.

Sincerely,

A handwritten signature in blue ink, appearing to read 'S. Frank', written in a cursive style.

Scott Frank
Legislative Post Auditor
April 28, 2017

Has the Department of Commerce Adhered to the New Promoting Employment Across Kansas (PEAK) Caps Outlined in the 2014 Law?

Background Information

The Department of Commerce administers the Promoting Employment Across Kansas (PEAK) program, which allows eligible businesses to retain some of their employees' state income tax withholdings in exchange for creating or retaining jobs. Economic development programs encourage outcomes such as job creation, job retention, and the growth of commerce and industry. These programs offer benefits, such as tax credits or revenues, to firms who meet specific guidelines. In Kansas, most economic development programs are administered by the Department of Commerce.

The Promoting Employment Across Kansas (PEAK) program allows eligible employers to retain some of their employees' state income tax withholdings. Generally, businesses calculate the tax for each of their employees based on their wages, filing status, and number of exemptions. Businesses typically remit these taxes to the Department of Revenue. However, the PEAK program allows qualifying businesses to keep 95% of the withholding taxes normally paid to the state on behalf of certain employees. The employees still get credit for those payments towards their income tax liability.

The Department of Commerce is responsible for administering the PEAK program. The department accepts applications, negotiates agreements, authorizes benefits, collects regular reports from participating firms, and conducts tasks related to the oversight and administration of PEAK. Some employers may elect to remit all their employees' withholding taxes to the state and have the state refund the eligible portion. The Department of Revenue is responsible for these refunds, and department staff told us refunds are the most common way businesses collect PEAK benefits.

The PEAK program provides benefits to eligible businesses that agree to create new jobs by locating, relocating, or expanding. To be eligible for the PEAK program, businesses must:

- be a for-profit business or a not-for-profit headquarters and belong to designated industries.
- offer adequate health insurance coverage to full-time employees and pay at least 50% of the premiums.
- not be delinquent in paying their taxes or involved in bankruptcy proceedings.
- agree to create a certain number of jobs over a two-year time period. Specifically, companies locating in a non-metropolitan county must create at least five jobs, while those locating in a metropolitan county must create at least 10 jobs. Additionally, any company promising to create a minimum of 100 jobs can qualify for a longer benefit period.

Currently, there are no statutory limits on how much the Department of Commerce can provide to locating or relocating businesses. Consequently, we did not evaluate department agreements or benefit amounts for these businesses as part of this audit.

Existing businesses that are considering leaving the State may be offered PEAK benefits to stay and retain jobs. State law gives the Department of Commerce the authority to provide PEAK benefits to businesses which promise to retain existing jobs. To be eligible, the business must have alternative locations outside of Kansas it is considering and its departure from Kansas may be imminent. Although the Secretary has broad discretion in the decision to provide these benefits, statute provides some guidelines for eligibility for the Secretary’s consideration:

- Quantity, quality, and wages of jobs to be retained
- Significance of the business to the Kansas economy
- Significance of the business to its industry in Kansas
- Location of the business

Our 2013 audit found the Department of Commerce had exceeded the statutory limits on the amount of benefits that could be given to expanding businesses. At that time, statute allowed the Department of Commerce to “authorize or grant” up to \$6 million in PEAK benefits for expanding businesses after fiscal year 2012. Our 2013 audit found the Department had authorized \$7.5 million in PEAK benefits in fiscal year 2016, which was \$1.5 million more than allowed by state law. At that time, Department officials told us that they viewed the statutory limit as being cumulative, meaning that each year they could authorize an additional \$6 million, rather than a total of \$6 million, in benefits for expanding businesses based on their conversations with individual legislators and other agency officials.

At the time of that audit, only two existing companies had a signed PEAK agreement to retain jobs. We did not evaluate the department’s compliance with the limits on this part of the PEAK program in 2013 due to the relatively low usage at that time.

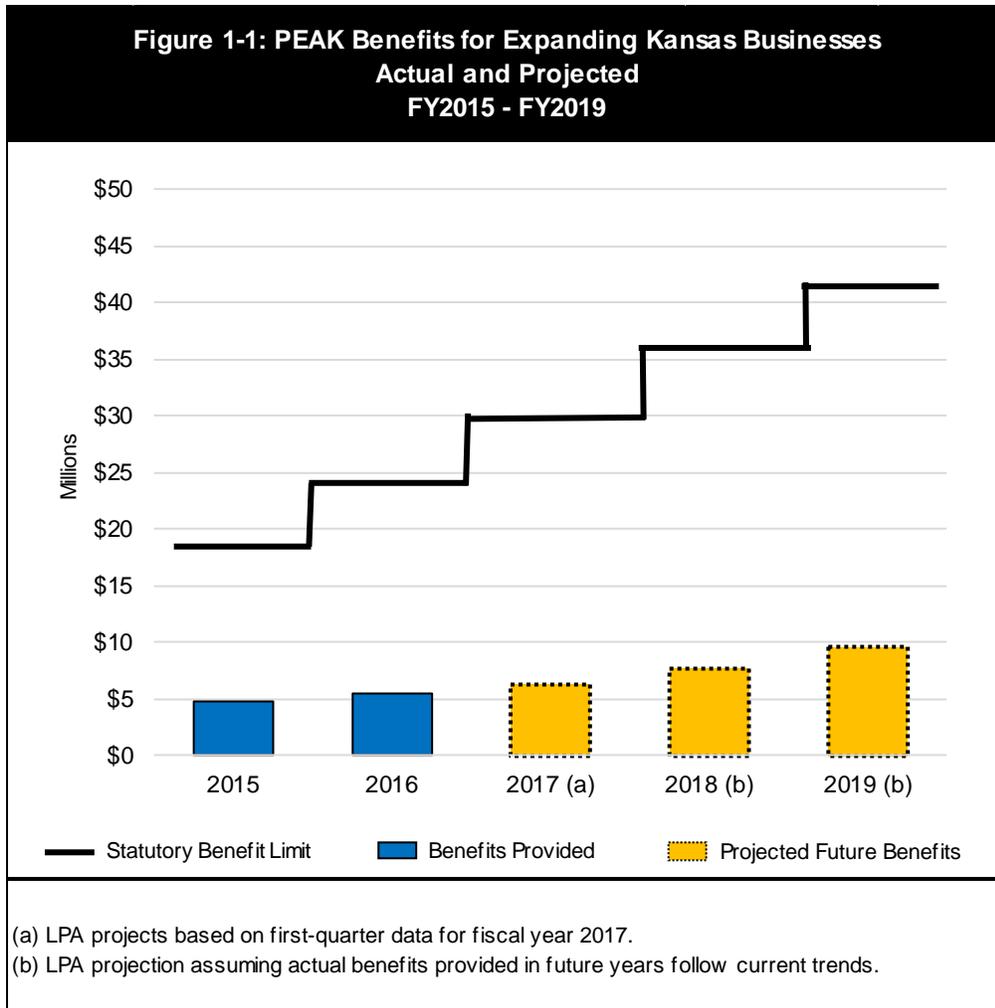
In response to the findings in our 2013 audit, the Legislature clarified the law, creating more specific limits for both expanding existing businesses and retaining jobs in Kansas. Among other things, legislation passed during the 2014 legislative session made three important changes to previous law:

- **Clarified that both benefit limits apply to “benefits received” by eligible businesses.** By contrast, the previous language for both expansion and retention referred to the benefits that the Department of Commerce had “authorized or granted.” This created confusion about whether the benefit limit should be applied to newly signed agreements or to the amounts being paid to businesses within a fiscal year.
- **Specified the limit for expanding businesses would increase by \$6 million each year until it reached a final limit of \$42 million in fiscal year 2019 and beyond.** By contrast, the previous statutory benefit limits for expanding businesses were set at a total of \$6 million each year. The department contended that this interpretation was restrictive. The Legislature agreed and raised the annual limits to their current levels.
- **Extended the window for providing benefits to retain existing jobs through the end of fiscal year 2018.** By contrast, the previous statutory time limit on benefits for job retention ended in fiscal year 2015. Statute ends both the eligibility of businesses for benefits to retain existing jobs as well as the statutory limit on those benefits.

Finding #1 The PEAK Benefits Paid to Expanding Businesses Have Stayed Within the Statutory Limit

State law limits the total benefits the Department of Commerce can authorize for expanding businesses each year. *Figure 1-1* summarizes the statutory benefit limit, as well as actual and estimated benefits provided, for expanding businesses. As the figure shows, the limit was \$18 million in fiscal year 2015 and grows by \$6 million each year until fiscal year 2019. The limit in fiscal year 2019 and all years after is \$42 million.

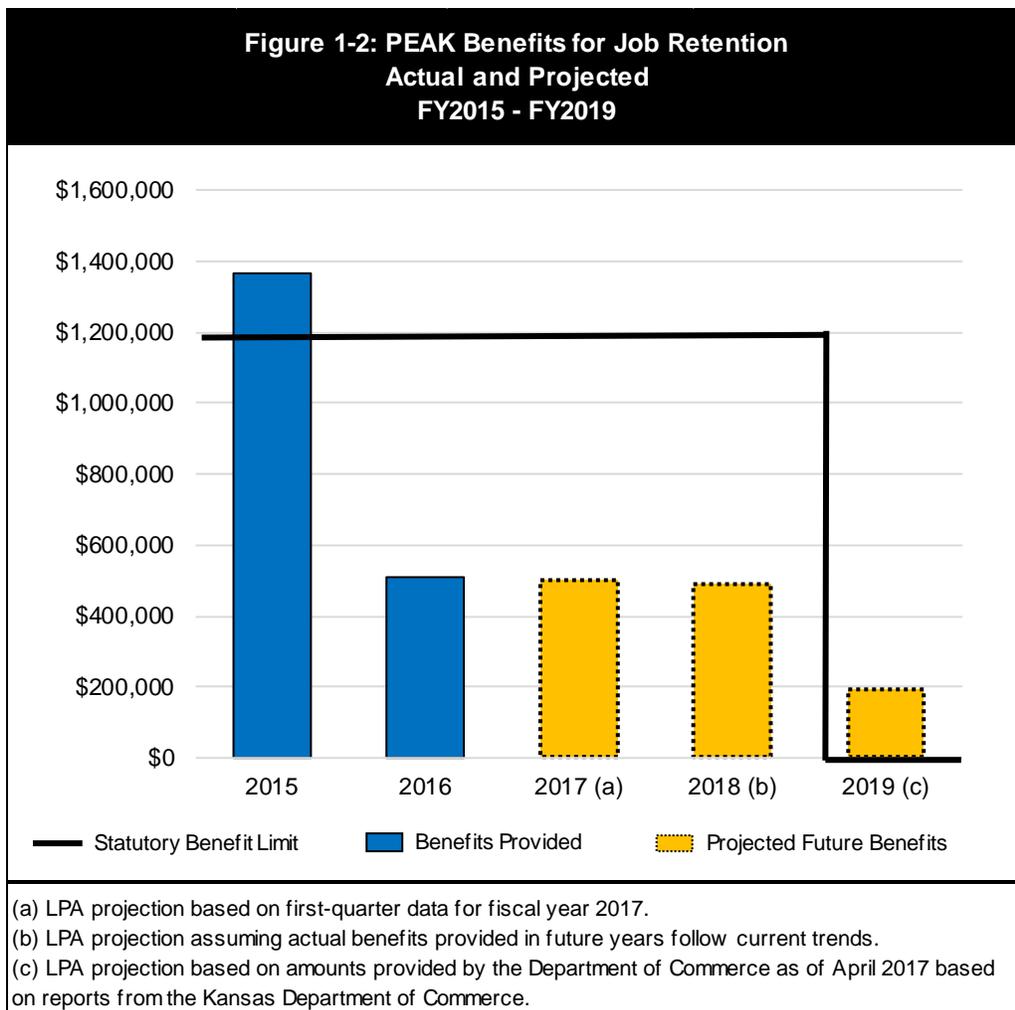
The department is expected to be compliant with limits on benefits for expanding businesses through fiscal year 2019. As *Figure 1-1* shows, the Department of Commerce complied with statutory limits regarding PEAK benefits for expanding Kansas businesses in fiscal years 2015 and 2016. Based on our projections, it appears the department will almost certainly remain compliant through fiscal year 2019.



Finding #2: The PEAK Benefits Paid to Retain Existing Jobs Exceeded the Statutory Cap Slightly in Fiscal Year 2015, But Remained Within the Cap in Other Years

State law limits the total benefits the Department of Commerce can authorize to retain existing jobs to \$1.2 million each year for fiscal years 2015-2018. *Figure 1-2* summarizes the statutory limit for benefits to retain existing jobs. As the figures show, the department can provide \$1.2 million per fiscal year from fiscal year 2015 to fiscal year 2018, and no benefits in fiscal year 2019 and beyond (we discuss this in greater detail in Finding #3 on page 5).

In fiscal year 2015, the department exceeded the \$1.2 million statutory limit on job retention benefits by about \$100,000. As *Figure 1-2* shows, the department provided more in PEAK benefits for job retention than state law allowed in fiscal year 2015. The department provided about \$1.3 million in benefits, which is about \$100,000 more than statute allowed. According to a department official, this happened because the department had already authorized benefits for this fiscal year when the Legislature changed the statutory benefit limit in 2014. After fiscal year 2015, the expiration of existing PEAK agreements and fewer new agreements helped bring into the program compliance with statute.



The department is expected to be compliant with limits on benefits for job retention through fiscal year 2018. As *Figure 1-2* shows, the Department of Commerce complied with statutory limits regarding PEAK benefits for job retention in fiscal year 2016, and based on our projections, it appears the department will remain compliant through fiscal year 2018.

Finding #3: The Department of Commerce Has Authorized Benefits for Retaining Existing Jobs to be Paid in Fiscal Year 2019—Beyond the Date Currently Allowed by State Law

State law allows the Department of Commerce to provide PEAK benefits to retain jobs in existing Kansas businesses through the end of fiscal year 2018, but not beyond. The statute authorizes the department to use PEAK benefits as an incentive to retain existing jobs, but only allows these benefits to be provided between January 1, 2013 and June 30, 2018 (the last day of fiscal year 2018):

- **Through the end of fiscal year 2018, state law allows the department to include PEAK benefits as part of the incentive packages it offers existing businesses to retain jobs in Kansas.** The specific statutory language is as follows (emphasis added):

“Effective January 1, 2013, and ending June 30, 2018, the secretary may use the promoting employment across Kansas act in conjunction with other economic development programs to develop a retention package [K.S.A. 74-50, 212(f)(2)].”

- **Also through the end of fiscal year 2018, state law allows the department to enter into retention agreements with businesses to provide benefits for a maximum of five years.** The specific statutory language is as follows (emphasis added):

“Commencing January 1, 2013, and ending June 30, 2018, any company, which meets the criteria provided pursuant to the provisions of K.S.A. 2016 Supp. 74-50,211, and amendments thereto, that retains the employees of an existing business unit located in Kansas and enters into an agreement with the secretary pursuant to K.S.A. 2016 Supp. 74-50,213, and amendments thereto, shall be eligible to retain 95% of the qualified company’s Kansas payroll withholding taxes for such employees for a period of up to five years.”

- **However, state law does not allow the benefits to be provided beyond the end of fiscal year 2018.** The specific statutory language is as follows (emphasis added):

“Commencing January 1, 2013, and ending June 30, 2018, pursuant to the provisions of subsection (e), the secretary of commerce, in the secretary’s sole determination, may provide the benefits of the promoting employment across Kansas act for situations where it is deemed necessary by the secretary that the state of Kansas provide incentives for a company or its operations currently located in Kansas to remain in Kansas so as to keep its retained jobs. The secretary shall establish and verify that a prospective company has competitive alternatives that it is seriously considering and that a company’s relocation may be imminent... [K.S.A. 74-50;212(f)(1)]”

Finally, the language specifying the cap on PEAK benefits for retaining jobs is similar to the language used for the cap for expanding businesses, with one key exception. The language referring to the final year of the expansion cap is “\$42,000,000 in any fiscal year commencing on or after July 1, 2018.” The language referring to the final year of the retention cap omits the phrase “on or after.” In combination with the statutory language included above, we think it is clear that the intent of these statutes was to end retention benefits after fiscal year 2018.

The department has authorized up to \$195,000 in PEAK benefits to be paid for retaining jobs in existing businesses in fiscal year 2019, which is beyond the date currently allowed by state law. The department can authorize benefits to retain existing jobs through an agreement which specifies the maximum amount of benefits that can be provided and the time period over which the business may receive them. Agreements for job-retention benefits allow existing businesses to collect for up to five years.

The department has already reached agreements that will authorize businesses to receive up to \$195,000 in job-retention benefits in fiscal year 2019—the fiscal year after the statutory end date. The benefits have not yet been provided to the businesses. But assuming they are paid out per the agreements, the department will have violated the statutory cap on job-retention benefits.

Department officials contend the statute only limits their ability to reach new agreements after fiscal year 2018. As was the case with our 2013 audit of the PEAK program, department officials disagree with how we interpret the statutory language on benefit limits. They interpret the statute as preventing new agreements to provide PEAK benefits to retain existing jobs after fiscal year 2018. However, they argue they are allowed to continue providing benefits under previously authorized agreements. For example, they could sign a five-year job-retention agreement in fiscal year 2017 and continue providing benefits through fiscal year 2022. Department officials told us this understanding was developed in talks with the Department of Revenue.

Department officials also contend our interpretation—that job-retention benefits cannot be paid beyond fiscal year 2018—limits the usefulness of their authority to authorize new deals through the end of fiscal year 2018. That is because they are unlikely to reach a meaningful agreement with a business if the incentives would only be available for a few months in fiscal year 2018. Although this concern clearly has merit, the statutory language is clear and does not allow PEAK benefits to be paid for job retention beyond the end of fiscal year 2018.

Finding #4: Including More Detailed Information in the Annual PEAK Reports Provided to the Legislature Would Help Assess Compliance with Statutory Benefit Limits

Under state law, the Department of Commerce files an annual report on the PEAK program with the Legislature and Governor. K.S.A. 74-50,216 requires the Department of Commerce to file an annual report with both the Legislature and Governor. Based on several statutory requirements, the PEAK annual report contains information such as the total amount of

benefits provided for all PEAK programs, the number of jobs created or retained, the number of companies receiving benefits, and the estimated fiscal impact of PEAK.

State law does not currently require the department to report information on either the statutory benefit limits for PEAK programs and whether the department has complied with them. The PEAK report provided to the Legislature each year aggregates benefit information for all four business types covered under state law (location, relocation, expansion, and retention), making it impossible for oversight committees to determine how many jobs were created or benefits were provided to specific business types. Additionally, the annual reports do not include comparisons of current benefits paid or authorized in relation to statutory benefit limits. This information is necessary to determine whether the department is in compliance with statutory benefit caps. Currently, statute does not require this kind of information in the annual report.

Recommendations

1. To address the Department of Commerce's concern regarding its ability to provide job-retention benefits to existing Kansas businesses after fiscal year 2018 (page 6), the department should ask the Legislature to amend the current law to allow it to provide PEAK benefits to retain existing businesses beyond fiscal year 2018.

Unless the law is changed, the department should cease authorizing additional job-retention benefits that would be paid beyond June 30, 2018.

2. To address the issue regarding limited compliance information in the PEAK annual report (page 6), the department should provide more detailed information in its PEAK annual reports, including separating out program activities based on the type of businesses (i.e., location, relocation, expansion, and retention) as well as a comparison to statutory limits.

Agency Response

On April 18, 2017 we provided copies of the draft audit report to the Department of Commerce for an official response. We made several minor clarifications to the final report as a result of their review, but those changes did not affect any of our findings or conclusions.

The Department of Commerce generally agreed with most of the audit's findings and recommendations, with one exception. Department officials did not agree with our interpretation of statute regarding their ability to provide PEAK benefits to retain existing jobs in the state of Kansas beyond fiscal year 2018. Although department officials intend to ask the Legislature for clarification on the statute per our recommendation, they contend that their statutory authority to enter into agreements to retain existing jobs for up to five years through fiscal year 2018 also allows them to provide benefits beyond that date. Moreover, department officials contend that our interpretation of the law is counterintuitive to the legislative intent to keep jobs in Kansas. In their view, to fulfill the intent of the PEAK program, they are required to interpret the law with that ultimate goal in mind. Although we fully understand the department's position, we think that the statutory language clearly prohibits the department from providing benefits to retain existing businesses beyond the end of fiscal year 2018.

The full text of the Department of Commerce's response is on file and available from Legislative Post Audit.