



Legislative Post Audit Performance Audit Report Highlights

Economic Development: Determining Which Economic Development Tools are Most Important and Effective in Promoting Job Creation and Economic Growth in Kansas, Part 1

Report Highlights

September 2013 • R-13-010

Summary of Legislator Concerns

Legislators have expressed concerns about the results of some economic development programs, and that clawback provisions are not being enforced as often as they should be.

Background Information

Several agencies have a role in implementing Kansas' economic development initiatives including the Department of Commerce and the Department of Revenue.

The two programs that are the focus of Question 1—PEAK and HPIP—are jointly administered by the Department of Commerce and the Department of Revenue.

For PEAK, the Department of Commerce has programmatic oversight responsibilities, whereas the Department of Revenue is responsible for processing tax incentive refunds.

For HPIP, the Department of Commerce is responsible for determining companies' initial eligibility while the Department of Revenue issues sales tax certificates and processes tax credits.

QUESTION 1: *What Economic Benefits Has Kansas Realized As a Result of the PEAK and HPIP Tax Incentive Programs?*

Findings Related to the Benefits of the PEAK Program

- Assessing the benefits of the Promoting Employment Across Kansas (PEAK) program is difficult because the Department of Commerce has not compiled meaningful information on the program.
 - The department has not developed or used good management information to help oversee the PEAK program.
 - Its data for the program were incomplete and had inaccuracies.
 - The department was more than a year behind in reporting PEAK outcomes to the Legislature.
 - The Department of Revenue's tax incentive information also was incomplete.
- Based on the best information we could compile, companies participating in PEAK have generated an estimated 5,200 jobs in exchange for \$21 million in forgone withholding taxes through December 2012.
 - We estimated that participating companies have generated 5,200 jobs—about half were relocated from outside the state while the other half were newly created within the state.
 - Withholding tax incentives for PEAK companies have grown rapidly each year from \$2.7 million in 2010 to an estimated \$12.5 million in 2012.
 - In addition to creating or relocating jobs, participating companies also projected they would invest \$1.4 billion in capital improvements when they initially qualified, but actual information was not available.
- Most of the jobs associated with the PEAK program are relatively high paying, located in metropolitan counties, and represent several different industries.
- A similar program in Missouri and the recent reduction of Kansas income tax rates could undermine the benefits of the PEAK program in the future.
 - The Missouri Quality Jobs program could potentially reduce the value of the PEAK program in enticing companies to Kansas.
 - Recent changes to the state's individual income tax rates will reduce the amount of possible PEAK tax incentives.

Findings Related to the Benefits of the HPIP Program

- The Department of Revenue reported that High Performance Incentive Program (HPIP) companies made \$310 million in capital investments and created or retained 6,900 jobs in exchange for \$21 million in tax credits in tax year 2010.
 - Participating HPIP companies reported making \$310 million in capital investments, creating about 1,100 jobs, and retaining 5,800 jobs in 2010.
 - They claimed \$19 million in capital investment tax credits and \$2 million in training tax credits in 2010.
- The Department of Revenue's HPIP tax credit data may not be completely reliable. For example, companies do not have to report outcome data to receive the tax credit and department staff do not audit or verify self-reported outcome data.

Findings Related to Management of the PEAK and HPIP Programs

- The Department of Commerce has exceeded the statutory cap intended to limit the initial growth of the PEAK program.
 - The Legislature capped the total amount of tax incentives at \$6 million a year for in-state companies that expand.
 - Based on agreements in place as of April 2013, the department had authorized \$7.5 million in incentives for fiscal year 2013, thus exceeding the statutory cap by \$1.5 million.
 - The department has made commitments that exceed the cap by \$22.5 million over the next 10 years.
 - Because these agreements have already been signed, the department may not be able to undo this situation.
 - Department officials do not agree with our interpretation of the statute and contend they have not exceeded the cap.
- The department has not been thorough or timely in reviewing PEAK applications and periodic reports, delaying some companies' PEAK benefits.
 - The department did not thoroughly review applications and quarterly reports.
 - It did little to follow up with companies that failed to submit required reports.
 - The department was slow in processing the reports it did receive, delaying some companies' refunds by several months.
- The Department of Commerce has not developed a systematic process for managing the PEAK program.
 - The department has not adequately staffed the program.
 - Officials have prioritized getting companies into the program rather than monitoring and measuring program results.
 - The department had not created adequate written policies and procedures and had not made their development a priority.
- We found a number of smaller issues related to the department's oversight of HPIP.
 - The department has not verified whether companies were reporting eligible training expenditures.
 - The department was inconsistent in requiring supplemental documentation to verify HPIP wage requirement calculations.
 - The department allowed companies to report wages in a way that could circumvent minimum wage requirements.

PEAK and HPIP use different forms of tax incentives to promote job creation and capital investment.

- *The PEAK program allows companies to retain employees' state withholding taxes in exchange for creating new or retaining existing jobs.*
- *HPIP encourages companies to make capital investments and train their workforce. Qualifying companies can receive sales tax exemptions and tax credits.*

For Question 2, we reviewed six programs and compared them to best practices for clawback terms. Those programs were:

- PEAK
- IMPACT
- Kansas Economic Opportunity Initiative Fund (KEOIF)
- Job Creation Program Fund (JCF)
- Kansas Industrial Training (KIT)
- Kansas Industrial Retraining (KIR).

We reviewed a sample of agreements for each of the first four programs to determine whether the Department of Commerce adequately enforced economic development agreements.

QUESTION 2: Does the Department of Commerce Adequately Enforce Performance Clauses for Economic Development Incentive Programs?

- The Department of Commerce included clawback terms in the six economic development program agreements we reviewed.
 - The program agreements we reviewed included performance requirements or clawback terms that generally followed best practices.
 - In addition, the PEAK and Investments in Major Projects and Comprehensive Training (IMPACT) programs have statutory or regulatory requirements that specify when performance clauses should be enforced.
- The department generally enforced clawback terms when it became aware that companies had not met performance requirements.
 - The department appropriately recouped about \$1 million in incentives when companies self-reported unmet performance requirements.
 - It relied on companies' periodic reports to identify when performance requirements were not met.
- The Department of Commerce did little to enforce reporting requirements which limited its ability to identify underperforming companies.
 - For three of the four programs we reviewed in depth, several companies had not submitted required reports.
 - When companies failed to report, the department did little to enforce the reporting requirements.
 - Because of the department's poor oversight, one company was able to keep \$700,000 in economic development incentives without creating any new jobs.
 - Our 2004 audit of the Department of Commerce found a similar pattern of lax enforcement.

Other Findings

- We identified additional problems with the Department of Commerce's management of four programs we reviewed in depth.
 - The department had not consistently enforced some IMPACT agreements we reviewed.
 - Some of its economic development agreements were poorly worded.
 - None of the four economic programs we reviewed had adequate written policies.
 - The department had not developed annual reports to allow it to better manage the four programs.

SUMMARY OF RECOMMENDATIONS

Question 1 Recommendations:

- For PEAK, we made a series of recommendations to the Department of Commerce aimed at addressing the problems regarding the department's data and management of the program.
- We also recommended the department cease entering into additional expansion contracts that would exceed the statutory cap and to request the Legislature to increase the cap if officials think they can adequately handle the increased workload.
- For HPIP, we recommended that staff revise administrative regulations to eliminate certain unenforceable training-related requirements, to require companies to document full-time-equivalent employee counts, and to verify company data, on a sample basis.

Question 2 Recommendations:

- We made a series of recommendations for the Department of Commerce aimed at addressing the problems regarding the department's monitoring, oversight, and enforcement of companies' performance as it relates to their PEAK, IMPACT, KEOIF, or JCF agreements.
- We also recommended the department correct template language and amend existing agreements as necessary to address issues with poorly worded JCF and KEOIF agreements.
- Finally, we recommended that the department produce annual reports for the PEAK, IMPACT, KEOIF, and JCF programs as required by statute.

AGENCY RESPONSE

- The Department of Commerce disagreed with several of the report's findings and recommendations related to its management of various economic development programs. More information on these issues can be found in Appendix E of the full report.

HOW DO I REQUEST AN AUDIT?

By law, individual legislators, legislative committees, or the Governor may request an audit, but any audit work conducted by the division must be directed by the Legislative Post Audit Committee. Any legislator who would like to request an audit should contact the division directly at (785) 296-3792.

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