



# **LIMITED-SCOPE PERFORMANCE AUDIT REPORT**

## **Kansas Department of Commerce: Evaluating the Department's Administration of the Job Creation Program Fund**

### **AUDIT ABSTRACT**

The Job Creation Program Fund is administered by the Department of Commerce and was created in 2011 to provide cash awards to companies to help create jobs and support other economic development. We found the department's process for awarding job creation program funds is inconsistent and lacks transparency. The department lacks written policies or procedures to guide which companies are awarded job creation funds or how much funding they are given. We identified several inconsistencies in the department's award process such as a lack of consistency in requiring companies to submit applications and inconsistencies in the department's expectations for awarding funds. Additionally, department officials conduct limited verification to ensure that companies act in accordance with the job creation fund agreement. Last, the department's annual report to the Legislature did not include statutorily required information.

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
July 2019**

## From the Legislative Post Auditor:

This limited-scope audit was authorized by the Legislative Post Audit Committee at its March 13, 2019 meeting. It addresses the following question: Is the Department of Commerce's process to administer and distribute Job Creation Program funds transparent and effective?

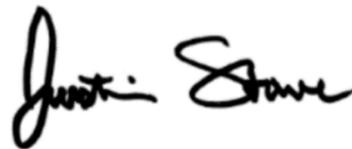
To answer this question, we interviewed Department of Commerce officials and reviewed state law, best practices, and several applications and contracts for fund recipients.

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. We evaluated the program's internal controls to ensure compliance with state law.

This audit was requested by Senator Julia Lynn and conducted by Heidi Zimmerman. Chris Clarke was the audit manager. If you need any additional information about the audit's findings, please contact Heidi at (785) 296-3792.

Sincerely,

A handwritten signature in black ink that reads "Justin Stowe". The signature is written in a cursive, flowing style.

Justin Stowe  
Legislative Post Auditor

# Is the Department of Commerce's Process to Administer and Distribute Job Creation Program Funds Transparent and Effective?

## *Background Information*

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**The Job Creation Program Fund was created in 2011 to provide cash awards to companies to help create jobs and support other economic development.** The fund was created by combining the former Investments in Major Projects and Comprehensive Training (IMPACT) and Kansas Economic Opportunities Initiative Fund (KEOIF). Job creation funds are awarded to companies with an expectation that the company will create or retain a specific number of jobs, provide training, or be used for other types of economic development. Typically, funds can be paid out in two ways; milestone payments dispersed over five years as the company meets its agreed goals or an upfront cash payment in the form of a forgivable loan. For forgivable loans, companies who do not meet the specified goals can be required to repay a portion of the funds each year over the term of the agreement. Companies who fail to meet a milestone payment do not receive the intended funds as listed in an agreement. Department staff can combine the cash award with other economic development incentives or provide it as a separate award. Department officials estimated that only about 2% of all major economic projects the department provided incentives for in 2018 also received job creation program funds.

**The fund is administered by the Department of Commerce, which has broad discretion in determining which companies receive the funds and how much funding they receive.**

Statute allows the department to use job creation funds for any one of eight purposes including:

- a major expansion of an existing Kansas commercial enterprise
- potential location in Kansas of the operations of a major employer
- award of a significant federal or private sector grant which has a financial matching requirement;
- potential departure from Kansas or the substantial reduction of the operations of a major Kansas employer
- training or retraining activities for employees in Kansas companies
- potential closure or substantial reduction of the operations of a major state or federal institution
- projects in counties with at least a 10% population decline during the period from 2000 to 2010
- other unique economic development opportunities

The department has awarded funds for a wide variety of projects in the last several years, including to create jobs at Federal Home Loan Bank, which is a nationwide cooperative of community banks, and to implement an agriculture education program at the Renwick school district.

**State law provides a dedicated funding stream for the job creation fund.** Currently, state law (K.S.A 74-50,107) provides funding for the job creation fund through 2.0% of the money withheld from the wages of individuals in accordance with Kansas tax law. The remaining expenses of the IMPACT program (it still has expenses related to funds it granted before the program was discontinued) are deducted from the total withholding amount and the remaining funds are directed to the job creation fund in an amount that should not exceed \$3.5 million annually. However, in fiscal year 2021 the job creation fund will receive funding related to two major tax changes. Starting that year, the fund will receive the net savings achieved by

eliminating or modifying several tax credits compared to an increase in expense deductions. Also starting in fiscal year 2021, statute does not cap the amount of funding the job creation fund can receive. The Division of the Budget estimated this could result in \$33.5 million in transfers to the job creation fund annually if a cap is not reinstated.

**In the last five years, the department has awarded \$25.6 million in cash or forgivable loans to companies from the job creation fund.** *Figure 1*, on the next page, shows the number and total dollar value of awards made from the job creation fund from fiscal year 2014 to 2018. As the figure shows, the number of awards varied significantly from 6 in 2016 to 25 in 2017. Department officials told us the variation in the number of awards made in each year was related to the amount of available funding. Additionally, the average award amount during the five years we reviewed was about \$361,000, but awards ranged from \$20,000 to \$2.0 million. More information on the 71 awards the department made can be found in *Appendix A*.

<b>Figure 1</b>		
<b>The Department Made 71 Awards Totaling \$25.6 Million in Fiscal Years 2014-2018</b>		
<b>Fiscal Year</b>	<b># of Awards</b>	<b>Total \$</b>
2018	8	\$930,000
2017	25	\$8,350,000
2016	6	\$3,787,500
2015	24	\$8,845,000
2014	8	\$3,736,000
<b>Total</b>	<b>71</b>	<b>\$25,648,500</b>
Source: Audited data provided by the Kansas Department of Commerce		

### ***Finding #1: The Department’s Process for Awarding Job Creation Program Funds Is Inconsistent and Lacks Transparency***

The National State Auditor’s Association lists several best practices for awarding economic development incentives. These include:

- having a systematic process for selecting award recipients
- requiring an application for the program
- having written and signed agreements between the state agency and the company
- maintaining appropriate records

These types of practices help ensure a consistent and equitable process for awarding economic development funds.

**We reviewed several specific projects and some aggregate information about the projects the department awarded job creation funds to in the last five years.** We reviewed information such as award amounts and jobs created and retained for all awards the department has made in the last five years. We also chose five specific awards to review in detail. We

selected some awards because they appeared to be typical economic development projects and others because they appeared to be less typical. Those awards included:

- a \$400,000 award given to Wyandotte County in 2014 to build a public safety building and commercial development
- a \$70,000 award given to Genesis Corporation (a New York-based professional technology firm with an office in Lenexa) in 2015 for construction costs and to create 200 new jobs
- a \$157,500 award given to Federal Home Loan Bank of Topeka in 2016 to create 24 new jobs at its Topeka facility
- a \$90,000 award given to the Renwick school district in 2016 to establish a Future Farmers of America chapter and implement an agriculture education program at the high school
- a \$80,000 award given to the Kanas Business Hall of Fame (located in Emporia) in 2018 to be used as matching dollars to encourage additional funding from other sources for the purpose of building a new facility

Last, although we think the projects we reviewed are indicative of the department's process, their specific characteristics (type of industry, location, etc.) are not generalizable to all projects that receive job creation funds.

**The Department of Commerce lacks written policies or procedures to guide which companies receive job creation funds or how much funding they are given.** Instead, these decisions are based largely on the knowledge and expertise of department staff. For example, if a company is considering multiple locations for a new office, department staff may decide they need to offer that company job creation funds to remain competitive with other states. In other situations, there may not be any competition from other states, but staff determine that the project would be beneficial and award the funds if it meets one of the eight statutorily defined purposes.

Department staff do not have a formula or other written guidance to determine how much money to award to a company. Officials told us they consider the total size of the project, the size of any potential competitive gap (the gap between the conditions and incentives in Kansas compared to another state), the location of the project, and the impact to the local economy when determining how much funding to award.

**The department required some companies to submit an application for an award but not others.** Requiring an application is a best practice that helps ensure similar information is gathered and considered for each award. Further, it ensures the company meets eligibility requirements for the award and allows the department to assess the likelihood that a company will achieve the expected results. Department officials told us they typically require an application for job creation fund awards (officials estimated all but 4% of awards in the last five years had an application). However, for two of the five specific awards we reviewed, the companies were not required to submit an award application. Department officials told us the two projects missing applications were developed informally through the Secretary of Commerce and thus were not required to submit one.

**We identified a few inconsistencies in the awards we reviewed.** Based on a review of both aggregate job creation fund data and specific awards, we found inconsistencies in what the department expects and the amount of funding it awards. Those inconsistencies included:

- **The department required some companies to produce jobs or other measurable economic activity to receive an award but not others.** Because the purpose of these funds is to help promote job creation and economic development, we expected the department to include such requirements for all of its awards. However, for three of the five projects we reviewed, the department did not include any requirements that the organization produce jobs or any other economic activity. For example, in 2018 the Kansas Business Hall of Fame received funds with only the expectation that it would raise matching funds. By contrast, in 2016 the Federal Home Loan Bank received funding with the expectation that it would create 24 new jobs at its Topeka facility.
- **The department’s award amounts were widely inconsistent on a per-job created or retained basis.** We reviewed the total award amount and the associated number of new or retained jobs for five projects. The amount of funding received on a per job created basis varied significantly from \$350 per job to nearly \$6,600 per job. Further, as noted above, there is no formula or basis to determine the amount to award.
- **Although some awards clearly fit the purpose of the funds, others were not as clearly related to economic development.** State law specifies that job creation fund awards should be given to promote job creation and economic development. Some of the awards we reviewed clearly aligned with that requirement. For example, the department awarded funds to Genesis to create 200 new jobs in Kansas. However, it was less clear if other awards fit the purpose of the fund. For example, the department awarded the Renwick school district \$90,000 to establish a Future Farmers of America chapter and to implement an agricultural education program. Although state law permits the department to award job creation funds for “unique economic development opportunities”, we are not certain whether these types of awards satisfy the legislative intent of the fund.

The lack of written policies to guide the department’s decisions reduces consistency in how awards are made and reduces the program’s transparency.

**All of the projects we reviewed had written and signed agreements and it appeared the department maintained records in accordance with best practices.** For the five projects we reviewed, the department maintained a copy of the signed award agreement. Further, when the department required an application, it also maintained a completed copy of that application in its files.

**The subjectivity of the award decision making process appears to be related to a lack of statutory direction and how department officials view the purpose of the fund.** Statute does not provide any criteria the department should consider when making awards nor does it direct the department to conduct any particular analyses to examine the cost effectiveness of the project before making the award. Further, statute permits the department to use job creation funds for a wide but vague range of activities including, “unique economic development opportunities.” Finally, the department appears to view this fund primarily as a deal closing fund meant to keep Kansas competitive in bringing new companies to the state or retaining existing companies. Consequently, they prefer to maintain flexibility and subjectivity in awarding these funds to meet the varying demands of different types of projects.

## ***Finding #2: The Department Conducts Limited Verification to Ensure Companies Meet the Terms of the Fund Agreement***

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**Best practices for monitoring economic development incentives focus on verifying and analyzing company data.** Best practices emphasize the importance of requiring companies to submit relevant data and then reviewing and verifying accuracy of that data. Best practices also include comparing the data the companies submit to the agreed upon expectations and holding companies accountable if they fail to achieve the agreed upon goals. These actions ensure that the program is being carried out as intended and to help ensure that tax dollars are being spent effectively.

**Department of Commerce officials conduct limited verification to ensure that companies act in accordance with the job creation fund agreement.** Each company that receives job creation funds signs an agreement with the department that describes what outcomes the company must achieve to receive the funds and requires the company to report annually on its progress towards meeting those outcomes. As mentioned previously, it is a best practice to independently verify the accuracy of the information companies submit. Company information can be verified through several means including corroborating with other state agencies, such as the Department of Labor, through on-site reviews, or audits. We found that the department does not take steps to verify the accuracy of much of the information companies submit. For example, for the projects we reviewed, most companies were required to make specific capital investments or to raise matching funds to receive job creation funds. Although the companies reported this information, the department did not take steps to independently verify that the data those companies submitted was accurate. Currently, companies are asked to sign a statement that says the information they submit is accurate. Department officials told us they felt this was sufficient to ensure that companies provided accurate information.

Additionally, we did find that the department required companies to provide the quarterly job and wage data reports it submits to the Department of Labor to verify that companies created the agreed upon number of jobs.

Last, for four of the five projects we reviewed, the agreement also required the company to spend job creation funds for specific purposes, such as for construction of a building or to implement a program. However, the department did not ask these companies to submit documents related to how it spent the funds and did not appear to conduct any other verification to ensure the funds were spent on allowable activities.

**The department requires companies who report a failure to meet award goals to payback award money.** Department officials reported that 20 companies have paid back money to the state in the last five years because they failed to meet the required goals. Typically, companies that do not achieve their goals must pay back those funds in the proportion in which they fell short. For example, if a company received \$60,000 with the promise to create 30 jobs in the first year of its agreement, but only created 15 jobs, it would be required to pay back \$30,000. We reviewed several files and found evidence that companies that reported that they did not meet their goals paid back money in accordance with the agreement they signed with the department. For example, one company paid back nearly \$105,000 (although it kept a little more than \$195,000) because it did not meet its job creation goals in four of the five years of its agreement

with the department. Due to the limited nature of this audit, we were not able to assess whether the department consistently and accurately requires companies to pay back money.

### ***Finding #3: The Department's Annual Reports to the Legislature Lack Statutorily Required Information***

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**State law requires the department to annually report specific job creation fund information to certain legislators and committees.** State law (K.S.A. 74-50, 224) specifies what information the department should include such as the projects that received awards, the reason why the project received an award, how much was awarded, and the associated number of created or retained jobs. Additionally, it requires that the report be submitted annually to specific committees such as the House Committee on Taxation and to certain legislators such as the Speaker of the House.

**The department's annual report to the Legislature does not include statutorily required information.** In the five years we reviewed, we found that the department submitted the report annually to the correct legislators and committees, but it did not include the following statutorily required items:

- specific information regarding all expenditures from the fund
- specific projects that received funds and the amount of funds expended for each project
- the characteristics of the jobs created or retained
- the number of jobs created or retained which do not continue to exist and the circumstances and effect of such job discontinuances
- other related accomplishments

Department officials told us they did not review the statutory reporting requirements when deciding what to include in the annual report. Further, they told us they would need Legislative direction in understanding certain aspects of the statute's reporting requirements. Last, the lack of specific information provided to the Legislature can diminish its ability to provide appropriate oversight of the program.

### ***Recommendations***

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1. The Department of Commerce should establish criteria it will use to evaluate job creation fund awards and a process for determining how much money it will award.
2. The Department of Commerce should verify that the data companies submit related to award requirements is accurate.
3. The Department of Commerce should include all elements in its annual report required by state law and seek out any legislative guidance it needs to understand those requirements.

## ***Potential Issues for Further Consideration***

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We identified several issues that might be worth evaluating in more detail, but because of the limited scope of the audit, we did not have time to fully develop these issues. Although we had unresolved questions about the following issues, more audit work would be needed to determine whether they represent an actual problem or not.

- 1. What criteria do other states use to determine who receives funding from programs similar to the Job Creation Fund Program?** Department of Commerce officials told us many other states have similar incentives to the Job Creation Fund Program in Kansas. Additional work would allow us to determine what criteria those states use to award cash funds.
- 2. Does the department use its payback provision consistently and in accordance with the terms of award agreements?** Our review of the department's use of a payback provision was very limited and only confirmed that the department did enforce it on the projects we examined. Additional work would allow us to determine if the department enforced it consistently and accurately over the last several years.

## *Agency Response*

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On May 21, 2019, we provided copies of the draft limited-scope audit report to the Department of Commerce for their review. We made several minor clarifications to the final report as a result of that review, but those changes did not affect any of our findings or conclusions. The Department of Commerce indicated it would implement the recommendations.

In its response, the department raised concerns about the validity of the sample of awards we reviewed and also noted that we did not identify any instances where companies submitted false information. This was a limited-scope audit designed to provide a brief look into program operations. Due to the limited nature of this audit, we only chose a small sample of awards to review and stated in the report that this was not intended to represent all awards. Further, because of the limited nature of this audit, we did not evaluate the accuracy of the information companies submitted to the department.

Finally, the department indicated that our findings provided evidence that the department's use of a payback function was sufficient, effective, and met best practices. We disagree. We saw evidence of some companies paying back awards, but we did not evaluate whether all companies who should have paid back did so in accordance with the agreement they signed with the department. As such, we did not determine that the department's process was sufficient or effective.

May 29, 2019

Legislative Post Auditor  
Mr. Justin Stowe  
800 SW Jackson, Suite 1200  
Topeka, KS 66612

Dear Mr. Stowe:

The Department of Commerce (Commerce) has received and reviewed the Limited-Scope Performance Audit Report for the Job Creation Fund Program. While we appreciate the time and effort that went into the review, there are several clarifications and observations which are pertinent. One of our concerns involves the lack of a statistically reliable review process and the drawing of conclusions resulting from that arbitrary process. Out of the 71 projects funded over the past five years, LPA selected five projects for review. The selection of projects was admittedly arbitrary and based on LPA's assumption as to business type according to the name of the recipient. Of these projects, two are very typical in nature while the other three were less typical. For example, JCF Agreements are structured two ways; milestone payments dispersed over five years upon goal completion, or as an upfront cash payment in the form of a forgivable loan. All projects reviewed in this sample fell into a single category, milestone payments. None of the files examined by the LPA were forgivable loans. We feel that the audit results are statistically and systemically flawed as they did not fully encapsulate the types of projects funded under this program. As we worked with the LPA audit team, they recognized and acknowledged that the projects, which were arbitrarily selected for review, were not a representative sample. Using a statistically invalid file selection makes the findings less reliable.

The statutes implementing JCF allow Commerce discretion in determining which companies receive funding and how much funding each company receives. All projects funded with Job Creation Funds; including those selected for review, met the statutory requirements of the program. The JCF allows Commerce to remain competitive with other states who have similar incentives. This program helps attract new business to our state, retain and grow existing business and foster economic development. The program is structured to be flexible which allows us to meet the needs of the businesses we serve. When making our decisions to fund projects, we consider the total size of the project, the size of any potential competitive gap (the gap between the conditions and incentives in Kansas compared to another state), location of the project and the impact to the local economy, wages, industry, and capital investment that will be made. We also compare the award to other projects that are similar in size and scope. The combined economic development knowledge and experience of our team warrants sufficient expertise for making funding decisions. The program is rarely used. Job Creation Funds are only given to approximately 2% - 4% of all major economic development projects funded by Commerce each year.

Using the arbitrarily selected five files as the basis, LPA notes other "anomalies" in Commerce' process. Out of the 71 projects that were funded over the past 5 years, approximately 4% did not have a formal application on file. These files were without applications due to the nature of the project. These projects were worked by prior Secretaries and information sufficient to make the award and

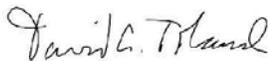
manage the project was gathered and verified during negotiation and drafting of the agreement. The other 96% of projects had applications and followed the standard practice. One of the projects in 2017, the Renwick School District, was a joint effort between the then Secretary of Commerce and the then Secretary of Agriculture, intended to expose high school students to ag and ag tech job opportunities. It is a best practice to involve and work with other stakeholders, economic development agencies, and organizations.

Another finding questioned the process used by Commerce to ensure program compliance. In order to verify the success of any JCF agreement, the company is required to report progress annually and, in some cases, bi-annually. These reports provide necessary information regarding progress of the project, retained and net new jobs, payroll, and capital investment. We adhere to the best practice of reviewing the Kansas Department of Labor reports and comparing those to the information certified by the company as being true and correct. Relying on a certification from a company is similar to the signature process relied upon by the state and federal governments for tax return purposes which is an accepted industry and legal threshold for providing information. The LPA suggests that additional levels of verification can be utilized such as conducting formal on-site reviews of all documents, internal payroll reports, and line by line expense reports; however, those methods are intrusive and impractical. Commerce utilizes a best practice which is reasonable and ensures accuracy. Upon review of the reports, if we determine that a company has fallen short of its intended goals, we request repayment as specified in the Agreement. In some cases, if a company falls short of its goals we withhold future payments. The LPA report shows that Commerce required 20 companies to repay funds based on the methods currently in use. LPA's own finding provides evidence that the methodology used for reviewing performance and evaluating claw-back is sufficient, meets best practices and is effective. LPA did not identify any instances where companies misrepresented or submitted false information.

JCF is a strong and necessary economic development tool. Commerce provided a total of \$717,500 in funding for the five arbitrarily selected projects reviewed by the LPA. In return, the state is projected to benefit by adding 224 net new jobs, and capital investment of \$27,950,000. Commerce has funded a total of 71 projects from 2014 to 2018. The projected benefit to the state for all of these projects is net new job creation of 12,916, the retention of 20,196 existing jobs, and over \$2.4 billion in capital investment. In addition to the jobs and capital investment; we have created economic development opportunities in underserved distressed areas where opportunity would not have otherwise existed. The JCF is a key component in Commerce' incentive package and retaining discretion is vital if the state is to remain competitive going forward.

Commerce appreciates LPA reviewing the JCF program and its professionalism. The audit/review process was relatively smooth and we hope the information is useful.

Sincerely,

A handwritten signature in black ink that reads "David C. Toland". The signature is written in a cursive style.

David C. Toland  
Secretary

**Itemized Response to LPA Recommendations**

**Audit Title:** Kansas Department of Commerce: Evaluating the Department's Administration of the Job Creation Program Fund

**Agency:** Department of Commerce

LPA Recommendation	Agency Action Plan
<b>Question 1</b>	
1. The Department of Commerce should establish criteria it will use to evaluate job creation fund awards and a process for determining how much money it will award.	The legislative intent behind the JCF and its predecessor, IMPACT, was to give the Secretary of Commerce wide latitude to meet the needs of recruiting and retaining companies and in meeting economic development opportunities. JCF is intended to be nimble, flexible and adaptable to meet the everchanging needs of businesses. It's a deal-closing fund that functions best with the flexibility to allow the state to invest in a way designed to meet a unique need. Having a "formula" used to calculate every award based on some sort of matrix would deprive the state of being competitive with other states. In the interest of increased transparency, Commerce will create a policy that lists and discusses the various criteria the agency uses to evaluate projects. However, the weight of the criteria will remain a subjective determination of the Secretary.
2. The Department of Commerce should verify that the data companies submit related to award requirements is accurate.	Commerce is continually striving to improve its verification efforts related to job creation and capital investments. We currently check job numbers against the Kansas Department of Labor report which is a best proactive. We will review our procedures and determine what additional processes, if any, would be cost-effective and add value.
3. The Department of Commerce should include all elements in its annual report required by state law and seek out any legislative guidance it needs to understand those requirements.	Commerce will work with the legislature to determine which metrics and data are most useful and provide that information in the Annual Report.

## Appendix A

This appendix provides additional information on the job creation program funds the Department of Commerce awarded in fiscal years 2014 through 2018. As the figure shows, a major expansion of a Kansas business was the most common reason for awarding job creation funds. Additionally, the largest number of awards (33) were made to companies in Johnson County.

<b>Most Funds were Awarded to Companies in Johnson County and for the Purpose of Expanding a Kansas Business</b>		
<b>Fiscal Year</b>	<b>County Location of Awarded Businesses</b>	<b>Reasons for Awards</b>
2018	Johnson (2) Lyon (2) Cowley (1) Doniphan (1) Douglas (1) Riley (1)	Major expansion of a Kansas business (7) Unique economic development opportunity (1)
2017	Johnson (12) Sedgwick (4) McPherson (2) Riley (2) Wyandotte (2) Douglas (1) Norton (1) Shawnee (1)	Major expansion of a Kansas business (23) Potential departure of a Kansas business (1) Unique economic development opportunity (1)
2016	Johnson (2) Shawnee (2) Cherokee (1) Finney (1)	Major expansion of a Kansas business (5) Potential departure of a Kansas business (1)
2015	Johnson (13) Wyandotte (4) Cowley (2) Geary (1) Reno (1) Riley (1) Saline (1) Sedgwick (1)	Major expansion of a Kansas business (8) Potential departure of a Kansas business (11) Potential location to Kansas (3) Training (1) Unique economic development opportunity (1)
2014	Johnson (4) Cowley (1) McPherson (1) Saline (1) Shawnee (1)	Major expansion of a Kansas business (7) Unique economic development opportunity (1)

Source: Audited data provided by the Kansas Department of Commerce.