



# **PERFORMANCE AUDIT REPORT**

## **Economic Development: Determining Which Economic Development Tools are Most Important and Effective in Promoting Job Creation and Economic Growth in Kansas, Part 2**

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
February 2014**

# Legislative Division of Post Audit

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February 6, 2014

To: Members, Legislative Post Audit Committee

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This report contains the findings and conclusions from our completed performance audit, *Economic Development: Determining Which Economic Development Tools are Most Important and Effective in Promoting Job Creation and Economic Growth in Kansas, Part 2*. The report does not contain any recommendations. The two questions answered in this audit report were added to the original scope statement approved by the Legislative Post Audit Committee on May 10, 2013. We would be happy to discuss the findings or any other items presented in this report with any legislative committees, individual legislators, or other state officials.

Sincerely,

Scott Frank  
Legislative Post Auditor

This audit was conducted by Joe Lawhon, Katrin Osterhaus, and Kristen Rottinghaus. Chris Clarke was the audit manager. If you need any additional information about the audit's findings, please contact Joe Lawhon at the Division's offices.

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# **Economic Development: Determining Which Economic Development Tools are Most Important and Effective in Promoting Job Creation and Economic Growth in Kansas, Part 2**

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Kansas offers a variety of economic development programs and incentives including state grant or loan programs, tax credits, and tax exemptions. Economic development assistance is intended to create and retain jobs and grow commerce and industry in the state.

In Kansas, most economic development programs and incentives are administered by the Department of Commerce, the Department of Revenue, and the Kansas Bioscience Authority. Economic development programs are funded through several sources including federal moneys, state lottery and casino proceeds, and wage tax withholdings for certain employees. Additionally, state and local governments also pay for economic development through forgone revenues including tax abatements, credits, and exemptions.

Our 2008 audit evaluating the impact of economic development programs identified a number of problems related to assessing the effectiveness of these programs. Those problems included unavailable and unreliable data, difficulties in measuring economic growth, and difficulties linking business outcomes with specific economic development assistance. Nonetheless, academic literature suggested that governmental entities must offer economic development incentives to remain competitive with other jurisdictions. That audit also identified a measurable, although small, relationship between economic development spending and job and business growth in various Kansas counties.

Legislators have expressed interest in knowing which Kansas economic development programs and incentives are most helpful to participating businesses.

This performance audit answers the following question:

**Does Kansas have the appropriate programs and incentives to enhance economic development in the state?**

A copy of the scope statement the Legislative Post Audit Committee approved for this audit is included in **Appendix A**. The scope statement includes five questions. For reporting purposes, we separated this audit into three parts. Part 1 addressed questions

one and two of the scope statement pertaining to the Promoting Employment Across Kansas (PEAK) program, the High Performance Incentive Program, and performance clauses. That audit report was issued in September 2013. This audit— Part 2— answers questions three and four, which we combined into a single question for reporting purposes. Part 3 will answer the last question of the scope statement, which relates to assessing the success of Kansas’ major economic development programs.

To answer the audit question, we interviewed officials from the Department of Commerce and the Kansas Bioscience Authority about programs those officials consider to be the state’s major economic development initiatives, and to identify states which compete most directly with Kansas. We reviewed available website information and contacted officials in those competing states (Indiana, Missouri, North Carolina, Oklahoma, and Texas) to learn more about those states’ major economic development programs. We then compared those initiatives to Kansas’ major programs. Our comparisons include several caveats listed below:

- We only compared each state’s major economic development programs. States generally have many programs, but the scope of this audit was intended to limit our work to an evaluation of major programs.
- We generally spoke with only one economic development official in each competing state. If we had spoken with others, it may have resulted in slightly different comparisons.
- Missouri officials declined to speak with us. As a result, we used our judgment to identify the programs that represent that state’s major economic development programs.

We also performed several other tasks to answer the audit question. We conducted a survey of stakeholders which included officials from local chambers of commerce, major universities, and site consultants. We also surveyed officials representing Kansas businesses that have either participated or are currently participating in one or more state-sponsored economic development programs. We have paraphrased and included survey responses in the report, where applicable. Lastly, we reviewed a number of recently published reports concerning the effectiveness of economic development programs.

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. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We did not perform



any work on internal controls because such work was not necessary to answer the audit question.

Our findings begin on page 7, following a brief overview.



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## Overview of Economic Development Initiatives in Kansas

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### *In Kansas, Three State Agencies Have Primary Responsibility for Implementing the State's Diverse Economic Development Initiatives*

Each state has economic development programs and incentives that are designed to grow the state's economy. However, the specific goals and programs each state uses to achieve its economic growth vary. The main agencies involved in developing and administering such programs in Kansas are discussed in the following section.

**The Department of Commerce, the Kansas Bioscience Authority, and the Department of Revenue administer the state's main economic development programs.** Overall, the state has about 75 programs in seven agencies that could be considered economic development. However, three agencies have primary responsibility. Their duties are briefly summarized below.

- **The Department of Commerce is charged with helping grow, diversify, and expand existing businesses as well as creating new businesses.** To accomplish this, the department provides financial incentives and other assistance to businesses to help create and retain jobs and increase capital investment. It also provides services to help ensure the state's workforce can meet industry needs.
- **The Kansas Bioscience Authority works to advance the state's bioscience sector.** The bioscience industry draws on research in the life sciences to create marketable products and services. Among other things, bioscience companies study animal health, develop pharmaceuticals and medical devices, create fuel from plant matter, and advance new agricultural technologies. The Kansas Bioscience Authority was created in 2004 and offers investment programs that provide capital to bioscience companies and helps them reduce business risk.
- **The Department of Revenue administers tax credits and refunds for withholding taxes related to economic development incentives.** The department also issues sales tax exemption certificates to qualified companies. Although the department has no oversight responsibilities for economic development programs, it coordinates and shares certain reporting requirements with the Department of Commerce.

**Businesses receive economic development incentives in many forms.** Some programs provide financial assistance through grants or loans. Other programs allow companies to receive income tax credits to reduce their state tax liability. Still other programs provide sales or property tax exemptions that help reduce business operating costs. The Promoting Employment Across Kansas (PEAK) program, as one of Kansas' newest economic development programs, allows participating companies to retain 95% of the withholding taxes (funds employers withhold

from wages to pre-pay employees' state income taxes) that otherwise would have been forwarded to the state for certain new employees.

**Some state-level economic development initiatives are readily available to all, while others are restricted to specific companies.** Some initiatives are available throughout the state and to any business or taxpayer that would like to participate. Others require a business to submit an application to the Department of Commerce or the Kansas Bioscience Authority for review and approval. A few examples are described below.

- **Property tax exemptions for new machinery and equipment and recent reductions in the state's income tax rates are examples of incentives that are available to anyone.** To help reduce businesses' operating expenses and incentivize machinery and equipment acquisitions, the 2006 Legislature passed a law exempting commercial and industrial machinery and equipment from property taxes. More recently, the Legislature amended state law to exempt certain non-wage business income that had been subject to individual income tax and reduced the state's individual income tax rates. This helps economic development because instead of turning that money over to the state, those changes have allowed taxpayers to keep the money and spend it on goods and services in Kansas.
- **The Promoting Employment Across Kansas (PEAK) and the High Performance Incentive Program (HPIP) are examples of incentives that are awarded to specific companies.** The PEAK program allows companies to retain state withholding taxes in exchange for creating new or retaining existing jobs. HPIP requires companies to make capital investments or train their workforce to qualify for income tax credits and a potential sales tax exemption. Both programs require companies to submit an application to the Department of Commerce for approval. However, while the department has considerable discretion in approving applications for the PEAK program, it must approve a company's HPIP application if the company meets the necessary statutory requirements.

The Department of Commerce has considerable discretion in awarding incentives for some programs, but not others. For example, the department negotiates with a business on the amount of PEAK funding to award. Conversely, HPIP tax credits are derived from a statutory formula, and the department has no discretion in setting the amounts.

## Does Kansas Have the Appropriate Programs and Incentives to Enhance Economic Development in the State?

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### ***Answer in Brief:***

*Studies suggest many economic development initiatives are difficult to evaluate or have not been successful, yet states must offer them to remain competitive (p. 7). Our analysis showed that Kansas has the appropriate programs for enhancing the state's economic development. That is because overall Kansas generally has the same types of economic development programs as five other states we reviewed (p. 8). Kansas' programs also generally provide the incentives that stakeholders indicated are useful (p. 13). Business officials and other respondents disagreed about how lowered income tax rates would affect economic development in Kansas (p. 16). Lastly, stakeholders offered a number of suggestions for improving the state's existing programs (p. 18).*

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### ***Studies Suggest Many Economic Development Initiatives are Difficult to Evaluate or Have Not Been Successful, Yet States Must Offer Them to Remain Competitive***

In this audit, we reviewed 20 studies, including several that university or Department of Commerce officials suggested. Of these reports, only two evaluated Kansas-specific economic development programs. Overall, the findings in these 20 studies were similar to findings we have identified in previous reviews of economic development literature, and are summarized below.

**Academic reviews and professional evaluations regarding the effectiveness of economic development initiatives often have mixed results.** In many instances, assessing the effectiveness of economic development initiatives is difficult because program goals may be unclear, the data needed to make such an assessment are either incomplete or inaccurate, or cause and effect cannot be determined with certainty.

The studies we reviewed drew a variety of conclusions about economic development initiatives. Many studies drew negative conclusions when the programs did not reach job or capital investment growth goals, or the costs outweighed the benefits. For example, a 2010 study of Connecticut's tax credit and abatement programs concluded that several programs had minimal or negative impacts, and that some programs should be eliminated because they had little to no participation. Similarly, a 2011 study of Massachusetts's film industry tax credit determined the credit cost the state more jobs than it created. In other instances, the researchers drew positive conclusions. For example, a 2012 audit of certain Wisconsin economic development programs concluded that about two-thirds of the contract recipients achieved contractual goals. Similarly the 2010 Connecticut study mentioned previously identified a few other programs where benefits exceeded costs.

**Several studies we reviewed cited the need for states to offer economic incentives to remain competitive.** For example, a 2008 review of the Minnesota Job Opportunity Building Zones program concluded the program had value as an economic development tool because it helped attract some out-of-state businesses and kept others from leaving the state. A 2012 audit of Virginia’s economic development incentive grants concluded these grants were among many factors businesses considered during site selection, and appeared to be most influential during final selection. Lastly, a 2007 academic review conducted by the UpJohn Institute called economic development incentives beneficial because corporations have become more mobile—implying that businesses will relocate to areas that provide the best environment.

**Many stakeholders we talked with agreed that economic development incentives help keep Kansas competitive.** During our 2008 audit and again during this audit, Department of Commerce officials suggested Kansas could lose out on economic development opportunities if it does not offer incentives like other states. Stakeholders we surveyed had similar comments. (More information about our survey is presented on page 13.) A few examples are paraphrased below.

*...Attracting new companies to Kansas is a must. Because other states are competitive, Kansas has to keep up by offering similar incentives...*

*...Offering the withholding tax incentive program is a competitive thing. Kansas is keeping up with other states (Missouri and Oklahoma)...*

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***In General, Kansas Has the Same Types of Economic Development Programs as Other States We Reviewed***

The goal of economic development incentives is similar across all states, and includes things such as job creation, job retention, and capital investment. States use a variety of economic development funding mechanisms like tax credits, grants, and loans to facilitate economic growth. Within each state, officials combine these goals and mechanisms into a multitude of economic development incentive programs. **Appendix B** summarizes the results of a recent comparison published by the Council of State Governments. It shows the tax and non-tax financial incentives each state used to promote economic development.

We compared the primary goals, funding mechanisms, and specific parameters of Kansas’ and five other states’ major economic development programs. Overall, we determined:

- At a high level, Kansas' and other states' programs were comparable.
- Individual programs had differences in operating guidelines such as eligibility rules and the duration of program benefits.
- Other states had a few programs that Kansas did not have, but generally those programs were narrowly focused and did not immediately concern Kansas officials.

**Out of approximately 75 Kansas programs, our review focused on six major incentives that are designed to accomplish job growth, job retention, and capital investment through a variety of funding mechanisms.** To identify Kansas' major economic development programs, we asked Department of Commerce and Kansas Bioscience Authority officials to designate their major programs. Those programs were:

- High Performance Incentive Program (HPIP),
- Job Creation Program Fund (JCF),
- Kansas Industrial Retraining (KIR),
- Kansas Industrial Training (KIT),
- Promoting Employment Across Kansas (PEAK), and
- Direct Equity Investment Program (a Kansas Bioscience Authority program).

*Figure 1-1* on the next page includes the description, primary goals, and funding mechanisms of these six programs. As the figure shows, Kansas' major programs incentivize job creation and retention, employee training, capital investment, product development, and investments in Kansas businesses. The programs provide funds through tax credits and exemptions, loans, grants, the retention or refund of certain employees' state withholding taxes, and equity investments.

**Our evaluation of program goals showed other states' major programs were intended to achieve the same primary outcomes as Kansas' programs.** Kansas officials identified five states they considered to be competitors for economic development opportunities: Indiana, Missouri, North Carolina, Oklahoma, and Texas. To the extent possible, we spoke with staff from each state's main economic development agency and equivalent bioscience agency and asked them to identify their state's major economic development programs. Officials from Missouri declined to participate; as a result, we used our professional judgment to identify Missouri's major programs. Overall, we reviewed 32 major programs in the five select states.

**Figure 1-1  
Goals and Funding Mechanisms of Kansas' Six Major Economic Development Programs**

Economic Development Program	Description	Primary Goals						Funding Mechanism
		Create New Jobs	Retain Existing Jobs	New Employee Training	Existing Employee Training/ Retraining	Capital Investment	Other	
DEPARTMENT OF COMMERCE								
High Performance Incentive Program (HPIP)	Provides an income tax credit to companies that make eligible capital investments and training expenditures. It also provides a sales tax exemption that a company can use in conjunction with its capital investment.				✓	✓		Income tax credit and Sales tax exemption
Job Creation Program Fund (JCF)	A closing fund that companies can use for an array of items associated with such things as expanding an existing business, locating a new business in Kansas, preventing the reduction of a major business, or training or retraining workers.	✓	✓	✓	✓	✓		Forgivable loan or Grant
Kansas Industrial Retraining (KIR)	Reimburses participating companies for eligible training expenditures such as instructor salaries, curriculum development, and materials. The program is intended to help companies that are restructuring or retraining (i.e. upgrading existing technology, incorporating new technology, diversifying production, developing new product) from having to lay off current employees because of obsolete or inadequate job skills.		✓		✓			Grant
Kansas Industrial Training (KIT)	Reimburses participating companies for eligible training expenditures such as instructor salaries, curriculum development, and materials. The program is intended to help new and expanding companies train employees for new jobs (i.e. pre-employment, classroom, and on-the-job training).	✓		✓				Grant
Promoting Employment Across Kansas (PEAK)	Allows companies to retain 95% of state withholding taxes for eligible employees in exchange for locating, expanding, or retaining business operations in Kansas.	✓	✓					Retention or refund of state withholding taxes
KANSAS BIOSCIENCE AUTHORITY								
Direct Equity Investment Program	Provides direct equity investments into high-growth-potential bioscience startups and companies through collaboration with private and accredited investors.						Equity investment, attract external capital, and product development	Equity investments
Source: LPA summary of program information provided by the Kansas Department of Commerce and Kansas Bioscience Authority.								



At the state level, we determined other states' programs had the same goals of job creation, job retention, capital investment, employee training, and business investments as Kansas. Our evaluation of funding mechanisms also showed that other states provided funds through a variety of mechanisms that Kansas uses, including tax credits, grants, and loans. **Appendix C** provides a description of all six states' major economic development programs. Additionally, for three states, it also provides certain program results data. Officials in the three other states did not provide complete data.

**Although other states' programs intend to accomplish similar goals, Kansas structures three of its main programs differently.** At the program level, we compared each of Kansas' six major economic development programs to those offered by other states. We determined the goals and funding mechanisms of Kansas' KIR, KIT, and PEAK programs are fairly similar to programs operated in other states. That is because they provide money to companies for training (KIR and KIT) and job creation (PEAK) through funding mechanisms comparable to other states.

Kansas' three other programs—JCF, HPIP, and Direct Equity Investment—are somewhat different than programs in other states because of the way their goals and funding mechanisms are structured. Kansas is the only state that has bundled the particular combinations of goals and funding mechanisms of JCF and HPIP into single programs. In addition, Kansas is one of only two states we reviewed that provides funds to start-up bioscience companies through an investment mechanism.

It is also important to note that the programs have differences in operating guidelines. For example, programs may provide funds upfront instead of throughout or post performance, restrict or prioritize certain industries, or allow varying benefit periods. We did not make a detailed comparison of the programs' operating guidelines because such differences would not be significant enough to influence our overall conclusion.

**Of the programs we reviewed, other states had five programs that Kansas does not offer, but Kansas officials thought the absence of only one program—an Enterprise Zone program—put the state at a competitive disadvantage.** Many of the major programs other states offer are similar to Kansas' programs. However, we identified a few small exceptions, which are described below.

- **Texas operates an Enterprise Zone Program that Kansas no longer provides.** Texas' Enterprise Zone program provides a sales tax refund to companies that make capital expenditures within economically distressed areas. Kansas had a similar Enterprise

Zone program but it was changed over time and was phased out to focus on other economic development measures. Department of Commerce officials indicated the lack of widely accessible sales tax exemptions related to capital purchases may put Kansas at a competitive disadvantage. Currently, sales tax exemptions related to capital expenditures are accessible primarily through the HPIP tax credit program. However, that program is used mostly by large employers in certain industries, and the tax exemption is not as widely accessible as it was before.

- **Indiana offers two tax credits that Kansas does not explicitly offer, but Kansas has other programs that address similar issues.** Indiana's Headquarters Relocation Tax Credit provides an income tax credit to companies for up to 50% of the moving costs associated with relocating their headquarters to Indiana. The state's Industrial Recovery Tax Credit also provides an income tax credit to companies for up to 25% of the investments they make to renovate former industrial facilities.

Department of Commerce officials told us Kansas does not have these programs because companies have not consistently cited a need, and they indicated the state has other incentives that may help companies in similar ways. Companies could use JCF funds to pay for moving costs (not just headquarter facilities) and HPIP provides tax credits to businesses that renovate old buildings (as long as the company met program requirements). Department officials think it is unlikely that Kansas is at a competitive disadvantage by not having these programs.

- **Oklahoma offers an aerospace engineering tax credit that Kansas does not offer.** Oklahoma's Aerospace Engineer Workforce Tax Credit provides an income tax credit to companies for up to 10% of the compensation paid to eligible aerospace engineers and 50% of the cost of tuition reimbursement. Department officials told us there have been efforts to create a similar program in the past, but such efforts have not caught on. In addition, they indicated that such targeted programs can be problematic and were uncertain if not having this program put Kansas at a competitive disadvantage.
- **Missouri has an entrepreneurial research and support program that neither the Department of Commerce nor the Kansas Bioscience Authority currently have.** Missouri's Building Entrepreneurial Capacity program provides investments to nonprofit research and entrepreneurial support organizations that expand the support system for entrepreneurs in high-tech industries. Department of Commerce and Kansas Bioscience Authority officials indicated neither entity offers a similar program. Authority officials were uncertain if that put the state at a competitive disadvantage.

**Finally, other states have a number of bioscience-related programs that Kansas also has, but no longer promotes due to reduced funding.** For example, one component of Texas' Emerging Technology Fund incentivizes educational institutions to recruit talented bioscience researchers to the state. Additionally, Missouri and North Carolina both have programs that provide start-up funds to early-stage bioscience-related

companies as well as programs that provide operating funds to more advanced companies. The Kansas Bioscience Authority currently has programs that could accomplish similar outcomes. According to authority officials, these programs have not been promoted recently due to uncertainty about the amount of funding the state provides to the authority. More information about its funding issues is shown in *Figure 1-2* below.

**Figure 1-2**  
**Funding Decreases for the Kansas Bioscience Authority**  
**Resulted in Strategic Programming Changes**

As part of the Kansas Economic Growth Act of 2004, the Legislature created the Kansas Bioscience Authority to help grow the state's bioscience sector. The bioscience industry draws on research in the life sciences to create marketable products and services. Among other things, bioscience companies research and develop technologies and advancements in animal health, human health, bioenergy, and agriculture and bio-based products. The act also created a number of programs and funding streams, and limited the amount the state would allocate to the authority over the next 15 years at almost \$582 million. Based on a funding formula driven by the growth of bioscience companies and their employees, the amount of funding transferred to the authority grew from almost \$20 million in 2006 to nearly \$36 million by 2008. Because of the recession and state budget constraints, then Governor Sebelius instituted an annual funding cap of \$35 million in 2009.

During the past few years, the Legislature has reduced funding for the authority, in large part due to operations and management issues that emerged in 2011. The problems were detailed in a 2011 forensic audit conducted by an independent CPA firm at the direction of the Kansas Bioscience Authority's Board of Directors and other Kansas officials. Among other things, the audit found the authority's former president received questionable reimbursements for vehicle allowance and maintenance costs, used authority-owned property for personal use, and charged questionable travel and entertainment expenses to the authority. Subsequently, the Legislature reduced the authority's funding to \$11.3 million in 2012, \$6.3 million in 2013, and \$4.0 million in 2014.

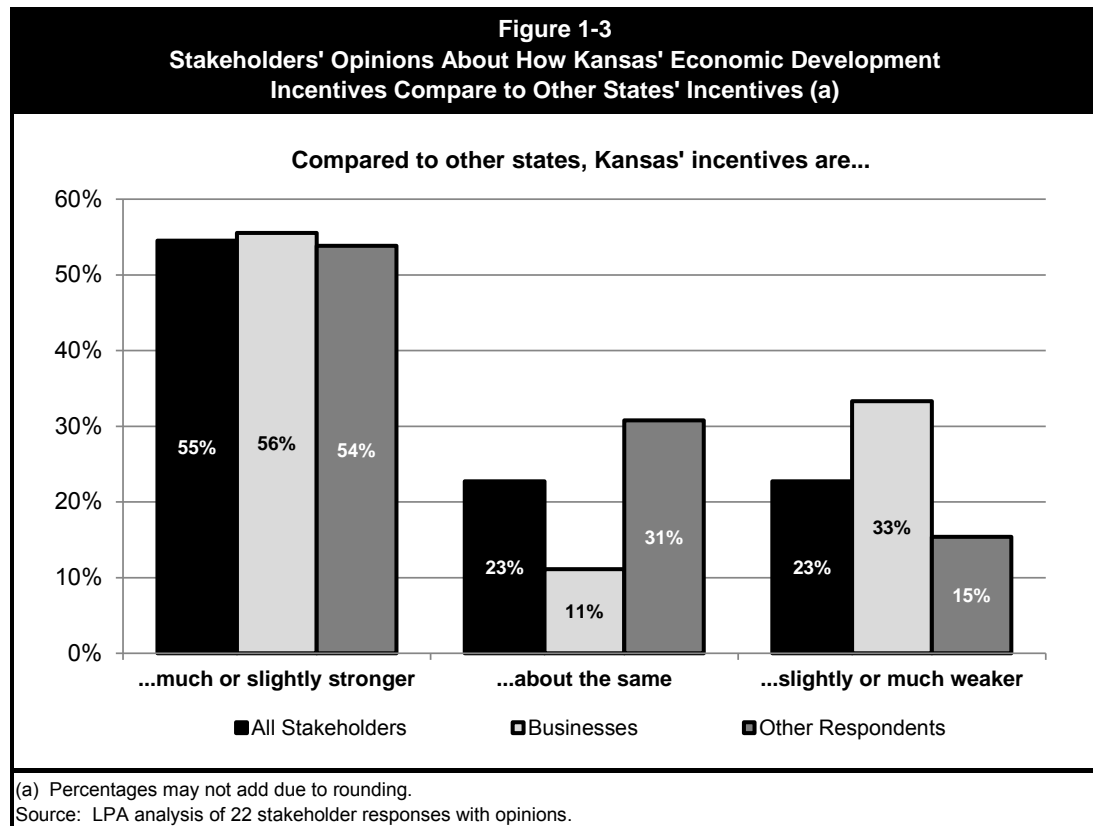
As a result of these actions and uncertainty about future funding commitments, authority officials recently changed how they promote the authority's economic development incentives. According to the current chief executive officer, by concentrating mostly on equity investments, the authority will be able to obtain a share in companies' ownership, thereby generating a return on its investments and increasing the likelihood that the authority will become self-sustaining. In turn, the authority no longer actively promotes some of its original grant programs which were intended to attract established bioscience companies to Kansas, help develop promising companies and technologies, as well as bring talented scholars and researchers to Kansas.

***Kansas' Economic  
Development Programs  
Generally Provide the  
Incentives that  
Stakeholders Indicated are  
Useful***

In this audit, we attempted to survey about 90 stakeholders about their perspectives on the usefulness of Kansas' programs. Overall, 28 stakeholders participated in the survey. Of those, 15 were business officials, and they represented companies with 12 employees to more than 5,000 employees. Almost all of the businesses had been in Kansas longer than five years, and about half operated multiple locations across the state. The 13 other respondents represented local economic development chambers of commerce or councils, site consultants, or university professors. The results of our survey are described more below.

**Most stakeholders thought Kansas' economic development programs were as strong, or stronger than, the programs in other states. *Figure 1-3* on the next page shows stakeholders' opinions about how well Kansas' incentives compare to those**

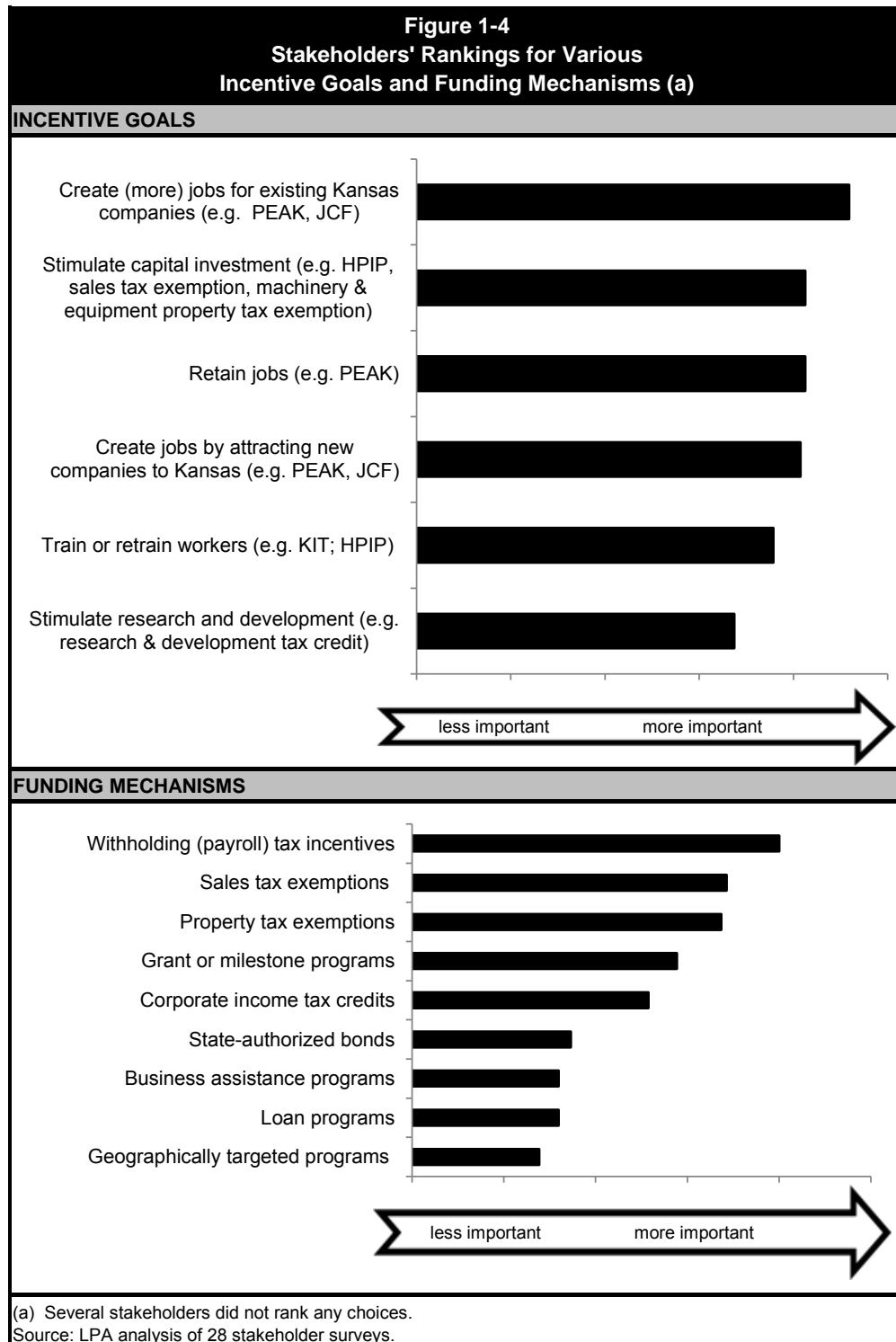
offered by other states. As the figure shows, a little more than half of the business officials and other respondents who expressed opinions thought Kansas offered slightly or much stronger incentives. However, three of nine (33%) business officials thought Kansas had slightly weaker incentives, as shown on the right side of the figure. Although some stakeholders suggested certain changes to existing programs (discussed on page 18), the general consensus was Kansas is not lacking any major economic development programs. Additional comments are included in *Appendix D*.



**Stakeholders thought the best way to enhance economic development in Kansas is to help existing companies create more jobs.** Kansas offers many programs to accomplish this activity, including the Job Creation Program Fund and the PEAK program, as shown in the top portion of *Figure 1-4* on the next page. Both survey groups ranked this goal as most important.

As the figure shows, three choices were closely ranked as the second best way to improve economic development in the state. Overall, business officials selected “stimulating capital investment” as their second choice, while other respondents chose “creating more jobs through attracting new companies.”

Interestingly, many stakeholders ranked research and development incentives as the lowest priority. They told us few companies conduct this type of work, and this goal is more regionally driven. At least one stakeholder commented that companies that conduct research and development do it because it supports their core mission and not because of available incentives.



**Stakeholders also indicated programs that allow businesses to predict the incentive amount and receive cash quickly work best.** The bottom portion of *Figure 1-4* shows that stakeholders ranked the withholding payroll tax incentive as the most important funding mechanism followed by sales and property tax exemptions. Stakeholders told us they ranked these incentives highly because it is important for businesses to know when and how much cash they can keep or will receive from incentives such as PEAK or the HPIP sales tax exemption. Stakeholders generally rated tax credits as less effective because they are hard to predict and may not actually be used. *Appendix D* provides examples of stakeholders' comments concerning accessibility to cash.

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***Business Officials and Other Respondents Disagreed about How Lowered Income Tax Rates Would Affect Economic Development in Kansas***

In 2012 and 2013, the Legislature implemented a number of changes in Kansas' income tax structure. One major revision included collapsing the three-bracket tax structure for individual income taxes previously set at 3.5%, 6.25%, and 6.45% into a two-bracket system with lower rates of 3.0% and 4.9%, effective for tax year 2013. The 2013 Legislature implemented additional individual income tax rate cuts beginning in tax year 2014 and continuing through 2018, when the bottom and top bracket drop to 2.3% and 3.9%. A second major revision included fully exempting certain non-wage business income from limited liability companies, subchapter-S corporations, and sole proprietorships.

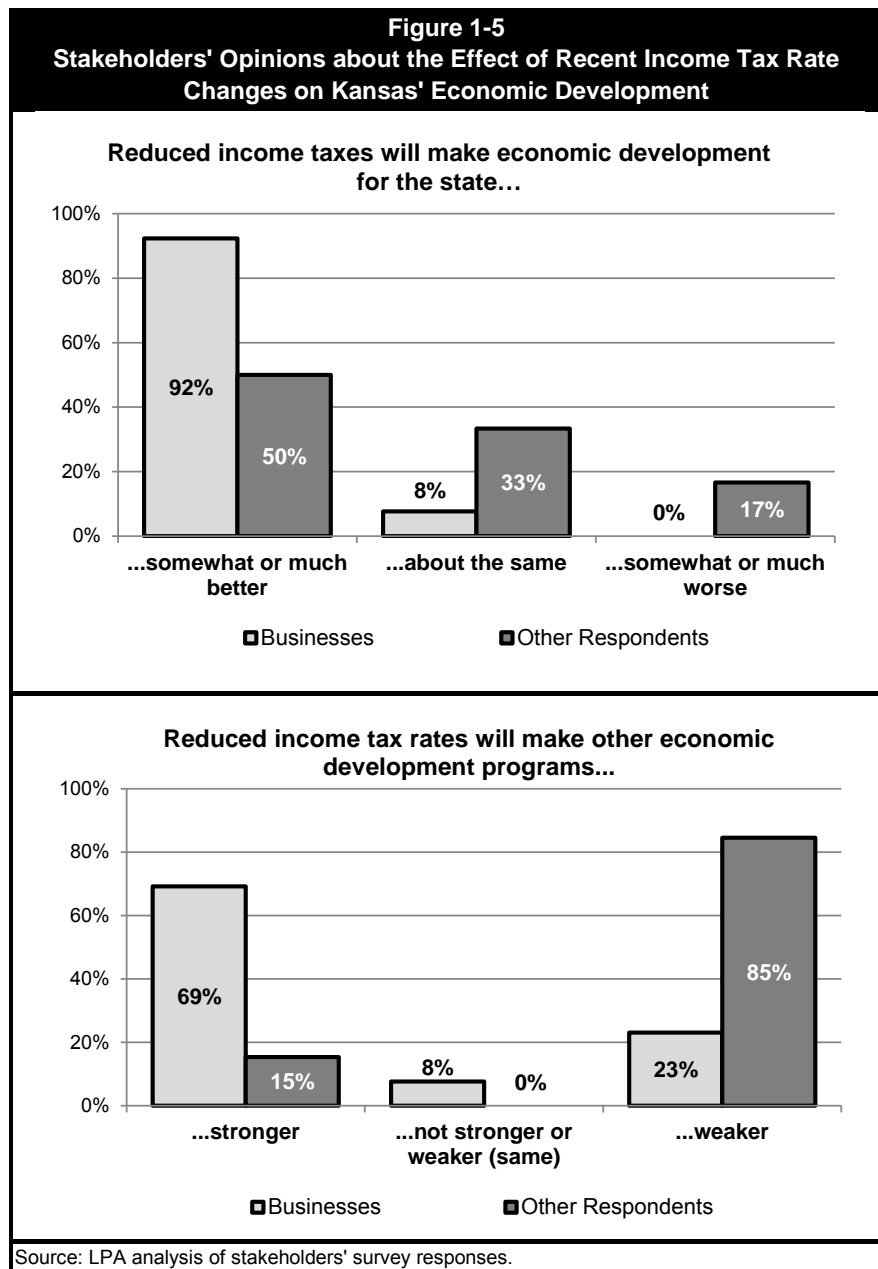
We asked stakeholders their opinions about how these changes might affect Kansas' economic development. The following sections provide more details about their responses.

**Business officials we surveyed were more optimistic than other respondents about the potential economic benefits of the recent income tax policy changes.** *Figure 1-5* on the next page summarizes the opinions of the two groups. As the figure shows, 92% of the business officials thought the tax changes would improve economic development within the state. Their comments included:

*...While this is a C-corporation and does not benefit, I have friends and attend many meetings where this is discussed. My impression is anything that makes the state more user-friendly makes it good for those smaller businesses...*

*...Keeping funds in businesses' hands means they are going to use them, which stimulates the economy. This is better than giving it to the state which is not as efficient...*

The other respondents were far less optimistic. Only 50% of them thought the change would produce positive results, and two respondents thought the state could experience negative consequences as a result of the tax changes.



**Business officials were also more optimistic about the effect the new tax changes would have on other economic development programs.** As shown in the bottom portion of *Figure 1-5*, almost 70% of the business officials thought the change would make Kansas' overall economic development package stronger. By contrast, only 15% of the other respondents shared this opinion. Conversely, only 23% of the business

officials thought the tax change would weaken Kansas' other economic programs, while 85% of the other respondents thought this. Their comments included:

*...With the uncertainty of the tax policy change, PEAK (the best program that Kansas has) could be affected negatively...*

*...The angel tax credit would be affected negatively. I want to be a cheerleader but it is difficult for me to do so...*

**Finally, a number of stakeholders expressed concerns and uncertainty as to whether the new tax policy would be successful in the long run.** These stakeholders—some business officials but primarily other respondents—expressed general concerns that the tax policy would not be able to deliver the anticipated balance between increasing the tax base and reducing the tax rate. Some of their comments are shown below:

*...The income tax rate is a powerful incentive because the labor pool is important to businesses. If lower rates can convince people to live here that would be good. However, I am not aware the literature shows there is a convincing effect...*

*...Companies do not have only a short-term mindset. They want to know how solid the tax policy is and whether it is sustainable. Will other state programs (schools, roads) suffer? If so, that is not good...*

*...I am not sure whether the trickle-down effect everyone banks on will work... Although workers will have more money in their pocket, it will be used to cover rising expenses (such as gas or food), so there may be no real extra spending...*

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***Stakeholders Offered a Number of Suggestions for Improving Kansas' Existing Economic Development Programs***

Our survey provided opportunities for stakeholders to express their opinions about whether Kansas should adopt other programs to strengthen the state's economic development activities. Although stakeholders occasionally mentioned programs in other states, there was no overall consensus that Kansas was lacking key programs. Nevertheless, they made a number of suggestions for improving existing programs, as summarized below.

**Many stakeholders indicated employee training and workforce development are critical and need more support through economic development initiatives.** Stakeholders



ranked the availability of skilled labor first in terms of what factors businesses consider most important when locating in a particular area. Many commented on the importance of having an adequate workforce, and one indicated that funding for the Kansas Industrial Training (KIT) and Kansas Industrial Retraining (KIR) programs is inadequate. In addition, some stakeholders indicated the HPIP program, which includes an employee training tax credit, focuses too much on larger companies and they criticized this program's accessibility to smaller companies. **Appendix D** contains more specific comments about this topic.

**Stakeholders suggested separating the sales tax exemption from the HPIP program and making it a stand-alone initiative.** A sales tax exemption reduces a company's cash outlay and provides an immediate benefit. This can be especially helpful for start-up companies. In Kansas, a sales tax exemption is currently available only for companies participating in the capital investment portion of the HPIP program, which is generally geared towards larger businesses. One site consultant indicated that some participants use the HPIP program only for the purpose of gaining access to the sales tax exemption. Many stakeholders suggested decoupling the sales tax exemption from this program. Another site consultant recommended making the stand-alone sales tax exemption discretionary (requiring Department of Commerce approval) to limit its use and cost.

**Stakeholders offered suggestions for making the tax credit portion of the HPIP program more useful to companies.** A number of these stakeholders thought income tax credits generally were not very useful because companies cannot project, with certainty, when and how much of the income tax credits they will be able to claim. Several commented that businesses often cannot use their HPIP tax credit because they do not have any tax liability. Department of Revenue officials told us that businesses have roughly \$472 million in unused HPIP income tax credits.

Stakeholders cited additional problems with the tax credit portion of the HPIP program. They noted only larger companies can qualify, the earned income tax credits cannot be shared with the company's other divisions that do not have a presence in Kansas, and the complex documentation requirements increase the risk that companies may lose the rights to earned financial benefits. Stakeholders suggested making the income tax credit totally or partially transferrable or refundable. This would allow some of the earned tax credits to be used or transferred to others who could use them.

**Stakeholders suggested the state should allocate more money to its cash closing fund, the Job Creation Program Fund.** This relatively new program was created in 2011 and allows the Department of Commerce to provide funds to companies for a wide variety of purposes. A number of stakeholders praised the program and also indicated they would like to see it increased in size. However, one local chamber of commerce official commented that local officials do not know enough about how to use it and who can access the program's funds.

**Stakeholders offered several other ideas to help improve how the state's economic development initiatives are administered.** Their suggestions and comments included:

- Simplifying program paperwork. One business official commented that "the hoops companies have to jump through are ridiculous."
- Increasing efforts to promote the state as a good business location. One stakeholder commented that the state's marketing budget is "embarrassingly low."
- Improving and consolidating the information about all available programs and incentives into a good website.
- Increasing efforts to disseminate program information (especially to smaller companies).

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## **Conclusion**

*Kansas appears to have an appropriate mix of economic development incentives. Although Kansas and other comparison states configure their programs differently, all states aim to achieve similar economic goals using similar funding mechanisms. Overall, Kansas stakeholders are pleased with the state's array of programs and incentives, particularly its newest programs, PEAK and JCF. That is largely because these programs provide businesses with fast and predictable cash which can be reinvested for further growth. Nevertheless, it is equally important to remember that other factors, such as an educated and skilled workforce, play a major role in businesses' decisions to locate or expand in Kansas. Stakeholders viewed the recent income tax rate reductions for individuals and certain entities favorably, but also expressed some uncertainty about whether the tax policy would be successful in the long run. Lastly, while numerous studies have shown that states must offer economic development incentives to remain competitive, it is critical for programs to be evaluated on a periodic basis to ensure those programs remain efficient and effective.*

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## **Recommendations**

None

## APPENDIX A

### Scope Statement

This appendix contains the revised scope statement approved by the Legislative Post Audit Committee for this audit. On July 10, 2012, the committee approved an audit requested by Senator Kultala and Senator Owens with three questions relating to economic development policies in Kansas. On May 10, 2013, the Legislative Post Audit Committee modified the original scope statement by eliminating the third question, designed to determine whether economic development contracts were written to address significant changes in company circumstances. The committee also added three additional questions, which are listed below as questions three, four, and five.

#### **Economic Development: Determining Which Economic Development Tools are Most Important and Effective in Promoting Job Creation and Economic Growth in Kansas**

Economic development activities in Kansas are incentivized in a variety of ways including state programs, tax credits, and tax exemptions. Economic development assistance is intended to result in outcomes such as job creation, job retention, and the growth of commerce and industry in the state.

In Kansas, most economic development programs and incentives are administered by the Department of Commerce and the Kansas Bioscience Authority. Economic development programs are funded through several sources including federal moneys, state Lottery and casino proceeds, and wage tax withholdings for certain employees. Additionally, state and local governments also incentivize economic development through forgone revenues including tax abatements, credits, and exemptions.

Our 2008 audit evaluating the impact of economic development programs identified a number of problems related to assessing the effectiveness of these programs and activities. Those problems included unavailable and unreliable data, difficulties in measuring economic growth, and linking business outcomes with specific economic development assistance. Nonetheless, academic literature suggests that economic development incentives must be offered to remain competitive with other states. Our audit also identified a measurable, although small, relationship between economic development spending and job and business growth in various counties.

Legislators have expressed interest in knowing which economic development programs and incentives are most helpful to participating businesses.

A performance audit in this area would address the following questions:

- 1. What economic benefits has Kansas realized as a result of the PEAK and HPIP tax incentive programs?** To answer this question, we would collect data on the PEAK and HPIP programs since 2009, including which companies have participated and how much they've claimed in tax credits through these programs. For both programs, we would select a sample of participating companies to evaluate the effects of the programs on either job creation, or capital and employee education expenditures. For a sample of companies participating in the PEAK program, we would determine how many jobs the program has created, where those jobs have come from, and how much state revenue has

been forfeited to create those jobs. In addition, we would determine how the recent statutory changes are likely to affect the PEAK program, both in terms of forecasted jobs and costs. For a sample of companies participating in the HPIP program, we would compare capital and employee education expenditures before and after receiving HPIP tax credits and exemptions to determine the program's likely effect. We would perform additional work in this area as needed.

2. **Does the Department of Commerce adequately enforce performance clauses for economic development incentive programs?** To answer this question, we would create an inventory of programs administered by the department intended to create and retain jobs or enhance capital investments in Kansas. We would determine whether those programs have specific requirements for creating or retaining a certain number of jobs in return for financial assistance. We would review department policies and procedures and interview department staff to determine how they determine whether companies receiving assistance met program requirements. Further, we would determine how often the department has recouped money through performance clauses over the past five years. For a sample of incentive contracts, we would determine whether required performance measurements had been met, and if not, whether the department appropriately recouped money it was owed. We would perform additional work in this area as needed.
3. **Which programs and incentives do companies and other stakeholders think are most useful in enhancing Kansas' economic development?** To answer this question, we would review relevant literature, previous economic development audits, and economic development studies to determine what they show about the effectiveness of certain types of economic development spending. Further, we would work with Department of Commerce and Kansas Bioscience Authority staff to identify companies that have received economic development assistance in the past several years. We would survey company management to determine which incentives they think have been most and least useful in helping them succeed—including assistance that has recently been discontinued such as enterprise zones. If possible, we would interview management for a sample of those companies to better understand how economic development assistance has affected the companies' strategic decisions and its continued growth or stability. We would also interview corporate site consultants, local chamber executives, city managers, and economic development specialists to get their perspective on these issues (including their opinion on the potential effect of recent statutory tax changes on major economic development programs). We would perform additional work in this area as necessary.
4. **Does Kansas have the modern economic development programs and tools necessary to succeed in today's highly competitive global economy compared to other states?** To answer this question, we would contact officials in other states to determine what types of programs they have that provide monetary benefits similar to those provided by the Promoting Employment Across Kansas (PEAK) program and the Kansas Job Creation Fund (JCF). For those programs, we would work with those officials to understand the history, eligibility requirements, funding levels, and intended outcomes of those programs. Moreover, to the extent possible, we would collect summary information on what those programs have accomplished in recent years. Finally, we would work with Department of Commerce and Kansas Bioscience Authority officials to collect the same information for Kansas programs. We would perform additional work in this area as necessary.

- 5. Has the implementation of major Kansas economic development programs been successful?** To answer this question, we would work with the Legislative Research Department and the Revisor of Statutes to summarize the legislative intent of major economic development programs in Kansas. Further, we would work with Department of Commerce and Kansas Bioscience Authority officials to collect various measures of economic impact for those major programs. Potential measures would include the total number of jobs created, retained, or relocated from other states. To the extent that data was available, we would also evaluate the compensation and education levels for those jobs and any capital improvements made to accommodate them (e.g. new offices). We would also work with state officials to determine how stable those jobs have been over time (e.g. what proportion of jobs created five years ago still exist). Further, we would estimate the potential effect of the jobs these programs facilitate on local government sales and property taxes. Using program funding levels, we would calculate the net cost of jobs created, retained, or relocated through these programs before and after any relevant withholdings, credits, or exemptions expire. We would perform additional work in this area as necessary.

**Estimated Resources:** 4 LPA staff

**Estimated Time:** 11 months (a)

- (a) *From the audit start date to our best estimate of when it would be ready for the committee. This time estimate includes a two-week agency review period.*

**Note:** The Legislative Post Audit Committee directed us to perform this audit in three parts. Part 1 addressed questions one and two of the scope statement and that report was released in September 2013. This audit is Part 2, and covers questions three and four. Part 3, which will answer the scope statement's fifth question, will be completed in 2014.



## APPENDIX B

### **Many States Offer Tax and Non-Tax Financial Incentives to Promote Economic Development**

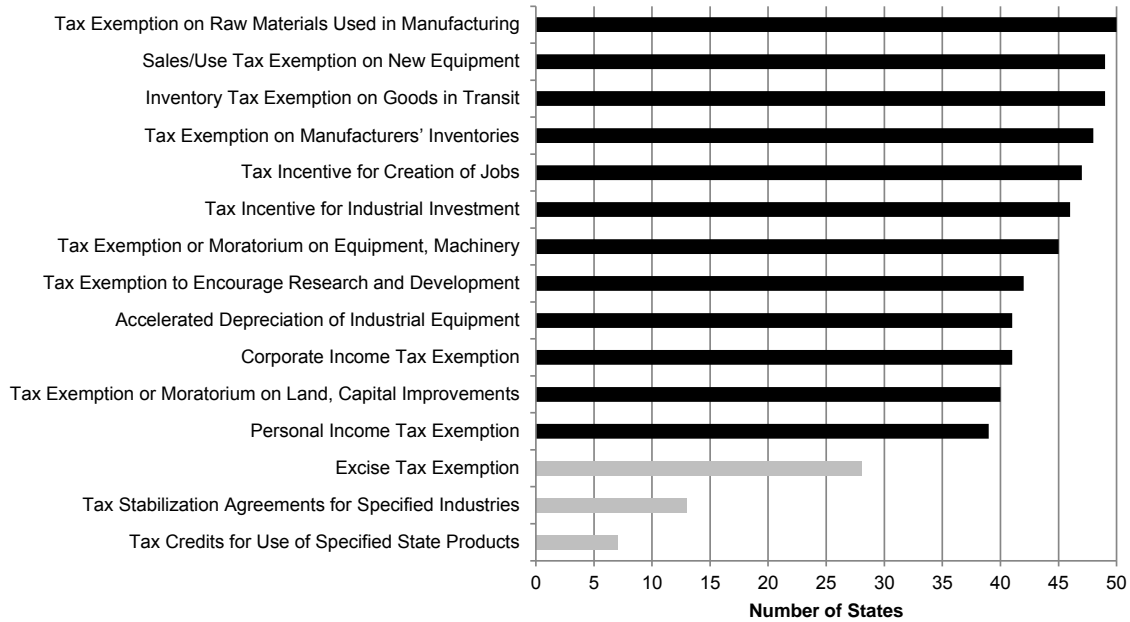
This appendix graphically summarizes two charts contained in The Council of State Governments' September 2013 report entitled, *Chairman's Report: State Business Incentives*. The graphs illustrate that Kansas and many other states offer a number of tax and non-tax financial incentives to businesses as a way to promote economic development. The original source of this data was a survey conducted by Site Selection Magazine.

We contacted Site Selection Magazine officials and asked them about their data collection procedures. Each year they send a copy of the most recent year's charts to a contact person in each state and ask the contact person to update the information as necessary. Site Selection Magazine officials told us they do not provide any supplemental materials along with the charts, such as instructions or definitions of the terms used.

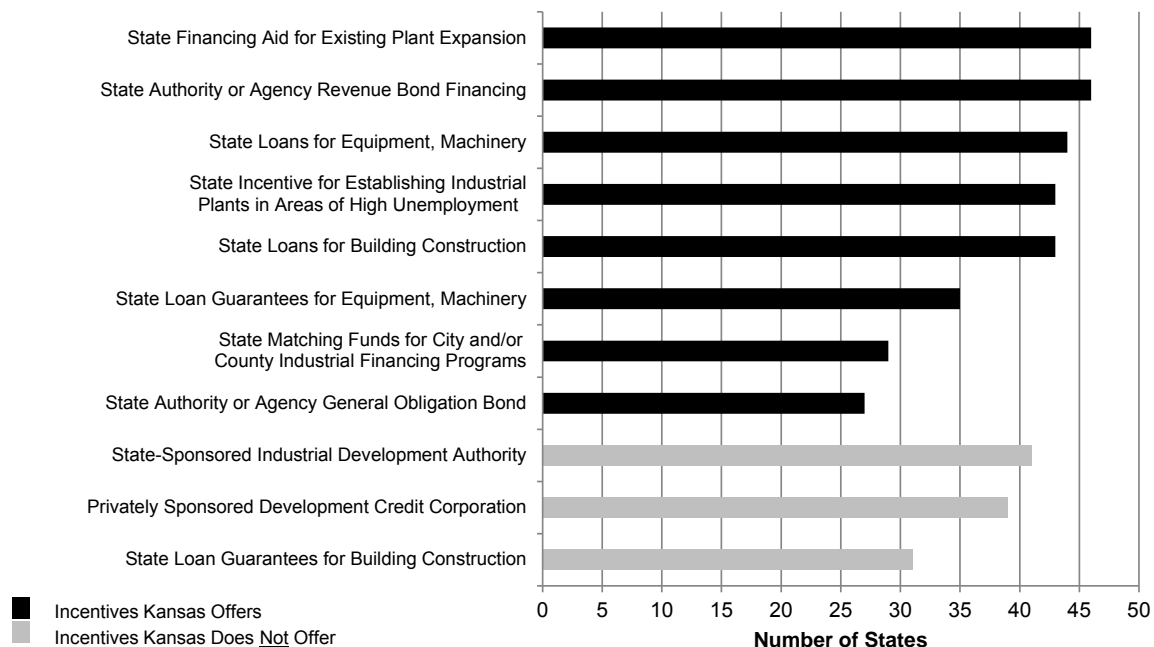
As a result, these data should be considered as a general indicator of the number of states offering various incentives, and should not be considered absolute fact.

**Appendix B**  
**Number of States Offering Select Tax and Non-Tax Financial Incentives**  
**to Promote Economic Development (a)**

**TAX INCENTIVES**



**NON-TAX FINANCIAL INCENTIVES**



(a) States have considerable discretion in completing the data collection document. For this reason, the data shown above should be considered as a general indicator of the number of states offering various incentives, and should not be considered absolute fact.

Source: LPA analysis of unaudited data gathered by Site Selection Magazine, 2012.



## APPENDIX C

### **Description and Results of Kansas' and Other States' Major Economic Development Programs**

This appendix summarizes the major economic development programs in Kansas and five other states and presents certain program results data.

- The first table (beginning on page 28) includes descriptive information (funding mechanisms, industry restrictions, benefit periods, and funding limits) for each of the 38 major programs included in our state comparisons.
- The second table (beginning on page 36) shows certain results (jobs created or retained, capital investments, and amount of incentives) for the major programs in Kansas, Texas, and North Carolina. (This information was not available for Indiana, Missouri, and Oklahoma.)

We used a combination of approaches to compile the information. First, we briefly reviewed each state's website for any published program information and economic development results data and to identify a contact person in each state. Then, we requested our state contacts to review and revise that information as necessary. If we were not able to locate results data, we asked our state contacts to provide the information using readily available data. It is also important to note the results listed in the second figure cover different time periods and in some cases include estimated or projected information rather than actual data.

As a result, these data should be considered a general indicator of the program information and results of states' major economic development programs, and should not be considered absolute fact.

Appendix C Description of Major Economic Development Programs in Kansas and Other States					
Economic Development Program	Description	Funding Mechanism (a)	Industry Restrictions	Benefit Period	Funding Limits
<b>KANSAS</b>					
Promoting Employment Across Kansas (PEAK)	Allows companies to retain 95% of state withholding taxes for eligible employees in exchange for locating, expanding, or retaining business operations in Kansas.	Cash or Cash Equivalent Funds	Bioscience companies cannot qualify and certain other industries (retail, restaurants, public admin., etc.) cannot qualify unless company is a headquarters or administrative/back office.	5 to 10 years	The annual cap on the cumulative amount of PEAK funds authorized to expanding companies is \$6 million and to retention companies is \$1.2 million in FY 2013, \$2.4 million in FY 2014, and \$1.2 million in FY 2015.
High Performance Incentive Program (HP/IP)	Provides an income tax credit to companies that make eligible capital investments and training expenditures. It also provides a sales tax exemption that a company can use in conjunction with its capital investment.	Corporate Tax Waiver	To qualify, a company must be a manufacturer or prove that most of its sales are to Kansas manufacturers and/or out-of-state businesses or government agencies. Headquarters or back offices can qualify in any industry.	N/A	None
Kansas Industrial Training (KIT)	Reimburses participating companies for eligible training expenditures such as instructor salaries, curriculum development, and materials. The program is intended to help new and expanding companies train employees for new jobs (i.e. pre-employment, classroom, and on-the-job training).	Cash or Cash Equivalent Funds	Priority is given to "Kansas Basic Industries" which include industries such as manufacturing, multi-state wholesale distribution, agriculture, R&D, and tourism.	Training contract is up to 12 months	None
Kansas Industrial Retraining (KIR)	Reimburses participating companies for eligible training expenditures such as instructor salaries, curriculum development, and materials. The program is intended to help companies that are restructuring or retraining (i.e. upgrading existing technology, incorporating new technology, diversifying production, developing new product) from having to lay off current employees because of obsolete or inadequate job skills.	Cash or Cash Equivalent Funds	Priority is given to "Kansas Basic Industries" which include industries such as manufacturing, multi-state wholesale distribution, agriculture, R&D, and tourism.	Training contract is up to 12 months	None
Job Creation Program Fund (JCF)	A closing fund that companies can use for an array of items associated with such things as expanding an existing business, locating a new business in Kansas, preventing the reduction of a major business, or training or retraining workers.	Cash or Cash Equivalent Funds and Financial Assistance	Priority is given to "Kansas Basic Industries" which include industries such as manufacturing, multi-state wholesale distribution, agriculture, R&D, and tourism.	Varies, but typically about 5 years	The annual cap on the cumulative amount of JCF funds granted is \$10 million.
Direct Equity Investment Program	Provides direct equity investments into high-growth-potential bioscience startups and companies through collaboration with private and accredited investors.	Cash or Cash Equivalent Funds	The incentive is available to bioscience companies in select NAICS codes only.	N/A	Funding limits are deal specific and related to milestones.

Appendix C Description of Major Economic Development Programs in Kansas and Other States					
Economic Development Program	Description	Funding Mechanism (a)	Industry Restrictions	Benefit Period	Funding Limits
<b>MISSOURI</b>					
Missouri Works Program	Provides funds to new and existing companies that create/expand/retain quality jobs in Missouri. The program is made up of six different components, each having its own set of eligibility criteria and benefits. The benefits provided to a company are the retention of state withholding taxes and/or refundable, transferable tax credits. The amount of the benefit is calculated as a percentage of the payroll associated with new jobs.  Companies that qualify under three of the six program components (Statewide Works and both Mega Works) can receive additional discretionary incentives up to a maximum of 9% of new payroll.	Cash or Cash Equivalent Funds  and  Corporate Tax Waiver	Certain industries cannot qualify for the program (such as gambling, some retail trade, educational services, and religious organizations) unless the company is a headquarters, administrative, or R&D office.	5 years (or 6 years for companies that have existed in Missouri for at least 10 years)	There is no annual limit on the state withholding taxes companies can retain for new jobs. The retention of state withholdings for retained jobs is limited to \$6 million in each fiscal year beginning with FY 2014.  The tax credits issued to all companies cannot exceed \$106 million in FY 2014, \$111 million in FY 2015, and \$116 million in FY 2016 and future years.
Business Use Incentives for Large-Scale Development (BUILD)	Provides financing to new and expanding companies to help offset the costs of qualified capital investments associated with large business projects. Bonds are issued for a minimum of \$500,000 and can be used to finance public or private infrastructure to support the project or new capital improvements at the project location. A company's loan payments and other annual fees are considered job development assessment fees. The company can claim a refundable income tax credit for the amount of such fees.	Corporate Tax Waiver  and  Financial Assistance	Certain industries cannot qualify for the program (such as retail, health or professional services) nor can intra-state relocations or replacement facilities.		The amount of financing provided is limited to 5% of the gross wages of each employee employed in a new job (or 10% if the project is located in a distressed community).
Missouri Customized Training Program (MCTP)	Provides funds to new and existing companies that train/retrain new and existing employees through company specific training. These funds are administered by the Missouri Division of Workforce Development and implemented by local educational institutions.	Cash or Cash Equivalent Funds			
Missouri Community College New Jobs Training Program	Provides funds to new and existing companies that train new employees through specialized training, adult basic education, on-the-job training, or occupational skills training. These funds are jointly administered by the Missouri Division of Workforce Development and the state's community colleges.	Cash or Cash Equivalent Funds	Only companies engaged in manufacturing, processing or assembling products, R&D, or providing services of interstate commerce are eligible. Retail companies cannot qualify.		
Missouri Community College Job Retention Training Program	Provides funds to companies that retrain existing employees through specialized training, adult basic education, on-the-job training, or occupational skills training. These funds are jointly administered by the Missouri Division of Workforce Development and the state's community colleges.	Cash or Cash Equivalent Funds	Only companies engaged in manufacturing, processing or assembling products, R&D, or providing services of interstate commerce are eligible.		

Appendix C Description of Major Economic Development Programs in Kansas and Other States					
Economic Development Program	Description	Funding Mechanism (a)	Industry Restrictions	Benefit Period	Funding Limits
<b>MISSOURI CONTINUED</b>					
Missouri TechLaunch	Provides pre-seed funding to start-up companies or relocating headquarters that leverage resources at Missouri's research universities and organizations (generally companies at this stage have not exceeded total debt and equity financing of \$250,000). The funds can be used for intellectual property development and evaluation, conducting competitive analysis, establishing proof of concept of a scientific discovery, and prototype design and development. Awards are made in the form of equity or convertible debt.	Cash or Cash Equivalent Funds			Individual awards cannot exceed \$100,000.
Seed Capital Co-Investment Program (SeedCap)	Provides seed funding to start-up companies or relocating headquarters (generally companies at this stage have not exceeded total debt and equity financing of \$1.5 million). The funds can be used for advanced intellectual property development and evaluation, conducting competitive analysis, advanced proof of concept of a scientific discovery, advanced prototype design and development, R&D to attract venture capital financing, and hiring personnel. Awards are made in the form of equity or convertible debt.	Cash or Cash Equivalent Funds			Individual awards cannot exceed \$500,000.
Venture Capital Co-Investment Program (VCCI)	Provides funding to start-up companies or relocating headquarters. The funds can be used for advanced intellectual property development and evaluation, conducting competitive analysis, advanced proof of concept of a scientific discovery, advanced prototype design and development, R&D to attract additional venture capital or capital markets financing, and hiring personnel. Awards are made in the form of equity or convertible debt.	Cash or Cash Equivalent Funds			Individual awards cannot exceed \$2.5 million.
High-Tech Industrial Expansion Program (HTIE)	Provides funding to companies or relocating headquarters. The funds can be used for purchasing equipment, facilitating construction, and hiring personnel. Awards are generally made in the form of a secured low-interest loan.	Financial Assistance			Individual awards cannot exceed \$3.0 million.
Missouri Building Entrepreneurial Capacity (MOBEC)	Provides strategic investments to nonprofit research institutions and organizations that expand the support system for entrepreneurs that are commercializing new technologies or that enhance the capacity of Missouri to grow its innovation economy.	Cash or Cash Equivalent Funds			Individual awards cannot exceed \$500,000.

Appendix C Description of Major Economic Development Programs in Kansas and Other States					
Economic Development Program	Description	Funding Mechanism (a)	Industry Restrictions	Benefit Period	Funding Limits
<b>TEXAS</b>					
Texas Enterprise Fund	Provides a cash grant to new or expanding companies that intend to create jobs and make a significant capital investment and that are deciding between locating/expanding in Texas or another state.	Cash or Cash Equivalent Funds	Retail projects are not eligible and preference is given to advanced technology manufacturing.	N/A	None
Texas Emerging Technology Fund	Provides a cash grant to new and expanding companies that develop and commercialize new and emerging technologies and educational institutions that recruit talented researchers.  Grants are awarded in 3 areas: 1. Commercialization: provide early-stage investments in new, technology-based, private entrepreneurial companies that collaborate with public or private institutions of higher education. 2. Matching: provide funds to companies that leverage public-private partnerships such as universities, the federal government, and industry. 3. Research Superiority Acquisition: provide funds to TX educational institutions to recruit talented researchers.	Cash or Cash Equivalent Funds	Limited to emerging technology industries (i.e. semiconductors and biotechnology)	N/A	None
Texas Enterprise Zone Program	Provides state sales and use tax refunds to companies (that partner with local communities) for qualified expenditures. The program is intended to assist economically distressed areas of the state. The amount of the refund depends on the capital investment that is made and the jobs that are created. The maximum potential refund ranges from \$25,000 to \$3.75 million.	Corporate Tax Waiver	None	1 to 5 years	The maximum potential refund is capped anywhere from \$25,000 to \$3.75 million based on six tiers of capital investment and job creation. The state may designate up to 105 enterprise projects each biennium.
Skills Development Fund	Provides a grant to community and technical colleges to provide job training for companies that want to train or retrain new or existing employees. Companies partner with a public community or technical college to develop the training. The college administers the grant, which covers the cost of the training for the business. In FY 2012, the average award was \$448,834.	Cash or Cash Equivalent Funds	None	N/A	Grants for a single business may be limited to \$500,000. The Skills Development Fund has \$48 million over the next two fiscal years.

Appendix C Description of Major Economic Development Programs in Kansas and Other States					
Economic Development Program	Description	Funding Mechanism (a)	Industry Restrictions	Benefit Period	Funding Limits
<b>INDIANA</b>					
Economic Development for a Growing Economy (EDGE) Tax Credit	Provides a refundable corporate income tax credit to companies that support job creation, capital investment, and improve the standard of living in the state. The tax credit is calculated as a percentage of the tax withholdings associated with new jobs.	Corporate Tax Waiver	None	Up to 10 years	None
Skills Enhancement Fund (SEF)	Provides a reimbursable grant to companies that train and upgrade the skills of new and existing employees. The amount of the grant is typically 50% of eligible training costs.	Cash or Cash Equivalent Funds	None	The grant can be provided over a period of 2 years from the commencement of the project.	None. However, it is limited to the funds available which are obtained through state budget appropriations.
Hoosier Business Investment (HBI) Tax Credit	Provides a non-refundable corporate income tax credit to companies that support job creation, capital investment, and improve the standard of living in the state. The tax credit is calculated as up to 10% of any eligible capital investments.	Corporate Tax Waiver	None	Up to 10 years	2013 imposes a \$50 million annual cap on awards. Prior to 2013 there was no limit.
Headquarters Relocation Tax Credit (HRTC)	Provides a tax credit to companies that relocate their headquarters to Indiana. The amount of the tax credit can be up to 50% of the moving costs a company incurs as a result of relocating to Indiana. Headquarter facilities must meet certain criteria such as having annual revenue of at least \$50 million and 75 employees in Indiana.	Corporate Tax Waiver	None	Negotiated	None
Industrial Recovery Tax Credit	Provides a tax credit to companies that make significant investments in rehabilitating or remodeling former industrial facilities. The tax credit is calculated as a percentage of the qualified investment based on three tiers and ranges from 15% to 25%. The credit can be used by employers, developers, and others with priority given to applicants that create new, full-time jobs or lease the facilities to an employer that will create new jobs.	Corporate Tax Waiver	None	Negotiated	None

Appendix C Description of Major Economic Development Programs in Kansas and Other States					
Economic Development Program	Description	Funding Mechanism (a)	Industry Restrictions	Benefit Period	Funding Limits
<b>INDIANA CONTINUED</b>					
21st Century Research & Technology Fund	Provides direct investments to early-stage entrepreneurial companies that need help solving capital formation issues (i.e. product demonstration and market penetration). The fund is managed by Elevate Ventures, a nonprofit organization that utilizes federal and state funds. Funds from the 21st Century Fund are co-invested alongside institutional investors.	Cash or Cash Equivalent Funds	None. Although investments typically go to life sciences, high technology, and advanced manufacturing companies.	Negotiated	None. However, it is limited to the funds available which are obtained through state budget appropriations.
Venture Capital Investment Tax Credit	Provides a non-refundable tax credit of 20% (up to \$1 million per company) to investors who provide qualified debt or equity capital to qualified Indiana companies.	Corporate Tax Waiver	None. Although investments typically go to life sciences, high technology, and advanced manufacturing companies.	Investor must make investment within 2 years, after which the credit can be claimed up to the 5-year carry forward.	Annual program cap of \$12.5 million. Investors may invest into unlimited companies, up to \$1 million per company.
<b>NORTH CAROLINA</b>					
Job Development Investment Grant (JDIG)	Provides an annual grant to new and expanding companies in the amount of 10% to 75% of the withholding taxes for new employees.	Cash or Cash Equivalent Funds	Retail facilities, warehouse facilities that serve only retail facilities, and professional or semi-professional sports teams or clubs cannot qualify.	Up to 12 years	The total amount paid to all qualified companies cannot exceed \$15 million in one year. The maximum number of grants that can be awarded in one year is 25. The amount per position per year cannot exceed \$6,500.
One North Carolina Fund	Provides financial assistance to local governments for use in recruiting, expanding, or retaining new and existing companies that recruit and expand quality jobs in value-added, knowledge-driven industries. The money can be used by the local government for such things as purchasing equipment, renovating existing buildings, and improving existing utility distribution lines.	Cash or Cash Equivalent Funds	None	Up to 3 years	The amount of funding committed to all qualified companies cannot exceed \$14 million in one fiscal year.
Incumbent Workforce Development Program (IWDP)	Provides funding to companies that implement a layoff aversion strategy through training of its incumbent workers. The funds can be used to address employees' skills gaps through occupational skills training or educational training.	Cash or Cash Equivalent Funds	None	Companies have up to 1 year to complete the qualified training activities.	The maximum amount per grant is \$25,000 with a lifetime funding limit of \$40,000 per company (for grants after July 1, 2008). Collaborative applications are an exception and have different funding limitations.
North Carolina Biotechnology Center Economic Development Award	Performance-based grants to existing or relocating life science companies to expand space and/or purchase equipment. Grants are tied to job creation or retention milestones, and include clawback provisions in case a company does not meet performance targets.	Cash or Cash Equivalent Funds	Funding is available only for life science companies.	Grant provided up front, milestones tracked over 3 years.	The annual maximum any one company may receive in any one year is \$100,000.

Appendix C Description of Major Economic Development Programs in Kansas and Other States					
Economic Development Program	Description	Funding Mechanism (a)	Industry Restrictions	Benefit Period	Funding Limits
<b>NORTH CAROLINA CONTINUED</b>					
Company Inception Loan (CIL)	Provides funds to start-up and early-stage life science companies that have a significant operating presence in North Carolina and are engaged in R&D or manufacturing of a product or technology with commercial potential. Funds are provided as a 3-year loan with an interest rate equal to the current prime rate plus 3%.	Financial Assistance	Funding is available only for life science companies.	Loan funds a project that typically lasts up to 1 year.	The maximum loan size is \$50,000.
Small Business Research Loan (SRL)	Provides funds to life science companies that have a significant operating presence in North Carolina and are engaged in R&D or manufacturing of a product or technology with commercial potential. The funds are to help companies with research to advance development of commercially viable technologies and position the company to obtain additional funding from private and public sources. Funds are provided as a 3-year loan with an interest rate equal to the current prime rate plus 3%.	Financial Assistance	Funding is available only for life science companies.	Loan funds a project that typically lasts up to 1 year.	The maximum loan size is \$250,000.
Strategic Growth Loan (SGL)	Provides funds to life science companies that have a significant operating presence in North Carolina and are engaged in R&D or manufacturing of a product or technology with commercial potential. Matching funds are required from angel or venture capital funds. The funds are to help position the company to obtain additional funding from private investors. Funds are provided as a 3-year loan with an interest rate equal to the current prime rate plus 3%.	Financial Assistance	Funding is available only for life science companies.	Loan funds a project that typically lasts up to 1 year.	The maximum loan size is \$250,000.
<b>OKLAHOMA</b>					
Quality Jobs Program	Allows companies that create new, quality jobs to receive quarterly cash payments of up to 5% of new taxable payroll for locating or expanding in Oklahoma. Payments for most businesses will be about 4% of payroll.	Cash or Cash Equivalent Funds	Companies can qualify if they are in a basic industry (i.e. manufacturing, R&D, technical services) or a service industry (i.e. motor freight transportation and warehousing, transportation of freight or cargo, certain communications services).	Up to 10 years	None
Small Employer Quality Jobs Program	Allows small businesses (90 employees or less) to receive quarterly cash payments of up to 5% of new taxable payroll for locating or expanding in Oklahoma.	Cash or Cash Equivalent Funds	Companies can qualify if they are in a basic industry (i.e. manufacturing, R&D, technical services) or a service industry (i.e. motor freight transportation and warehousing, transportation of freight or cargo, certain communications services).	Up to 7 years	None



Appendix C Description of Major Economic Development Programs in Kansas and Other States					
Economic Development Program	Description	Funding Mechanism (a)	Industry Restrictions	Benefit Period	Funding Limits
OKLAHOMA CONTINUED					
21st Century Quality Jobs	Allows companies with high wage, high skill jobs (annual wage at least 300% of state wage (currently \$102,300) or 300% of average wage in county of location, whichever is less) to receive quarterly cash payments of up to 10% of new taxable payroll for locating or expanding in Oklahoma.	Cash or Cash Equivalent Funds	Companies can qualify if they are in a basic industry (i.e. manufacturing, R&D, technical services) or a service industry (i.e. motor freight transportation and warehousing, transportation of freight or cargo, certain communications services).  Includes same industries as Quality Jobs Program except: oil & gas, spectator sports, and real estate industries are restricted and specialty hospitals, performing arts, heavy and civil engineering, motion picture, and several other industries are included.	Up to 10 years	None
Aerospace Engineer Workforce Tax Credit	Provides an income tax credit to individuals (engineers) and the aerospace companies that hire them. The employer can receive a tax credit for compensation paid and tuition reimbursement. The annual compensation income tax credit is equal to 10% of the compensation paid to qualified graduates of Oklahoma institutions and 5% to graduates of non-Oklahoma institutions. The annual tuition tax credit is equal to 50% of the tuition reimbursed to employees.	Corporate Tax Waiver	Only aerospace companies can qualify.	Up to 5 years (employee tax credit and employer tax credit for compensation)  Up to 4 years (employer tax credit for tuition)	Employee tax credit is limited to \$5,000 per year for a maximum of 5 years.  Employer tax credit for compensation is limited to \$12,500 per employee per year.  Employer tax credit for tuition is limited to 50% of the average annual tuition at a qualified program at a public Oklahoma institution.
(a) We categorized funding mechanisms as one of three options: a corporate tax waiver, cash or cash equivalent funds, or financial assistance. A corporate tax waiver includes things like credits, exemptions, refunds, abatements, preferential rates, and rebates. <u>Cash or cash equivalent funds</u> includes things like reimbursements, grants, and forgone employee withholding taxes. <u>Financial assistance</u> includes things like loans and bonds. Source: LPA summary of program information obtained from the Kansas Department of Commerce, Kansas Bioscience Authority, and other states (unaudited).					

Appendix C Results Data for Major Economic Development Programs in Kansas, Texas, and North Carolina (a)						
Economic Development Program	Most Recent Year		Preceding Year		Results (Jobs, Capital Investment, etc.)	
	12-Month Period	Amount of Incentives Provided by State	Results (Jobs, Capital Investment, etc.)	12-Month Period		Amount of Incentives Provided by State
KANSAS						
Promoting Employment Across Kansas (PEAK)	FY 2011	\$5.0 M	Jobs Created/Retained/Trained: 2,000 Capital Investment: \$75 M (estimated) Total Payroll: \$132.3 M Estimated Indirect Jobs: 2,892 Estimated Indirect Income: \$133.9 M	FY 2010	\$95,300	Jobs Created/Retained/Trained: 193 Capital Investment: \$21.8 M (projected 5-year) Total Payroll: \$3.3 M Estimated Indirect Jobs: 122 Estimated Indirect Income: \$1.8 M
	Tax Year 2010	\$21.0 M	Jobs Created/Retained/Trained: 6,857 Capital Investment: \$310.1 M Additional Revenue Generated: \$443.7 M Additional Sales Generated: \$2,735.0 M Additional Payroll Generated: \$60.1 M	Tax Year 2009	\$33.2 M	Jobs Created/Retained/Trained: 3,505 Capital Investment: \$310.1 M Additional Revenue Generated: \$175.3 M Additional Sales Generated: \$2,537.6 M Additional Payroll Generated: \$61.8 M
Kansas Industrial Training (KIT)	FY 2014	\$1.9 M (encumbered)	Information not provided	FY 2013	\$2.0 M (encumbered)	Information not provided
Kansas Industrial Retraining (KIR)						
Job Creation Program Fund (JCF)	FY 2013	\$8.9 M	Total companies: 13	The first JCF agreement was signed in August 2012 (FY 2013), so there is no results information available for previous years.		
Direct Equity Investment Program	FY 2012	\$1.5 M	Total companies: 2	FY 2011	\$2.2 M	Total companies: 4
TEXAS						
Texas Enterprise Fund	FY 2013	\$50.6 M (committed)	Jobs Created/Retained/Trained: 7,874 (committed) Capital Investment: \$4.5 B (committed) Total Projects Funded: 18	FY 2012	\$27.1 M (committed)	Jobs Created/Retained/Trained: 4,968 (committed) Capital Investment: \$2.5 B (committed) Total Projects Funded: 8
Texas Emerging Technology Fund	FY 2013	\$47.9 M (committed)	Jobs Created/Retained/Trained: 2,046 Total Projects Funded: 6	FY 2012	\$5 M (committed)	Jobs Created/Retained/Trained: 2,470 Total Projects Funded: 4
Texas Enterprise Zone Program	FY 2013	N/A	Jobs Created/Retained/Trained: 43,054 (committed) Capital Investment: \$5.5 B (committed) Total Projects Funded: 56	FY 2012	N/A	Jobs Created/Retained/Trained: 26,453 (committed) Capital Investment: \$5.1 B (committed) Total Projects Funded: 38
Skills Development Fund	FY 2012	\$22.4 M	Jobs Created/Retained/Trained: 19,840 Total Grants Funded: 50 Total Businesses Served: 111	FY 2011	\$14.6 M	Jobs Created/Retained/Trained: 11,510 Total Grants Funded: 43

Appendix C Results Data for Major Economic Development Programs in Kansas, Texas, and North Carolina (a)						
Economic Development Program	Most Recent Year		Year Preceding Most Recent Year			
	12-Month Period	Amount of Incentives Provided by State	Results (Jobs, Capital Investment, etc.)	12-Month Period	Amount of Incentives Provided by State	Results (Jobs, Capital Investment, etc.)
NORTH CAROLINA						
Job Development Investment Grant (JDIG)	CY 2012	\$134.7 M	Jobs Created/Retained/Trained: 15,829 (projected) Capital Investment: \$1 B (projected) Total grants awarded: 23 Estimated indirect jobs: 10,008	CY 2011	\$100.9 M	Jobs Created/Retained/Trained: 11,594 (projected) Capital Investment: \$788.1 M (projected) Total grants awarded: 22 Estimated indirect jobs: 7,639
One North Carolina Fund	FY 2012	\$14.1 M	Jobs Created/Retained/Trained: 17,016 (projected) Capital Investment: \$1.2 B (projected) Total grants awarded: 58	FY 2011	\$19.5 M	Jobs Created/Retained/Trained: 20,888 (projected) Capital Investment: \$1.2 B (projected) Total grants awarded: 62
Incumbent Workforce Development Program (IWDP)	Program Year 2011	\$360,000	Jobs Created/Retained/Trained: 470 Total companies: 29	Program Year 2010	\$1.4 M	Jobs Created/Retained/Trained: 2,000 Total companies: 75
North Carolina Biotechnology Center Economic Development Award	FY 2013	\$200,000	Jobs Created/Retained/Trained: 208 Capital Investment: \$142.6 M Estimated Indirect Jobs: 624 Total Estimated Employment Impact: 832	FY 2012	\$200,000	Jobs Created/Retained/Trained: 174 Capital Investment: \$13.4 M Estimated Indirect Jobs: 522 Total Estimated Employment Impact: 696
Company Inception Loan (CIL)	FY 2013	\$50,000	Total Companies Awarded Funds: 7	FY 2012	\$30,000	Total Companies Awarded Funds: 5
Small Business Research Loan (SRL)	FY 2013	\$1.3 M	Total Companies Awarded Funds: 8	FY 2012	\$795,000	Total Companies Awarded Funds: 5
Strategic Growth Loan (SGL)	FY 2013	\$250,000	Total Companies Awarded Funds: 3	FY 2012	\$250,000	Total Companies Awarded Funds: 2
(a) This table contains information for Kansas and two of the five other states we reviewed. That is because Texas and North Carolina were the only states that provided a comprehensive listing of program results. Source: LPA summary of program information obtained from the Kansas Department of Commerce, Kansas Bioscience Authority, and other states (unaudited).						

(a) This table contains information for Kansas and two of the five other states we reviewed. That is because Texas and North Carolina were the only states that provided a comprehensive listing of program results.  
(Source: LPA summary of program information obtained from the Kansas Department of Commerce, Kansas Bioscience Authority, and other states (unaudited))



## APPENDIX D

### Sample of Stakeholders' Comments About Economic Development by Topic

We asked stakeholders a number of questions about economic development. A few examples of their comments, grouped by topic, are paraphrased below.

#### **WITHHOLDING TAX INCENTIVE PROGRAM (PEAK PROGRAM)**

*...By offering this incentive, Kansas is keeping up with other states. I consider the program to be self-governing: Companies only get payroll taxes for created jobs. If companies do not keep the jobs, they do not get the money, and no labor intensive clawing back is necessary...*

*...The payroll incentive comes back to the company immediately so the company can reinvest the money into people and other things immediately...*

*...The PEAK program was designed to make Kansas more competitive and has done so. Now, we see hesitancy in the business community because businesses cannot predict what the benefits will be...*

#### **QUICK CASH**

*...PEAK is used by many of the companies I work with that are growing or relocating from outside. If businesses want to grow, PEAK is the only tool to do so while providing the company with flexible cash that can be used in any way businesses need. Cash is king. Tax credits are not cash. Some companies have difficulties getting money from tax credits...*

*...Any incentives that involve straight forward calculations to generate cash and directly affect the companies' profit and loss statements are most desired. This includes sales/property tax exemptions. Money in the company's pocket can be spent on other things...*

*...To this company, cash (reduction of cash outflow) is most important. Tax credits, withholding taxes, sales and property tax exemptions have helped this company become successful. Without those programs, the company may not have been able to expand or may have expanded elsewhere...*

#### **EMPLOYEE TRAINING**

*...From the perspective of this company, having a trained workforce is most important. The company invests a lot of money in Kansas every year which resulted in the company headcount almost doubling...*

*...Attracting and retaining employees is key for this company. This is so important that the company is talking to the Kansas Department of Education/universities to help ensure the workforce has training that matches company needs...*

*... To manufacture this company's product, access to a labor pool that is ready to go is crucial. Having a skilled labor pool means the business does not have to spend much on headhunters or advertising to get staff or to train staff...*

*...Science, Technology, Engineering, Mathematics (STEM) internship funding through the state would help attract/keep highly educated kids here...*

*... It is difficult to see the fiscal effect [to justify funding training/retraining programs]...*

*...Typically, companies want to do their own training... Southern states have done an excellent job in helping companies train employees for jobs involving few technical skills. In those states, this may be very important because those states do not want to lose these types of jobs. When jobs are highly technical, companies would rather stay independent and not receive any help from the state...*

## **APPENDIX E**

### **Agency Response**

On December 20, 2013 we provided copies of the draft audit report to the Department of Commerce and Kansas Bioscience Authority. Those agencies' responses are included in this appendix.

The agencies generally concurred with the report's findings and conclusions. The report did not include any recommendations. We made a few minor clarifications to the report as a result of the agencies' review of the draft report, but those changes did not affect any of our findings or conclusions.

Legal Section  
1000 S.W. Jackson St., Suite 100  
Topeka, KS 66612-1354

Pat George, Secretary



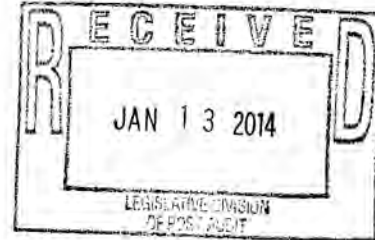
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Sam Brownback, Governor

January 8, 2014

Scott Frank  
Legislative Post Audit  
800 SW Jackson, Suite 1200  
Topeka, KS 66612



RE: Economic Development Audit, Part 2

Dear Mr. Frank:

Thank you for the opportunity to review and respond to the draft audit report related to *"Economic Development: Determining Which Economic Development Tools are Most Important and Effective in Promoting Job Creation and Economic Growth in Kansas, Part 2."* The Department of Commerce appreciates your staff's review of the state's economic development programs.

Although the Part 2 of the audit contained no findings, we found the analysis and survey results to be interesting. Generally, the results were as Commerce anticipated. We appreciated the professionalism of LPA staff on Part 2 of the audit.

If you have any questions, please let me know.

Sincerely,

Pat George  
Secretary





January 9, 2014

Scott Frank, Legislative Post Auditor  
Legislative Division of Post Audit  
800 Southwest Jackson Street, Suite 1200  
Topeka, Kansas 66612-2212

Dear Mr. Frank:

Thank you for providing a draft copy of part two of the economic development performance audit. We have reviewed the contents and do not recommend any changes regarding the broad description of historical and current KBA programming.

As a point of clarification regarding funding levels, we wish to note that should the legislature allocate additional resources to the Kansas Bioscience Authority, those dollars would be invested according to our new organizational objectives:

- Return on and of invested dollars
- Attraction of external private equity dollars into Kansas
- Commercialization of intellectual property
- Attraction and growth of economic-based jobs
- Increased exportation of products, goods and technology to global markets

This change represents a shift from previous models, which were heavily grant based, to a private sector approach that seeks to optimize the return on the state's investment in a way that will result in tangible growth in the sector while working towards self-sufficiency.

Once again, thank you for the opportunity to participate in this process, and review your findings. Please do not hesitate to contact me with further questions.

Sincerely,

Duane Cantrell  
CEO, Kansas Bioscience Authority