



MEMORANDUM

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TO: Members, Legislative Post Audit Committee
FROM: Scott Frank, Legislative Post Auditor
DATE: December 15, 2017
SUBJECT: Staff Proposal for Evaluating Tax Incentives

At the October 2017 meeting of the Post Audit Committee, members directed us to prepare a proposal for an ongoing review of the state's tax incentives by this office, including an estimate of the resources required. This memo outlines that proposal.

Background Information

In October 2017, our office released an audit comparing Kansas' process for evaluating its tax incentives to best practices from other states. As part of that audit we found the Pew Charitable Trusts had examined the evaluation practices of different states and identified three major criteria for evaluating tax incentives:

- States should have a formal policy that requires regular, systematic evaluation of all major tax credits and exemptions.
- Evaluations of tax incentives should address key questions regarding the costs and economic impacts of those incentives.
- States should have formal processes in place to ensure lawmakers consider the results of tax incentive evaluations.

We found that although Kansas maintains a comprehensive inventory of its tax credits and exemptions, it does not regularly evaluate its tax incentives to inform policy. Kansas does not have formal policies to systematically evaluate its major tax incentives, to evaluate the cost or economic impact of those incentives, and to ensure lawmakers consider the results of evaluations. By contrast, several other states, including Kansas' neighbors, met many of Pew's best practices.

Based on the audit findings, we recommended the Legislature develop a process to systematically evaluate tax incentives which aligned with Pew's best practices. In response to the audit, members of the Post Audit Committee directed us to estimate the resources required for this office to conduct the evaluations and prepare a proposal for the committee's consideration.

Summary of the Proposed Process

As directed by the Post Audit Committee, we have put together a proposal for what it would take for our office conduct regular evaluations of the state's tax incentives. Based on our analysis of Pew's best practices, we propose the following steps to comprehensively evaluate the state's tax incentives:

- **The Legislature needs to identify which tax incentives to include in an ongoing evaluation process.** During the 2018 session, tax committees should review all of the tax incentives and identify about 50 incentives for ongoing evaluation. The committees should consider information from the Department of Revenue, Legislative Research, previous Post Audit reports, and outside testimony in making their selections.
- **The Legislature would need to pass legislation to establish a special committee to review the incentives and to set up a five-year schedule for those reviews.** The special committee would meet during the interim to formally review the selected tax incentives based on a schedule. The schedule would include about ten incentives a year, with the first evaluations to be conducted during the 2020 interim. In crafting the legislation, the Legislature may want to specify the types of information it wants the committee to consider (such as the Post Audit reports described in the next bullet). It also may want to specify whether the committee should make a formal recommendation to keep or eliminate each incentive it reviews.
- **The Legislature should also establish an audit schedule in statute for Post Audit to evaluate the same tax incentives.** The legislation should specify the types of questions the Legislature wants answered about each incentive, such as the number of entities that use the incentive, the total taxes forgone, and the estimated economic impact of the incentive. The first audit in the audit schedule would be to determine if there is a clear purpose for each incentive, inventory the data available, and make recommendations for additional information to be collected to facilitate future audits. This audit would be due by the start of the 2019 session. After that, the audit schedule would mirror the Legislature's schedule for reviewing the incentives (previous bullet), with audits due by the start of the 2020 through 2024 sessions.
- **The Legislature would repeat the entire evaluation process in 2024, and every five years thereafter, to set a new schedule for legislative reviews and audit reports.** For example, in 2024 the Legislature would set the schedule for 2025 through 2029.
- **To staff the audits, the Legislature would create a new five-person tax incentives audit team within Post Audit.** This would be similar to the five-person school audit team the Legislature created and funded from 2005 to 2010. We would suggest phasing in the new staffing, adding 3.0 FTE during FY 2019 and the other 2.0 FTE during FY 2020. The annual cost of the five-person team would be approximately \$450,000.