



PERFORMANCE AUDIT REPORT

**Economic Development: Determining the
Amounts the State Has Spent on
Economic Development Programs and the
Economic Impacts on Kansas Counties**

Executive Summary
with Conclusions and Recommendations

A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
August 2008

Legislative Post Audit Committee

Legislative Division of Post Audit

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August 26, 2008

To: Members of the Kansas Legislature

This executive summary contains the findings and conclusions, together with a summary of our recommendations and the agency responses from our completed performance audit, *Economic Development: Determining the Amounts the State Has Spent on Economic Development Programs and the Economic Impacts on Kansas Counties*.

This report also contains appendices showing the estimated total cost of economic development that's attributable to Kansas counties, the estimated amount of forgone tax revenue, the estimated amount of cash payments to companies for economic development purposes by county, a summary of economic development income tax credits, reported agency accomplishments, a summary of Kansas GDP for the years 2000 through 2006, and others.

This report includes one recommendation for the Kansas Technology Enterprise Corporation. We would be happy to discuss the findings presented in this report with any legislative committees, individual legislators, or other State officials. These findings are supported by a wealth of data, not all of which could be included in this report because of space considerations. These data may allow us to answer additional questions about the audit findings or to further clarify the issues raised in the report.

If you would like a copy of the full audit report, please call our office and we will send you one right away

A handwritten signature in black ink that reads "Barbara J. Hinton". The signature is fluid and cursive.

Barbara J. Hinton
Legislative Post Auditor

EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

Question 1: How Much State, Federal, and Local Money Has Been Spent on Economic Development Programs During the Past Five Years?

A 2007 report by Kansas, Inc. showed that Kansas' spending for economic development generally falls in the middle when compared to five neighboring states. That study focused on economic development expenditure data for the period from 1989 through 2007. Although the study provided useful comparative state spending information for Kansas and its neighboring states, it didn't fully address the questions for this audit, and as a result, we didn't use that report's information.

We established a definition of economic development and set limits on the data we could collect. We defined economic development as activities whose primary purpose is to stimulate the Kansas economy, expand or maintain employment opportunities within the State, or encourage the establishment and growth of commerce and industry in the State. We collected expenditure data from five State agencies whose primary mission includes economic development—Kansas Department of Commerce, Kansas Technology Enterprise Corporation, Kansas, Inc., Kansas Bioscience Authority, and the Kansas Small Business Development Center. We did not attempt to collect expenditure data from local governments.

We also used Department of Revenue and Department of Commerce data to compile estimates about the amount of tax revenues forgone at the State and local levels for economic development purposes. We didn't attempt to verify the reliability of the self-reported spending and forgone revenue data that State and local governments provided to us, as well as the other agency data we used to develop our estimates of forgone revenues. The number of entities reporting data and the amount of data we collected made that task impractical.

However, we did work extensively with Department of Commerce staff after the initial report covering questions 1 and 2 of this audit was released to develop a revised estimate of the Department's expenditures. The revision was necessary because the Department's expenditure data initially included some funding that didn't meet our definition of economic development, and had not been allocated correctly between federal, State, and other sources of funding. The figures in the current report, which covers questions 1 through 3, have incorporated those revisions.

Throughout this report, we refer to the combination of spending and forgone revenues as the "cost" of economic development.

The estimated cost of economic development in Kansas for the past five years has been at least \$1.3 billion. The table below shows the costs—both expenditures and forgone revenues—that we identified in this audit.

Estimated Costs of Providing Economic Development Fiscal Years 2003 through 2007 (in millions)		
Agency or Economic Development Program	Amount	% of Total
Self-Reported Agency Expenditures (a)		
Department of Commerce (b)	\$367.1	27.9%
Kansas Technology Enterprise Corporation (KTEC)	\$70.0	5.3%
Kansas Small Business Development Center	\$8.7	0.7%
Kansas Bioscience Authority (c)	\$5.8	0.4%
Kansas, Inc.	\$1.8	0.1%
Subtotal of State Agency Expenditures (d)	\$453.4	34.5%
Forgone Revenues Identified by LPA (e)		
Industrial Revenue Bond Exemptions	\$349.7	26.6%
State Income Tax Credits	\$137.6	10.5%
Sales Tax and Revenue (STAR) Bonds	\$131.2	10.0%
Property Tax Abatements	\$113.7	8.7%
Pay As You Go Projects	\$43.2	3.3%
Neighborhood Revitalization Act	\$38.7	2.9%
General Obligation and Special Revenue Bond Projects	\$21.6	1.6%
State Bond and Rebate Projects	\$20.1	1.5%
Transportation Development District Act	\$4.5	0.3%
Subtotal of Forgone Revenues (c)	\$860.2	65.5%
Total	\$1,313.6	100.0%
<p>(a) Does not include economic development spending data from local governments of other local entities.</p> <p>(b) Expenditure amounts for the Department of Commerce and the Department of Labor have been combined into a single amount.</p> <p>(c) Includes only the actual Bioscience Authority expenditures made through June 30, 2007. As of March 31, 2008 the Bioscience Authority also had \$45.6 million in future commitments. The Legislature has authorized up to \$582 million for various bio-science initiatives.</p> <p>(d) Numbers may not add due to rounding.</p> <p>(e) For a program known as the Downtown Redevelopment Act, the amount of forgone revenue is estimated to be \$14,400. Because that figure is so small in relation to the other figures, that program is not shown in this table. Also, figures include forgone revenues for some local units of government.</p> <p>Source: LPA analysis of cost information provided by agencies.</p>		

Of the \$453 million State agencies reported spending, the majority was State money, and most was spent by the Department of Commerce. About 43% of the reported spending was federally funded, and about half was State funded. The Department of Commerce accounted for slightly more than 81% of the reported spending. For the past five fiscal years, agencies reported paying companies about \$110 million directly to help spur economic development; the remainder of these expenditures were for agency operations and “pass-throughs” to other entities. The amount agencies reported spending in fiscal year 2007 was about 13% more than what they reported spending in 2003.

Most of the estimated \$860 million of forgone revenues has been local property tax revenues related to industrial revenue bond exemptions. *The table below shows the amount of State and local taxes, by tax type, that have been forgone during this five-year period.*

Amount and Type of Tax Revenues Forgone Fiscal Years 2003 through 2007, Cumulatively (in millions)										
Program Through Which Revenues Were Forgone	State				Local			Unallocated	Grand Total	% of Total
	Sales Tax	Property Tax	Income Tax	Sub-total	Sales Tax	Property Tax	Sub-total			
Industrial Revenue Bond Exemptions	---	\$69.7	---	\$69.7	---	\$280.0	\$280.0	---	\$349.7	40.7%
STAR Bonds	\$92.1	---	---	\$92.1	\$39.0	---	\$39.0	---	\$131.2	15.3%
Property Tax Abatements	---	\$20.0	---	\$20.0	---	\$93.7	\$93.7	---	\$113.7	13.2%
State Income Tax Credits	---	---	\$137.6	\$137.6	---	---	\$0.0	---	\$137.6	16.0%
Neighborhood Revitalization Act	---	---	---	\$0.0	---	---	\$0.0	\$38.7	\$38.7	4.5%
Pay As You Go Projects	---	---	---	\$0.0	---	---	\$0.0	\$43.2	\$43.2	5.0%
State Bond and Rebate Projects	---	---	\$20.1	\$20.1	---	---	\$0.0	---	\$20.1	2.3%
General Obligation and Special Revenue Bond Projects	---	---	---	\$0.0	---	---	\$0.0	\$21.6	\$21.6	2.5%
Transportation Development District	---	---	---	\$0.0	---	---	\$0.0	\$4.5	\$4.5	0.5%
Total Forgone	\$92.1	\$89.7	\$157.7	\$339.5	\$39.0	\$373.7	\$412.8	\$108.0	\$860.2	
Percent of Total	10.7%	10.4%	18.3%	39.5%	4.5%	43.4%	48.0%	12.6%	100.0%	100.0%

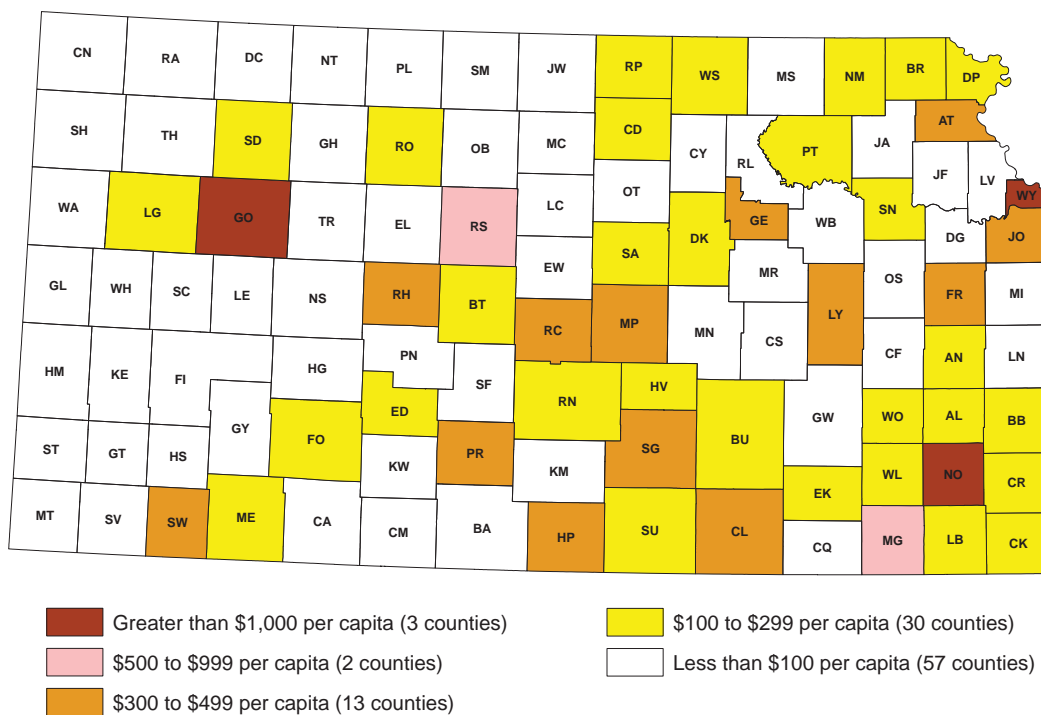
Source: LPA analysis of forgone tax revenue information provided by State agencies and units of local government.

The table shows that about half of the estimated forgone tax revenue was local tax revenue, while about 40% of that amount was State tax revenue.

More than half of the government-funded economic development financial assistance between 2003 and 2007 has occurred in three urban counties. *To get a sense of which counties are providing and receiving the most government-funded financial assistance for economic development, we attempted to allocate cash assistance payments intended to encourage economic development and the amounts reported as forgone revenues to their county of origin. Overall, we could allocate about \$900 million of the identified costs of economic development to specific counties.*

The map on the next page allocates economic development costs at the county level on a per-capita basis, using population estimates as of July 2005. It shows that the per-person cost of economic development on a county level varies across the State.

Per Capita Government Funded Economic Assistance by County (2003-2007)



State and local governments will incur additional costs of about \$404 million in future years because of the repeal of the business and machinery property tax. *In 2006, the Legislature exempted certain commercial and industrial machinery from State property taxes. This change will reduce property tax revenue collections in some counties. To help offset that loss, the Legislature established a mechanism that requires the State to reimburse those counties that lose revenue for a portion of the lost revenue for the next five years. The Legislative Research Department has estimated this exemption would cost the State approximately \$159 million in both lost tax revenues and payments to counties over the next five years. In addition, we estimated the unreimbursed loss to the counties to be approximately \$245 million over five years.*

Question 1 Conclusion. *The cost of economic development that we were able to measure has been at least \$1.3 billion over the past five years. That includes both spending at the State level and forgone revenues at the State and local levels. However, we know this figure is understated—we weren't able to systematically capture local spending, and data limitations prevented us from making a more complete analysis. In addition to any ongoing economic development spending we've already identified, State and local government could incur an estimated \$404 million in additional costs in the next five years because of a recent repeal of the business and machinery property tax.*

Question 2: What Have Past Audits and Studies Shown About the Effectiveness of Economic Development Programs?

Economic development assistance can take various forms.

States have various economic development options to choose from to aide businesses. However, most options include types of cash assistance, tax-based incentives/awards, or training programs. Some research has concluded that, in more recent times, governments have started shifting away from offering cash assistance to companies and have begun to offer other forms of assistance, such as training and tax abatements.

There are a number of problems in trying to assess the effectiveness of economic development programs and activities.

Based on our reviews, we saw recurring themes regarding the difficulties in assessing the effectiveness of states' economic development efforts. Depending on the types of programs or activities being evaluated, those difficulties can include:

- *economic development data are costly to acquire, generally inaccessible, or largely unavailable*
- *economic development data that are available may not be reliable*
- *nearly all economic growth measures are in some way problematic*
- *some economic development efforts are too new to evaluate, or can take years before any results can be seen or measured*
- *it's often difficult to prove that any particular results were caused by the economic development assistance offered*

Most studies of economic development incentives suggest these incentives don't have a significant impact on economic growth. *The literature we reviewed concluded that, thus far, negative and inconclusive findings are far more numerous than positive findings. Most reviews of economic development assistance find few results are achieved – a theme that audits in Kansas and other states commonly find, as well. Findings of ineffectiveness include promised jobs weren't created, return on investment is low or negative, and incentives offered weren't a determining factor.*

The literature also suggests that economic development incentives must be offered to remain competitive with other states.

Almost every state offers economic development incentives. And although the literature we reviewed suggests that, in general, these incentives don't have a significant impact on economic growth, it also suggests that states have to continue offering such incentives to remain competitive.

Kansas, Inc. recently released a strategic plan for guiding Kansas' economic development. *The overall vision of the Strategic Plan is for Kansans to increase personal and business wealth and improve the quality of life by focusing on the State's inherent and emerging strengths.*

Kansas, Inc. staff identified 43 strategies in the 2007 Plan to help advance economic development in Kansas. Included with the strategies are 98 recommendations or actions that could be taken to implement each specific strategy.

Question 2 Conclusion. *Governments have used economic development incentives for a number of years to help spur economic growth and create jobs. Determining if those incentives are effective is a question that has been asked over and over again. Many factors, including lack of reliable data, have hampered researchers' ability to concretely answer the question. The majority of research concludes there is a lack of demonstrated impact from the typical types of economic development assistance, and that incentives aren't cost-effective. However, in order for a state to remain competitive, it must continue to offer assistance.*

Question 3: What Results Can Be Seen from State Spending for Economic Development in Kansas?

As noted earlier, it's difficult to accurately assess the results of economic development expenditures. *Data often are unavailable, unreliable, or potentially biased. Further, absent a specific pilot project or "controlled" experiment, no one can really know what would have happened without government assistance.*

Kansas, Inc. and the Department of Revenue have been tasked by law with evaluating the effectiveness of the State's economic development programs and tax policies. Kansas, Inc.'s 2007 evaluation of the Department of Commerce concluded that businesses that had received assistance performed better than those that had not in terms of total jobs, total wages, and average wages. The Department of Revenue will issue its first comprehensive report evaluating the cost-effectiveness of various economic development related tax credits and sales tax exemptions in January 2009.

To help assess the results of economic development spending, we took several approaches to answering this question. We did the following:

- *reviewed and reported on the achievements State economic development agencies reported to us*
- *created statistical macro-level models to determine whether there were any statistical relationships between economic development spending and growth in jobs, businesses, or per-capita wages*
- *attempted to assess the impact of Nebraska Furniture Mart on the State and county levels*
- *followed up on the findings of a February 2004 audit we issued regarding companies that received State economic development assistance in 1998.*

Economic development agencies reported multiple accomplishments to us for the past five years. As reported in Question 1, the estimated cost of economic development in Kansas for fiscal years 2003 through 2007 was at least \$1.3 billion. We asked agencies to summarize their economic development accomplishments and results for the same time period. The results we were most interested in for this audit included the number of jobs created or saved, the number of companies created, and investments in companies' infrastructure and facilities.

The Figure below summarizes the accomplishments agencies reported to us.

Summary of Economic Development Results Reported by State Agencies to Legislative Post Audit Generally, Fiscal Years 2003 through 2007 (All dollar amounts are reported in millions)										
Agency	Reported # of Jobs Created	Reported # of Jobs Saved	Reported # of Businesses Created	Reported Capital Expenditures Made in Kansas By Client Companies	Amount of Funding Client Companies Reported Receiving or Raising Through...			Increased Sales (in millions)	Estimated Payroll (in millions)	
					...Other Government Funds	...Private Funding	...Federal Funding			
Department of Commerce	Traditional Programs	28,056	41,074		\$540.3	\$146.1			\$56.9 (a)	\$11,246.5 (b)
	Special Projects (c)	1,317	2,140		\$610.0					\$221.0 (f)
	STAR Bond Projects	5,321			\$933.0					
Bioscience Authority (d)		882			\$81.5		\$9.1	\$3.3		
Small Business Development Center		6,632	7,380	1,557			\$169.8	\$52.3	\$352.3	
KTEC	Investments	320	145	0		\$0.7	\$67.8	\$0.6	\$115.9	
	Affiliates	1,087	1,011	99			\$167.0	\$323.6	\$442.7	
NetWork Kansas (d)		53				\$0.4	\$3.0			
Tax Credits Claimed by Tax Payers to the Department of Revenue	Business & Job Development Tax Credits (e)	34,191			\$2,387.3					
	High-Performance Incentive Program (e)	2,655			\$442.5					
	Angel Investor Tax Credits	213			\$81.4					
	Regional Foundation				\$4.9					
Total		80,727	51,750	1,656	\$5,080.9	\$147.2	\$416.7	\$379.8	\$967.8	\$11,467.5

(a) Increased sales reported for two trade show assistance programs.
(b) Payroll amounts reported for major job training and retaining programs (IMPACT, KEIEP, KEOIF, KIT, and KIR).
(c) Special projects include financial assistance provided to four businesses--Goodyear, Spirit Airlines, Innovia, and Eaton--through arrangements set in State law. These projects were mentioned in Figure 1-2.
(d) Kansas Bioscience Authority data reflect accomplishments through April 17, 2008; NetWork Kansas data are through March 11, 2008.
(e) With the passage of a new law in 2006 the Department of Revenue will be responsible for reporting information such as actual jobs created, additional payroll generated, actual jobs retained, and additional sales generated as a result of credits claimed.
(f) The Department reported this amount as an annual figure.

Source: LPA analysis of accomplishment data reported by State agencies.

Altogether, State agencies reported the following achievements for the past five years:

- more than 80,000 jobs created
- more than 51,000 jobs saved
- more than 1,600 companies created
- more than \$5 billion in capital expenditures by private companies, and about \$147 million in matching expenditures by local governments
- more than \$967 million in increased sales by client companies
- more than \$11 billion in estimated payroll for client companies, and

- *about \$800 million in funding for companies from the federal government and private sources*

While these numbers suggest Kansas' programs have had a significant impact on the State's economy, the jobs created and saved figures likely include significant double counting. In addition, the number of new jobs reported aren't always "net" jobs; companies reporting some of their results don't always include supporting documentation and agencies generally don't or can't verify that information, and agency officials can't know what would have happened without the assistance they provided.

To put the agencies' reported accomplishments in perspective, we compared the reported jobs figures with job data from the Kansas Department of Labor. Between 2003 and 2007, Department of Labor statistics show that the number of net new non-farm jobs in Kansas grew by about 47,000. That figure is significantly smaller than the figures agencies reported.

We also noted that the Bioscience Authority and Department of Commerce use detailed databases to track both investments being made and the results of those investments, but that KTEC, doesn't have an integrated system for tracking results for the companies it has made equity investments in. KTEC officials said they'd recently purchased a new software system that should allow them to improve their tracking of results for each company.

We used statistical methods to analyze the relationship between economic development spending and economic growth.

To try to help isolate the impact of the State's economic development programs and tax credits, we used a technique called regression analysis to analyze actual historical information for each county from 2003 to 2007. That information included the economic development spending that we could allocate to counties, along with their population levels, jobs, wage rates, commercial property valuations, percent of people over 65, etc. These analyses allowed us to determine whether statistically measurable relationships exist Statewide between economic development spending and the actual growth in jobs, businesses, and per-capita wages.

Our analyses showed that economic development spending had a measurable relationship with job and business growth. However, those relationships were small, and other factors, such as population and employment levels were much stronger predictors of job growth than economic development spending was. We found the following:

- *all other things being equal, on average \$27,000 in economic development spending in a county led to one additional job being created or retained in that county from 2003 to 2007 over what would have been expected. Unfortunately, there's no way to know the extent to which those created or retained jobs simply may have gone from one Kansas county to another, rather than being new to the state. As a result, these results can't be extrapolated to calculate a Statewide total.*

- *all other things being equal, \$1 in economic development spending was related to a \$2.46 increase in commercial property values.*

When we split the economic development spending into forgone revenues (\$555.7 million) and direct payments to companies (\$112.8 million), we found that forgone revenues had a statistically measurable impact on job and business growth, but direct payments had no measurable relationship. That's likely because direct payments by themselves represent such a small portion of the economic development spending we could analyze.

It's possible for some economic development projects to help some communities in Kansas while hurting others. *As a way of determining the impact a single economic development project could have on both the State and surrounding areas, we examined Nebraska Furniture Mart, which opened in August of 2003 as part of the Village West shopping complex in Wyandotte County. Using data from the Departments of Revenue and Labor, we examined Nebraska Furniture Mart's impact on four areas: furniture store sales, sales taxes collected from furniture store sales, furniture stores in Kansas, and furniture store employment levels. We found the following:*

- *Statewide, furniture store sales increased by 88% from 2002 to 2007, and sales taxes collected from furniture sales increased by about 68%.*
- *Statewide, the number of furniture stores in Kansas declined 24% from 2002 to 2007, while the number of furniture store employees increased 27%.*

We also examined the impact Nebraska Furniture Mart has had on communities nearest to Wyandotte County and found that, since 2002, Johnson County has experienced significant declines in furniture store sales (from 42% of the State total to 19%), while Wyandotte County has experienced significant increases (from 1.5% of the State total to 49%).

Our analyses also showed that, since 2002, counties nearer to Nebraska Furniture Mart have seen the number of furniture stores and furniture store sales decline more than counties located further away. However, our analyses show that Wyandotte County, and the State as a whole, have benefitted from having Nebraska Furniture Mart open a retail location in Wyandotte County.

Out of a sample of 115 companies or individuals that received economic development assistance in 1998, a little more than one-third appear to be operating. *In February 2004, we issued a report reviewing Department of Labor data for a sample of 115 companies or individuals that received economic development assistance in 1998. In that report, we found that 54 (47%) of those 115 companies or individuals were still operating as a business in Kansas during fiscal year 2003.*

To help assess the longer-term impact of that economic development assistance, we followed up on the 54 companies operating in 2003 to see if they still were operating in Kansas in fiscal year 2007. We found that, of those 54 companies, 39 (34% of the original 115) were operating in 2007. Existing companies that were recruited to Kansas in 1998 have demonstrated a greater ability to remain in business than have other companies.

Question 3 Conclusion. *Despite the problems that exist with some of the results data related to the State's economic development programs and tax credits—including the fact that much of it is self-reported and unverified, and some is double-counted—the data State agencies reported to us do suggest that some programs have achieved significant results. Looking at a more macro-level, our own analyses showed that economic development spending has had a small but statistically measurable relationship with job and business growth in recent years. However, other factors had a far larger impact on job growth, including pre-existing population and employment levels.*

Question 3 Recommendations for Executive Action. *We recommended that KTEC ensure that its new software system for tracking information on companies it invests in include information on investment data, survey results, capital expenditures, funding companies obtain from other sources, and results of staff reviews and/or quarterly financial statements, and that it be able to produce summary information on a periodic basis for its Board of Directors.*

These appendices can be found in the full report:

APPENDIX A: *Scope Statement*

APPENDIX B: *Information Presented in the November 2007 Kansas, Inc. Report*

APPENDIX C: *State Agency Expenditures for Economic Development Services*

APPENDIX D: *Department of Commerce Expenditures by Division*

APPENDIX E: *Annual Amount of Estimated Forgone Revenue To Provide Economic Development Services*

APPENDIX F: *Estimated Total Costs of Economic Development That's Attributable to Kansas Counties*

APPENDIX G: *Estimated Amount of Forgone Tax Revenue, by County, for Each Type of Economic Development Tool*

APPENDIX H: *Estimated Amount of Cash Payments to Companies for Economic Development Purposes, by County*

APPENDIX I: *Summary of Economic Development Income Tax Credits Allowed, by County*

APPENDIX J: *Summary of Major Changes Shown in This Report*

APPENDIX K: *Economic Development Accomplishments, by Agency*

APPENDIX L: *Methodology for the Statistical Model Used to Determine Relationships Between Economic Development Spending and Growth in Jobs, Business and Wages*

APPENDIX M: *Kansas Per Capital GDP, Growth and Rank*

APPENDIX N: *Agency Responses*

Kansas' economic development agencies agree with the expenditure amounts we've reported, but some disagree with our characterization of forgone revenues. The agencies acknowledge that, in some cases, it can be difficult to clearly identify the results of economic development programs. For example, some quantitative results, such as job created, can be measured, and some qualitative measures, such as enhanced skills and knowledge, aren't easily measured. The agencies acknowledge that in some cases, their "hard" data are incomplete. Overall, the agencies contend that their data does show they have played a major role in helping to advance the State's economic development efforts. We acknowledge that some economic development programs have achieved significant results, but we have reservations about the reliability of some claimed results. KTEC has agreed to implement the one recommendation we made to that agency.

APPENDIX O: *Additional Information Provided to Legislative Post Audit Committee*

This audit was conducted by Joe Lawhon, Heidi Zimmerman, Amy Thompson, Levi Bowles, Jack Brooks, Lisa Hoopes, Justin Stowe and Nathan Ensz. 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. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call us at (785) 296-3792, or contact us via the Internet at LPA@lpa.