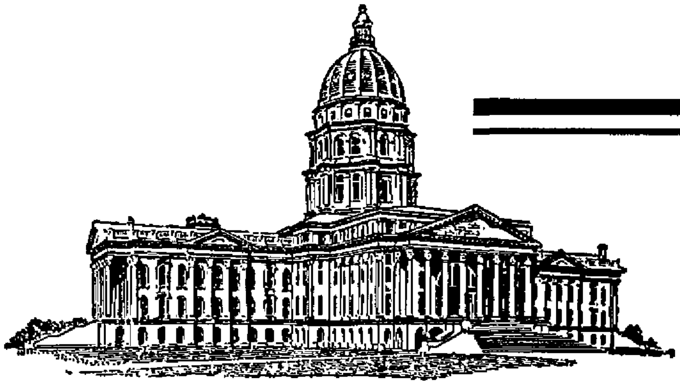

PERFORMANCE AUDIT REPORT

Examining the Use of Economic Development Initiatives Fund Moneys

A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
July 1995

95-53

Legislative Post Audit Committee

Legislative Division of Post Audit

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PERFORMANCE AUDIT REPORT

EXAMINING THE USE OF ECONOMIC DEVELOPMENT INITIATIVES FUND MONEYS

OBTAINING AUDIT INFORMATION

This audit was conducted by Cindy Lash, Chris Clarke, and Barbara Reed. If you need any additional information about the audit's findings, please contact Ms. Lash at the Division's office.

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EXAMINING THE USE OF ECONOMIC DEVELOPMENT INITIATIVES FUND MONEYS

Summary of Legislative Post Audit's Findings

The Department of Commerce and Housing and the Kansas Technology Enterprise Corporation received more than $27.4 million in fiscal year 1995 from the Economic Development Initiatives Fund to support a variety of economic development programs. Many of these programs distribute direct financial assistance to businesses and organizations across the State.

Are Economic Development Initiatives Fund moneys being used to move companies to different sites within Kansas, and are those companies' jobs being counted appropriately? During fiscal years 1994 and 1995, $1.2 million in Fund moneys (about 1.2% of the total Fund) were used to assist four companies that relocated within the State. Two of the companies received money for capital expenses that were directly related to their relocations, as well as money for training. The other two received only training money, for which they were eligible regardless of whether they moved. One of those companies was granted $54,000 to train 50 new employees, but never generated the required new jobs. We also questioned whether another company should have received moneys earmarked for "major expansions" because it only added 16 new jobs.

The Department of Commerce and Housing appeared to correctly classify the jobs associated with these relocations as "new" or "retained." However, the Department did not have an accurate overall system for tracking and reporting jobs created and retained. Department officials said their new database, which will be available in fiscal year 1996, should improve job-tracking information.

How are Economic Development Initiatives Fund moneys being used by the entities that receive them from the State? Businesses and community organizations reported spending money on things that seemed consistent with guidelines for the programs they participated in--personnel, brochures, supplies, construction, training materials, and the like. However, we found little assurance that some entities that received Fund moneys actually spent the money for the things they reported. Out of nine programs we reviewed, only one program had consistently good documentation to demonstrate how moneys actually were spent. When we visited two entities that received Fund moneys, one had good supporting documentation, while the other routinely threw away receipts and invoices that would document how its money was spent.

This report contains several recommendations for the Department of Commerce and Housing and the Kansas Technology Enterprise Corporation. We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton

Barbara J. Hinton
Legislative Post Auditor

Examining the Use of Economic Development Initiatives Fund Moneys

Under current law, 90% of the moneys credited to the State Gaming Revenues Fund (which receives part of the proceeds from the sale of lottery tickets and race track wagers and fees) is transferred to the Economic Development Initiatives Fund. The Legislature then appropriates moneys in the Fund to a number of State agencies, including the Kansas Department of Commerce and Housing, the Kansas Technology Enterprise Corporation, and Kansas, Inc.

A primary goal of most economic development activities financed from the Economic Development Initiatives Fund is to create or retain jobs in Kansas, or to create the necessary conditions for job creation and retention. Over the years, legislative concerns have been raised about whether moneys spent for economic development purposes actually have realized those goals.

A specific concern at this time is that Fund moneys have been used to move companies within Kansas, rather than to create or bring in new business from other states or countries. Concerns also have been raised that jobs of companies that relocate within the State have been counted as "newly created." This practice would appear to artificially inflate job creation numbers. Finally, legislators have raised questions about how companies or groups spend moneys they receive from programs financed by the Economic Development Initiatives Fund.

This audit addresses the following questions:

1. **Are Economic Development Initiatives Fund moneys being used to move companies to different sites within Kansas, and are those companies' jobs being counted appropriately?**

2. **How are Economic Development Initiatives Fund moneys being used by the entities that receive them from the State?**

To identify companies that relocated within the State and that received assistance from programs financed by the Fund, we interviewed officials and reviewed records at the Department of Commerce and Housing, the Kansas Technology Enterprise Corporation, and Kansas, Inc. We also surveyed representatives of local chambers of commerce and the Kansas Industrial Developers Association. We reviewed budgets and worked with Department officials to determine whether jobs associated with the companies that relocated were counted as "new" or "retained."

We reviewed the distribution of Economic Development Initiatives Fund moneys among State agencies for fiscal year 1995, and looked at how the moneys were used. For a sample of entities that received such funds through the Department or the

Corporation, we checked expenditure records to see how these entities used the moneys they received in fiscal year 1994.

In conducting this audit, we followed all applicable government auditing standards set forth by the U.S. General Accounting Office.

In general, we identified three programs financed with Fund moneys that provided significant direct financial assistance to four companies that relocated within the State in fiscal years 1994 or 1995. Two of the companies received money for capital expenses that were directly related to their relocations, as well as training money. The other two received only training money, for which they were eligible regardless of whether they moved. The Department of Commerce appeared to correctly classify the jobs associated with these companies as "new" or "retained," but did not have a good overall system for tracking and reporting jobs created and retained. Finally, we found that, for a sample of programs we reviewed, the Department and the Technology Enterprise Corporation cannot really tell how community groups and businesses spend Fund moneys they receive, although these groups and businesses claim to be spending the money in ways that are in-line with program goals and purposes. These and related findings will be discussed in more detail after a brief overview.

Overview of the Economic Development Initiatives Fund

The 1986 Legislature created the State Gaming Revenues Fund in anticipation of constitutional amendments authorizing parimutuel wagering and a State-owned lottery. The Legislature directed that up to $50 million in proceeds from racing wagers and from the Lottery could be credited to the Gaming Revenues Fund annually; proceeds exceeding that amount were to be transferred to the State General Fund. The legislation called for money in the Gaming Revenues Fund to be distributed as follows:

- 10% to the Juvenile Detention Facilities Fund and the Correctional Institutions Building Fund, with the portion for juvenile detention facilities specified annually in appropriation acts

- 30% to the County Reappraisal Fund to pay a portion of the cost incurred by counties in carrying out Statewide reappraisal of real property

- 60% to the Economic Development Initiatives Fund to finance programs to support and enhance the existing economic foundation of the State, and to foster economic growth

The 1986 legislation also abolished the County Reappraisal Fund effective July 1, 1989, and gave the Economic Development Initiatives Fund 90% of the proceeds from the State Gaming Revenues Fund from that point forward.

In November 1986, voters passed constitutional amendments approving parimutuel racing and a State lottery. The 1987 Legislature created the Kansas Racing Commission and the Kansas Lottery Commission to organize and administer those functions. The Legislature also extended the County Reappraisal Fund for one year, to July 1, 1990. (After the Fund was abolished, the Legislature provided funding for reappraisal each year from 1991 through 1995 by appropriating approximately $3 million annually in Economic Development Initiatives Fund moneys for this purpose to the Department of Revenue. No such funding was provided for 1996.)

Lottery proceeds were first credited to the Gaming Revenues Fund in fiscal year 1988. Proceeds from parimutuel racing were not credited until fiscal year 1990. The table on the following page shows the amount deposited into the Gaming Revenues Fund each year, and the amounts transferred out.

Transfers Into and Out Of the Gaming Revenues Fund
Fiscal Year 1988 - Fiscal Year 1994
(amounts shown are in millions of dollars)

Fiscal Year	Transfers Into the Gaming Revenues Fund	Transfers out of the Gaming Revenues Fund: Detention & Correctional Facilities	County Reappraisal	Economic Development	State General Fund
1988	$ 8.5	$ 0.9	$ 2.5	$ 5.1	n/a
1989	21.6	2.2	6.5	12.9	n/a
1990	22.9	2.3	6.9	13.7	n/a
1991	27.0	2.7	n/a	24.3	n/a
1992	32.8	3.3	n/a	29.5	n/a
1993	38.3	3.8	n/a	34.5	n/a
1994	53.8	5.0	n/a	45.0	3.8

The 1994 Legislature authorized the transfer of an additional 5% of the State Gaming Revenues Fund to the Juvenile Detention Facilities Fund beginning July 1, 1995. This will reduce transfers to the Economic Development Initiatives Fund from 90% to 85% of the State Gaming Revenues Fund.

Are Economic Development Initiatives Fund Moneys Being Used to Move Companies To Different Sites Within Kansas, And Are Those Companies' Jobs Being Counted Appropriately?

Three programs financed with Economic Development Initiatives Fund moneys provided significant direct financial assistance to four companies that relocated within the State in fiscal years 1994 or 1995. Two of the companies received money for capital expenses that were directly related to their relocations, as well as training money. The other two received only training money, for which they were eligible regardless of whether they moved. The Department of Commerce and Housing appeared to correctly classify the jobs associated with these companies as "new" or "retained," but did not have a good overall system for tracking and reporting jobs created and retained. These and other findings are discussed below.

Three Programs Financed with Fund Moneys Have Been Used To Assist Companies That Moved Within the State

These programs are the Kansas Economic Opportunity Initiatives Fund (KEOIF), the Kansas Industrial Training (KIT), and the Kansas Industrial Retraining (KIR) programs. All three programs have provided significant direct monetary assistance to companies that relocated within the State in fiscal years 1994 or 1995. These programs are operated by the Business Development Division of the Department of Commerce and Housing.

The Kansas Trade Show Assistance Program also provided assistance to one company that relocated within the State, but the amount was minimal ($6,306 over a two-year period) and will not be included in this discussion. The Kansas Technology Enterprise Corporation and Kansas, Inc., did not award any Fund money to companies that relocated within the State in fiscal years 1994 or 1995.

The Kansas Economic Opportunity Initiatives Fund is designed to address critical opportunities or emergencies, and moneys are used to attract new businesses, retain existing businesses, or aid expanding businesses. The Legislature first appropriated moneys for this program in fiscal year 1993 to provide funding for economic emergencies or unique economic development opportunities. In fiscal year 1994, the Legislature formally established the program in the statutes. To receive funding, a company's application must be approved by a majority vote of a five-member committee, and must relate to one or more of the following:

- a major expansion of an existing Kansas commercial enterprise
- the potential location in Kansas of the operations of a major employer
- the award of a significant federal or private sector grant which has a financial matching requirement

- a major employer's potential departure from Kansas, or the substantial reduction of a major employer's operations

- the closure of a major federal or State institution or facility

The 5-member review committee of the Kansas Economic Opportunities Initiatives Fund consists of the Secretary of Commerce and Housing, and the Presidents and private sector chairs of the boards of Kansas, Inc., and the Kansas Technology Enterprise Corporation. The table below shows program activity for fiscal year 1994 and the first 10 months of fiscal year 1995.

Fiscal Year	Amount Awarded (in millions)	No. of Companies Participating	No. of Jobs Created	No. of Jobs Retained	Range of Award Amounts Low	Range of Award Amounts High
1994	$ 1.1	6	113	342	$ 50,000	$ 500,000
1995	1.2	4	987	381	100,000	800,000

The Kansas Industrial Training program provides training assistance in the form of grants for companies creating new jobs. Those grants are awarded primarily to manufacturing, distribution, and regional or national service firms that are in the process of adding five or more new jobs to a new or existing Kansas facility. The Kansas Industrial Training program has been in operation since fiscal year 1973. The table below shows program activity for fiscal year 1994 and the first 10 months of fiscal year 1995.

Fiscal Year	Amount Awarded (in millions)	No. of Companies Participating	No. of New Employees Trained	Range of Award Amounts Low	Range of Award Amounts High
1994	$ 1.2	44	2,354	$ 1,382	$ 80,005
1995	1.6	50	2,061	2,945	70,000

The Kansas Industrial Retraining program provides retraining assistance in the form of matching grants to industries that are restructuring their operations. Employees who are retrained are otherwise likely to be displaced because of obsolete or inadequate job skills and knowledge. This program has been in operation since 1989. The table below shows program activity for fiscal year 1994 and the first 10 months of fiscal year 1995.

Fiscal Year	Amount Awarded (in millions)	No. of Companies Participating	No. of Existing Employees Retrained	Range of Award Amounts Low	Range of Award Amounts High
1994	$ 1.2	42	3,689	$ 566	$ 205,484
1995	1.0	24	3,060	724	165,888

Four Companies That Recently Moved Within the State Received Assistance from Programs Financed By the Economic Development Initiatives Fund

A primary goal of most programs financed by the Fund is to create or retain jobs in Kansas. Concerns have been raised that using State economic development moneys to help or encourage companies to move from one Kansas community to another is a questionable use of these funds, because it does not create new jobs in the State, and is economically disadvantageous for the community the company left. Yet in some instances, companies intend to move, and it is simply a matter of whether they will move to another Kansas town or move out-of-State.

Officials said it was not common for companies to move within the State, and we identified only four such companies that participated in programs financed by the Fund in fiscal years 1994 and 1995. We interviewed officials at the Kansas Department of Commerce and Housing, at the Kansas Technology Enterprise Corporation, and at Kansas, Inc., to identify companies that recently relocated within the State, and that participated in Fund-sponsored programs. In conjunction with the Kansas Chamber of Commerce and Industry, we also sent a survey to local chambers of commerce and to members of the Kansas Industrial Developers Association requesting information on Kansas businesses that moved into or out of their communities.

We identified 32 companies that had relocated within the State, or intended to do so. However, only four of these companies moved within the State in fiscal years 1994 or 1995 and participated in one or more Economic Development Initiative Fund programs. The four companies we identified are:

- <u>Sealright Packaging Co.</u>, a manufacturer of packaging for food and dairy products, moved from Kansas City to DeSoto

- <u>King's Avionics, Inc.</u>, a manufacturer of custom-built instrumentation for the aircraft industry, moved from the Johnson County Executive Airport in Olathe to the Johnson County Industrial Airport near Gardner

- <u>Bell & Carlson, Inc.</u>, a manufacturer of synthetic gunstocks, moved from Atwood to Dodge City,

- <u>Fleming Companies, Inc.</u>, a wholesale supplier of grocery products, consolidated its Topeka and Merriam operations in a newly expanded plant in Kansas City, Kansas

The four companies identified above received funds from the three programs described earlier, in the following amounts:

	Kansas Economic Opportunity Initiatives Fund FY94	Kansas Industrial Training Program FY95	Kansas Industrial Retraining Program FY94	FY95
Sealright	$500,000		$205,484	$165,888 (a)
King's Avionics	100,000	16,000		
Bell & Carlson		54,000		
Fleming			200,000	
Total	$600,000	$70,000	$405,484	$165,888

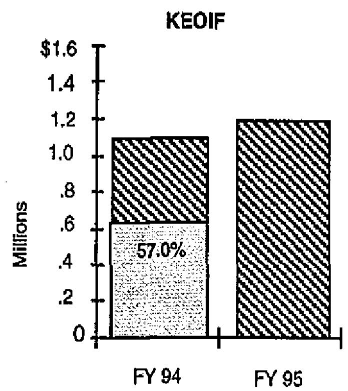
(a) This amount has been obligated by the Department of Commerce and Housing, but the company has not yet received it.

The graphs on the facing page show how much the Kansas Economic Opportunity Initiative Fund and the Kansas Industrial Training and Retraining programs obligated to spend in fiscal years 1994 and 1995, and how much of those moneys were distributed to companies that relocated within the State. In fiscal year 1994, more than half the money awarded by the Kansas Economic Opportunity Initiatives Fund, and almost one third of the money awarded by the Kansas Industrial Retraining program, went to companies that relocated within the State.

Sealright intended to relocate its operations, and said it would stay in Kansas only if $500,000 for a rail spur could be secured from Kansas Economic Opportunity Initiatives Fund. Company officials said they wanted to relocate the operations of their Kansas City, Kansas, plant because of the age of the plant, the layout limitations, and the inability to expand. Sealright considered locations in Kansas and in Missouri. Although Missouri reportedly was offering an attractive incentive package, company executives told Department officials the company would locate in DeSoto if $500,000 for a rail spur could be secured through the Kansas Economic Opportunity Initiatives Fund. The Kansas Economic Opportunity Initiatives Fund Committee met on June 28, 1993 and approved the $500,000 grant to Sealright by unanimous vote. The committee wanted to prevent the loss to the State of a major employer.

King's Avionics qualified for funding through the Kansas Economic Opportunity Initiatives Fund under the criteria of a "major expansion," even though it expected to create only 16 additional full- time jobs. The company considered relocating and expanding because its lease at the Johnson County Executive Airport in Olathe was about to expire. King's Avionics expressed an interest in sites in both Johnson County and in Kansas City, Missouri. Before the relocation, the company employed 16 full-time employees, and anticipated relocating 20 employees (16 full-time) from Arkansas. Company officials applied for $100,000 in Kansas Economic Opportunity Initiatives Fund moneys to help defray the expenses associated with moving to a new site in Johnson County. Although the company planned to double in size, one member of the program review committee initially felt the scale of the project was too small to be considered a major expansion. However, the com-

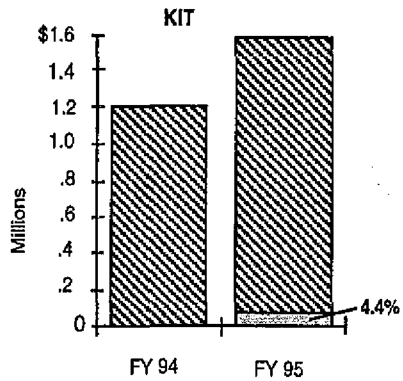
Economic Development Initiatives Fund Money Provided To Companies that Relocated Within the State As a Percentage of Total Obligations, Fiscal Years 1994 and 1995



Kansas Economic Opportunity Initiative Fund

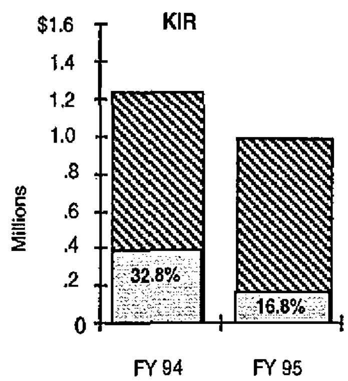
In fiscal year 1994, more than half the Fund was distributed to two companies that relocated within the State. KEOIF monies were used to help prevent the loss of a major employer (Sealright - 325 employees), and to assist a "major expansion" of a Kansas company (King's Avionics - from 16 to 32 full-time employees).

The KEOIF appropriation for fiscal year 1995 was originally $1.7 million. By March 1995, the program had obligated $1.2 million. In April 1995, the program was awarded an additional $1.0 million, for fiscal year 1995. The fiscal year 1996 appropriation is $4.0 million, an increase of 48% from fiscal year 1995.



Kansas Industrial Training Program

In fiscal year 1995, 4.4% of the program moneys were distributed to two companies that relocated within the State. King's Avionics used KIT money to train seven new employees. Bell & Carlson received $54,000 in KIT funds, but apparently did not hire or train 50 new employees as called for in the KIT contract.



Kansas Industrial Retraining Program

In fiscal year 1994, almost one third of the moneys from this program went to two companies that relocated within the State. Sealright received $205,484, and Fleming received $200,000 in KIR funds. In fiscal year 1995, an additional $165,888 was obligated for Sealright, but no disbursements had been made as of 5/1/95.

Total Program Money Obligated (as of 4/1/95)

Program Money Distributed to Companies that Relocated Within the State

mittee ultimately approved King's application by unanimous vote. The grant was to be distributed as follows: $50,000 for construction of a new facility, and $2,500 for each new job created in Kansas.

Bell & Carlson's contract with the Department of Commerce and Housing provided funding for training employees in 50 new positions, but no new positions were ever created. In 1992, Bell & Carlson decided to expand its operations, expand its product lines, and relocate. At that time, the company had 65 employees and anticipated hiring an additional 50 employees. Bell & Carlson decided to move to Dodge City because of the work ethic of local residents and the town's future growth potential. Bell & Carlson applied for and received $54,000 in Kansas Industrial Training assistance to train 50 anticipated new employees. However, the company currently employs fewer than the original 65 employees. Apparently no new positions were ever created. The Department of Commerce and Housing currently is investigating whether it can recover the $54,000 from Bell & Carlson.

Fleming received money to retrain 420 existing employees after it consolidated its Topeka and Merriam operations in a newly modernized and expanded plant in Kansas City, Kansas. The expanded facility has a new computerized inventory control system, time-and-attendance system, and support systems. Fleming applied for and received $200,000 in Kansas Industrial Retraining assistance to retrain 420 existing staff on the new computer systems.

The profiles on pages 12-13 provide additional detail on these four companies.

The Department of Commerce Correctly Categorized Jobs Associated with Companies That Moved Within the State, But Does Not Have an Accurate Overall System For Tracking and Reporting Jobs Created and Retained

When companies move within the State, the jobs they bring are considered "new" jobs by the receiving communities. From a Statewide perspective, these jobs must be regarded as "retained," because they don't create a net increase in employment opportunities in the State. Concerns have been raised that the Department may have reported jobs from companies that relocated in the State as "new," which would have overstated those figures. As a result, we attempted to determine how the Department had, in fact, classified the jobs.

The Kansas Industrial Training program only provides funding to train employees in new jobs, so all jobs associated with this program are reported as "new." Similarly, the Kansas Industrial Retraining program provides funding only for retraining existing employees, so all jobs associated with that program are classified as "retained."

Because the Kansas Economic Opportunities Initiatives Fund is so new, the Department had not yet published figures in its budget or in other official documents showing jobs created and retained by the program. As a result, we asked agency officials how they would classify the jobs associated with Sealright and King's Avionics under this program. They told us the only jobs they would classify as new were the additional jobs King's Avionics was relocating from Arkansas. King's Avionics' existing jobs and all of Sealright's jobs would be classified as retained.

The table below shows the number of new and retained jobs for each company for each of the three programs:

Company	No. of Jobs Created	No. of Jobs Retained
Sealright - KEOIF	—	325
Sealright - KIR	—	329
King's Avionics- KEOIF	14	16
King's Avionics - KIT	7	—
Bell & Carlson - KIT	—	—
Fleming - KIR	—	420

The classifications reported for Sealright and Kings's Avionics under the Kansas Economic Opportunities Initiatives Fund program appeared to be correct, and to be consistent with the way the jobs were funded through the Kansas Industrial Training and Retraining programs.

As the table above shows, the Department told us Sealright retained 325 jobs under the Kansas Economic Opportunity Initiatives Fund program, and retained 329 jobs under the Kansas Industrial Retraining program. Such differences in job figures reported by different programs for the same company are not unusual. For example, King's Avionics has to-date added 14 of the 16 new employees projected in it's application for Kansas Economic Opportunities Initiatives Fund moneys, but has received money from the Kansas Industrial Training program to train only seven of the 14.

The fact that the Department reports jobs created and retained by program, rather than by company could cause job figures to be overstated. Even though Department officials told us they do not add numbers for different programs together, their method of reporting duplicates job figures for companies that participate in more than one program. For example, the same 300-plus jobs at Sealright are claimed and reported by two separate programs. This type of reporting may be misleading, because people outside the Department may be inclined to add figures for different programs together.

Sealright Packaging Company

Sealright designs and manufactures packaging and packaging systems for food and dairy products, beverages, household supplies, and medical supplies. Sealright is the largest supplier of frozen dairy dessert packaging in North America, with plants in Kansas, New York, and California. The company is 75 years old and employs 1,900 people in the United States. The company's approximately 330 Kansas employees earn an average wage $15.06 per hour.

Sealright wanted to relocate the operations of its Kansas City, Kansas, plant because of the age of the plant, the layout limitations, and the inability to expand. Sealright considered locations in Kansas (Kansas City and DeSoto), and in Missouri (Lees Summit, Independence, and Kansas City). Although Missouri reportedly was offering an attractive incentive package, Sealright indicated that it would locate in DeSoto if $500,000 could be secured through the Kansas Economic Opportunity Initiatives Fund.

The Kansas Economic Initiatives Opportunity Fund Committee met in June 1993, and approved the $500,000 grant to Sealright by unanimous vote. The State Finance Council approved the expenditure in July.

Sealright also applied for Kansas Industrial Retraining assistance because new production processes would be implemented at the new DeSoto facility. The company anticipated the restructuring process would take three years to accomplish. In the first phase of retraining, Sealright was granted $205,484 to retrain 200 existing employees; $165,888 is earmarked for the second stage.

In fiscal years 1994 and 1995, Sealright also received Economic Development Initiatives Fund assistance through the Kansas Trade Show Assistance Program. Sealright attended one foreign trade show each year, and received a total of $6,306 in assistance.

After the move, Sealright qualified for the High Performance Incentives Program, which involves sales tax and investment tax credits. Sealright also received a 10-year property tax abatement on land, building, machinery, and equipment.

Bell & Carlson, Inc.

Bell & Carlson manufactures synthetic gunstocks and replacement gunstocks for all types of shotguns and rifles. The company manufactures approximately 20% of the synthetic gunstock market in North America. It is located in Dodge City, and pays an average starting wage of $7.92 per hour to new employees.

Founded in 1986, Bell & Carlson was originally located in Atwood. In 1992, the company decided to expand its operations and relocate. Bell & Carlson anticipated hiring 50 new employees (in addition to 65 current employees), and expanding its product line to include scope holders, tripods, fishing lures, and guitar necks. Several communities in Kansas and Oklahoma submitted incentive proposals to Bell & Carlson. The company decided to relocate to Dodge City, even though Dodge City had not submitted a proposal. Management thought the people of Dodge City had a strong work ethic and the town had future growth potential. The company moved in early 1995, and Bell & Carlson now qualifies for Enterprise Zone tax incentives.

Bell & Carlson received $54,000 in Kansas Industrial Training assistance to train 50 anticipated new employees. The Department of Commerce and Housing currently is investigating Bell & Carlson's performance under the Kansas Industrial Training contract. Although Bell & Carlson received the training money, apparently no new employees were ever hired. The company currently employs fewer than the original 65 employees.

King's Avionics, Inc.

King's Avionics manufactures, repairs, and sells custom-built instrumentation for the aircraft industry. The company has a nationwide customer base, including McDonnell Douglas and the federal government.

In early 1994, King's Avionics considered expanding and relocating because its lease at the Johnson county Executive Airport in Olathe was about to end. At that time, the company had 16 full-time employees, and anticipated relocating 20 additional employees (representing 16 full-time jobs) from Arkansas. King's Avionics was interested in sites in both Johnson County and Kansas City, Missouri.

The company applied for $100,000 in Kansas Economic Opportunity Initiatives Fund money to defray moving expenses. A member of the review committee initially indicated he would vote no on the application. He felt the scale of the expansion was too small and did not meet the legislative intent for the use of the Kansas Economic Opportunity Initiatives Fund. Ultimately, the committee voted unanimously to approve the application, and the approval appeared as a line item in the 1994 session laws.

The $100,000 grant was to be distributed as $50,000 for construction of the new facility, and $2,500 for each new employee hired. King's Avionics moved to the Johnson County Industrial Airport in Gardner in late 1994.

Before the move, King's Avionics applied for Kansas Industrial Training assistance to train eight new employees. The Department of Commerce & Housing approved the application, and King's Avionics received $16,000 in assistance. Average salary for new employees is $11.25 per hour.

After the move, King's Avionics qualified for Enterprise Zone tax incentives.

Fleming Companies, Inc.

Fleming supplies 2,900 supermarkets in 36 states and several foreign countries with national brand grocery products and high-volume, private-label items. Fleming also provides a full line of perishables including meat, dairy items, deli products, frozen foods, and fresh produce.

In 1994, Fleming consolidated the Topeka and Merriam, Kansas, operations into a newly expanded Kansas City, Kansas, facility. The expanded facility has a new computerized inventory control system, a computerized time and attendance system, and computer systems for support, transportation, and sales staff.

Fleming applied for Kansas Industrial Retraining assistance to retrain the 420 consolidated existing jobs in the above-mentioned computer systems, total quality management, and customer service. Fleming was granted $200,000 in assistance for retraining existing employees. Average salary for these employees is $14.58 per hour.

Fleming also qualified for Enterprise Zone tax incentives and a 10-year property tax abatement on new land, buildings, machinery, and equipment.

The Department's figures for jobs created and retained by the Business Development Division varied depending on where and when we got the numbers. We ran into numerous difficulties when we tried to tie down the number of jobs created and retained by several programs in fiscal year 1994. We found that:

- Numbers change by design. In the Kansas Industrial Training and Retraining programs, the job count initially is based on the number of jobs companies expect to create or retain at the time they sign a contract with the Department. As individual contracts are closed out (up to 18 months after they began), the Department adjusts its numbers to reflect the actual number of people trained. This means the fiscal year 1994 numbers may continue to fluctuate well into fiscal year 1996.

- Numbers change because of errors. The agency budget, the Governor's budget, and an agency official all concurred that the number of new jobs created as a result of training was 3,799. This number was arrived at by attributing 2,354 jobs to the Kansas Industrial Training program, and 1,445 jobs to the SKILL program. However, a Kansas, Inc., document credited SKILL with creating only 488 jobs. When we tried to resolve this discrepancy, agency staff that work directly with the program indicated that a fiscal year 1993 project with 957 jobs initially had been erroneously classified as a fiscal year 1994 project. At some point after the budgets were printed, the error was realized and corrected. Although program staff were aware of the change, other officials within the Department apparently were not, and continued to report the published numbers.

- Some numbers printed in the agency and Governor's budgets are not updated. Agency staff acknowledged that job creation numbers reported as fiscal year 1994 actuals for site location assistance (2,500 jobs) and business/community contacts (1,000 jobs) are target numbers that were never changed to reflect actual results.

- Sometimes it is not clear exactly what is included in the numbers. The Department's 1994 Annual Report stated that 4,744 jobs were created or retained as a result of business recruitment activities by the Business Development Division. In a recent publication, Kansas, Inc., which got its numbers from the Department, reported that 5,164 jobs were created or retained because of general recruitment efforts that year.

The Department is developing an integrated database that should correct many of the problems we identified with counting jobs. The database will centralize job creation and retention figures for all programs, which means all agency officials will have access to the same numbers. In addition, once a year the Department will survey each company that received assistance that year, to obtain independent information on the number of jobs actually created and retained. This component of the database will be separate from the program outcomes data, and should provide an unduplicated count of jobs created and retained.

Although the database is not expected to be completed until the end of fiscal year 1996, Department officials said that by the end of fiscal year 1995 all programs financed with Economic Development Initiatives Fund moneys should be on-line. (Housing and Community Development Block Grant programs will be among the last to be added.) Officials indicated they were currently in the process of preparing surveys to mail to fiscal year 1995 program participants.

Conclusion

Over the last two years, $1.2 million in Economic Development Initiatives Fund moneys (about 1.2% of the total Fund) have been used to assist companies that relocated within the State. Although using Fund moneys in this way does not create new jobs for the State, economic development officials believe it may convince companies to stay in Kansas, thereby averting job losses. The main program that can and has provided direct financial assistance to such companies, the Kansas Economic Opportunity Initiatives Fund, has received a significant increase in funding for fiscal year 1996, and likely will continue to make awards to companies that relocate within the State. In one of their fiscal year 1994 awards, members of the review committee for that Fund may have used an overly broad definition of the term "major expansion."

Although it appears the Department of Commerce and Housing correctly categorized new and retained jobs associated with companies that moved within the State, the Department currently does not have a system for producing consistent, reliable, unduplicated numbers for jobs created and retained as a result of its efforts. This is a serious flaw for an agency charged with increasing the number of jobs in the State, but agency officials expect that their new database will address this problem.

Recommendation

1. The members of the review committee of the Kansas Economic Opportunity Initiatives Fund should carefully consider legislative intent when approving projects. Projects should meet the criteria listed in K.S.A. 74-50,151, which limits use of the Fund to economic emergencies, or to unique opportunities to secure economic benefits or avoid economic losses for the State, and which further specifies five circumstances under which the money may be awarded.

2. The Department of Commerce and Housing should continue its efforts to recover Kansas Industrial Training program funds from Bell & Carlson, Inc., and should inform the Legislative Post Audit Committee of the outcome of its efforts.

3. In its continuing development of a new database system, the Department of Commerce and Housing should make it a priority to ensure that the system will accurately and consistently provide unduplicated job creation and retention figures.

How Are Economic Development Initiatives Fund Moneys Being Used By the Entities That Receive Them From the State?

In fiscal year 1995, 16 State agencies received moneys from the Economic Development Initiatives Fund. Most of the agencies further distributed those moneys to community groups and businesses throughout the State for economic development projects. The 47 entities we reviewed that received moneys from the Department of Commerce and Housing or the Kansas Technology Enterprise Corporation reported spending their moneys on such things as personnel, construction/renovation, design and printing of promotional materials, and the like. However, the Department and the Corporation have little assurance that State moneys actually were spent as reported because they frequently accept inadequate documentation of expenditures. In addition, at least one agency had inadequate documentation to show that it funded the most highly qualified proposals. These and related findings will be discussed in more detail in the sections that follow.

In Fiscal Year 1995, 16 State Agencies Received Appropriations From the Economic Development Initiatives Fund

As the amount of money transferred into the Fund has increased over the years, so have the variety of uses for which it has been appropriated. The 1988 Legislature adopted a concurrent resolution that endorsed the following recommendations, developed by Kansas, Inc., for use of Fund moneys:

- expenditures from the Economic Development Initiatives Fund should not be used for salaries of permanent personnel

- the Fund's purpose is to provide financing for economic development "initiatives," and it should not replace the State General Fund as a source of financing for established economic development programs

- expenditures from the Fund should only be made for programs and policies that are clearly identified with the economic development strategy of the State

The resolution is not binding on the Legislature, and numerous activities that generally might not be considered "economic development initiatives" (such as aid for talking book services, equine studies, and equipment for radio and television stations) currently are supported by the Fund. The table on pages 18-19 shows Fund moneys appropriated to State agencies for fiscal year 1995, including reappropriations of fiscal year 1994 moneys, and general uses of the money.

As the table shows, the Department of Commerce and Housing and the Kansas Technology Enterprise Corporation received the majority of Fund moneys. These two agencies spent a significant amount of this money on routine agency operations, but like the remaining 14 agencies, gave or loaned most of the money to community groups and businesses or spent it on special projects within the agency.

FISCAL YEAR 1995 APPROVED EXPENDITURES, ECONOMIC DEVELOPMENT INITIATIVES FUND

Kansas Technical Enterprise Corporation (KTEC)		**$13,481,108**
Operation, Assistance & Grants (including $57,255 reappropriation)	8,406,093	
EPSCoR Matching Grants	2,028,793	
Ad Astra Fund-Seed Capital Grant	1,500,000	
MAMTC Grant Support	1,004,921	
Agricultural Value Added Center	541,301	
Department of Commerce & Housing		**$13,947,158**
State Operations	5,274,613	
KIT/KIR Training	2,727,500	
Kansas Economic Opportunity Initiatives Fund - KEOIF	2,700,000	
Capital Improvements	878,025	
Certified Development Companies	475,000	
Non-metropolitan Strategic Planning Grants	400,000	
Tourism Grants	379,600	
Small Business Development Centers	325,000	
Trade Show Promotions	247,420	
Metropolitan Strategic Planning Grants	200,000	
Boot Hill Tourism Grants	0	
Mid-America World Trade Center	100,000	
Database Development / Special Projets & Grants	100,000	
High-Performance Incentive Grants	75,000	
Kansas Quality Information Network	65,000	
Department of Education		**$9,230,000**
Post-secondary Aid for Vocational Education	5,700,000	
Vocational Education Capital Outlay	1,500,000	
Innovative Program Assistance	1,485,000	
Technology Innovation and Internship	495,000	
Kansas Foundation for Agricultural Products Grant	25,000	
Kansas Cultural and Heritage Arts Center	25,000	
Kansas Board of Regents		**$3,140,262**
KSU-Cooperative Extension Service Fund	1,395,856	
KU-General Research Fund	601,308	
WSU-Center of Excellence/General Research	393,686	
KU-Center of Excellence	228,427	
KSU-Center of Excellence	225,130	
KSU-Other Research Fund	183,564	
KSU Land Use-Value Fund	72,291	
Board of Regents-Ks. Council on Economic Education	40,000	
Department of Revenue		**$2,927,709**
Aid to Counties for Reappraisal	2,927,709	
Kansas Water Office		**$2,000,000**
State Water Plan	2,000,000	

State Library		**$1,350,277**
Supplemental Grants-in-Aid Program	973,077	
Literacy Grant Fund	277,200	
Supplemental Aid for Talking Book Service	100,000	
Kansas Arts Commission		**$1,124,650**
Grant Matches for Arts Programming	1,124,650	
Department of Wildlife and Parks		**$652,337**
Wichita Education Center (Reappropriation)	302,337	
Prairie Spirit Rails-to-Trails	200,000	
Hillsdale State Park Development	100,000	
Wildscape Grant	50,000	
Department of Administration		**$588,776**
KOOD/KSWK-TV Capital Equipment	159,500	
KTWU-TV Capital Equipment	155,000	
KCPT-TV Capital Equipment	100,000	
KANU-FM Capital Equipment	45,641	
KHCC-FM/KHCD-FM/KHCT-FM Capital Equipment	40,000	
KPTS-TV Capital Equipment	33,720	
KKSU-AM Capital Equipment	27,500	
KANZ/KZNA-FM Capital Equipment	17,500	
KMUW-FM Capital Equipment	9,915	
Kansas, Inc.		**$516,889**
Special Studies and Economic Model	400,000	
Operating Expenses	116,889	
Board of Agriculture		**$366,707**
Economic Development Fund, used for:		
Marketing	321,707	
Statistical Services Equine Study	45,000	
School for the Blind		**$150,000**
Accessible Arts, Inc. Fund	150,000	
State Historical Society		**$119,200**
Kansas Humanities Council	75,000	
Funston Home Fund	24,500	
Other Operating Expenditures	19,700	
Kansas State Fair		**$114,000**
Advertising Contract	50,970	
50% Livestock Premium	45,475	
Out-of-State and Other Advertising	15,000	
Booth Enhancements	2,555	
Department of Human Resources		**$100,000**
Neighborhood Improvements & Youth Employment	100,000	
TOTAL APPROVED EXPENDITURES		**$49,809,073**

Programs at the Department and the Corporation financed by Fund moneys generally fit into the State's new economic development strategy. Legislative questions were raised about whether Fund expenditures were consistent with the State's overall economic development strategy. In 1993, Kansas, Inc., published "A Kansas Vision," a new economic development strategy, in response to economic challenges facing the State. Up to that point, the State operated under an economic strategy developed in the 1986 Redwood-Krider report.

To develop the new strategy, Kansas, Inc., held a series of workshops across the State with education, community, business, and government leaders that resulted in a regional vision statement. Next, the State's three research universities analyzed economic, demographic, labor, and industrial issues that face Kansas. Based on the analysis of this data and on the regional vision statement, the Board of Kansas, Inc., and a strategic planning committee developed a mission statement, four goals, and 52 strategies for achieving the State's economic development vision for the 21st century.

We looked at the programs financed with Fund moneys at the Department and the Corporation to see if they generally fit with the goals and strategies outlined in "A Kansas Vision." We didn't try to assess the extent to which the State had programs in other agencies to help meet the economic development goals. Appendix A shows the programs that fit with the strategies, and those that didn't.

Nearly all the programs fit with one or more of the 52 strategies or with one of the four major goals. For example, the Kansas Industrial Training/Retraining Programs support the strategy "to encourage private firms to increase the training and retraining of their workers, especially through consortia-based programs." The Applied Research Matching Fund supports two strategies—"to increase Kansas industry investments in research and development" and "to increase the access of small and medium-size manufacturing firms to research and development services."

In creating "A Kansas Vision", the developers excluded tourism development and "quality-of-life" programs, focusing instead on activities that were expected to produce high-wage jobs. For this reason, Department programs in the Travel and Tourism Division financed with Fund moneys do not fit with any of the strategies. These programs include Marketing Grants, Attraction Development, and the Travel Information Centers.

Entities That Received Fund Money Reported Spending It On A Wide Variety of Activities Related to Their Program Goals

Legislative concerns had been expressed that local recipients of Fund moneys might be spending State funds on such things as lavish business trips, golf outings, and promotional coffee cups. We reviewed seven programs at the Department of Commerce and Housing and two at the Kansas Technology Enterprise Corporation that distribute Fund moneys to community groups and businesses. To determine whether expenditures by program participants were reasonable and appropriate, we reviewed the purpose of the programs and looked at how a sample of 47 grant recipients in fiscal years 1994 and 1995 spent the money they received. The box on the following page describes the programs we reviewed.

The things recipients reported spending their money on seemed consistent with program goals and purposes, and we did not see any unreasonable expenditures in the information reported to the Department or to the Corporation. For example, Marketing Grant recipients reported spending their money primarily on designing and printing promotional materials such as brochures. Attraction Development grant recipients reported spending most of their money on construction or renovation of facilities and capital acquisitions (one purchased a building, another purchased a trolley). Applied Research Matching Fund recipients reported spending most of their money on salaries for researchers, equipment, and supplies. Participants in the Kansas Industrial Training and Retraining programs reportedly spent nearly all their money for instructors' salaries.

The charts on page 23 show how a sample of recipients in 7 of the 9 programs we reviewed reportedly spent their money. The charts show money disbursed to companies as of April 1995. We combined expenditure information for the Kansas Industrial Training and Retraining programs into one chart because the programs are so similar.

We were unable to generate expenditure charts for two programs—Strategic Planning Grants and Special Projects. We could not separate out individual expenditures because recipients in these programs typically just requested a draw against their grant awards without specifying how the money was used, or received periodic payments as called for in their contracts.

During our review we also looked at supporting documentation for the recipients' requests for funds to identify expenditures for questionable activities such as lavish business trips and golf outings. We did not find any such expenditures in information reported to the Department or the Corporation. However, as the next section of the report discusses, it is difficult to know how recipients actually spent their Fund money, because of the type of expense documentation the Department and the Corporation accept.

The Department and the Corporation Had Little Assurance That Some Moneys They Distributed to Entities in our Sample Were Being Spent as Reported

For eight of the nine programs we reviewed, participants did not receive Fund moneys up-front, but rather were reimbursed for approved expenditures. (Although money could be released in advance for major expenditures, if necessary.) By contrast, in the Certified Development Company program, companies received annual

Programs Reviewed During the Audit

Department of Commerce and Housing

Travel and Tourism Development Division

- Marketing Grant Program - Provides grants to not-for-profit entities to encourage out-of-State marketing and activities, such as conducting tours to familiarize travel writers and group tour promoters with the State, creating new brochures, and attending trade shows for the first time. This program requires an equal match by the recipient.

- Attraction Development Program - Provides grants for the development of new tourist attractions or enhancement of existing attractions with the emphasis on increasing jobs and revenue. This program pays 40% of the project cost, and requires a 60% local match.

Business Development Division

- Kansas Industrial Training Program (KIT) - Provides training assistance primarily to manufacturing, distribution, and regional or national service firms in the process of adding five or more new jobs to a new or existing Kansas facility. KIT will pay the negotiated cost of pre-employment, on-the-job and classroom training expenses.

- Kansas Industrial Retraining Program (KIR) - Provides retraining assistance to restructuring industries with at least five employees who are likely to be displaced because of obsolete or inadequate job skills and knowledge. Eligible industries include those restructuring their operations through the incorporation of new or existing technology, product diversification, or new production activities. The program requires a matching amount, usually 50%.

- Certified Development Companies (CDCs) - Provide loan packaging assistance to small companies. Certified Development Companies are regional or local entities, certified by the Small Business Administration, that receive Fund moneys to support general operations.

Trade Division

- Kansas Trade Show Assistance - Provides grants to companies participating in foreign trade shows and in domestic shows with international impact. This program will reimburse up to 50% of a company's eligible direct expenses. Companies are limited to a total maximum reimbursement of $7,000 per year.

Community Development Division

- Strategic Planning Grants - Provides grants and technical assistance to encourage metropolitan and non-metropolitan counties to develop and carry out area and county-wide economic development based strategic plans. The planning grants require a 25% match and action grants require a 100% match from the community.

Kansas Technology Enterprise Corporation

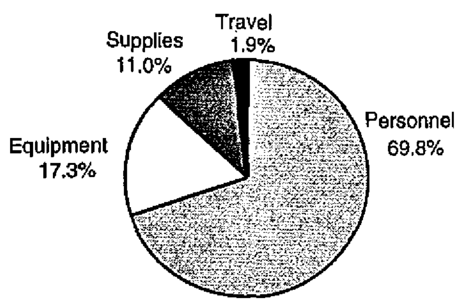
- Applied Research Matching Fund - Provides small-to-medium sized companies up to 40% of the cost of an applied research project that has the potential to be successfully marketed. Money cannot be used for exploratory research, marketing, construction of facilities, patent costs, or general business expenses. Applicants are eligible for up to two awards and a total of $100,000 during the fiscal year. The Corporation now requires royalties from projects that are successfully commercialized.

- Special Projects - Funding allows the Corporation to explore projects, through studies and initial tests, that are not covered under any of its existing programs. Many of the projects later become part of the services offered by the Corporation. Past projects include the Innovative Technology Enterprise Corporation, Return of Public Investment, and telecommunications projects.

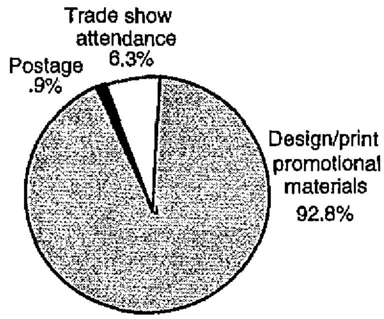
Types of Expenditures by Program Participants
Fiscal Years 1994 and 1995

These pie charts of seven programs that distribute EDIF money show typical expenditures by a sample of participants. Even though the categories vary for each program, we determined that the types of expenditures reported were appropriate for the program. The percentages are based on the money received through April 1995 by the recipients in our sample.

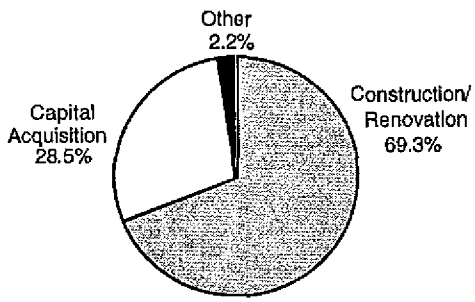
Applied Research Matching Fund



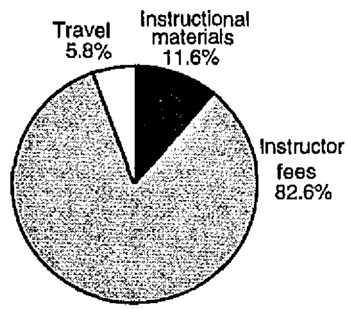
Marketing Grant Program



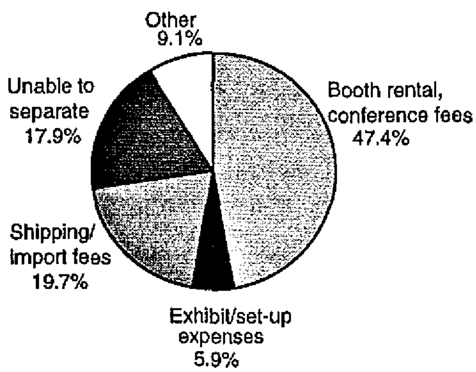
Attraction Development Program



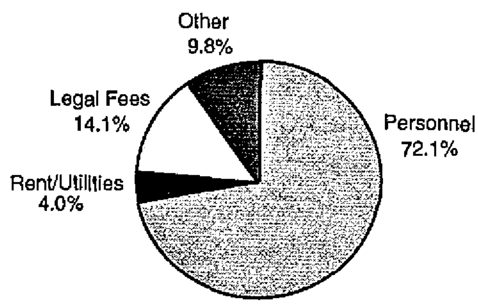
Kansas Industrial Training and Retraining Programs



Kansas Trade Show Assistance Program



Certified Development Companies



performance grants to help support their operations, without any requirement to show how the money was spent.

Although staff of many of the programs said they required recipients to submit invoices in order to be reimbursed, we found that the Department and the Corporation frequently approved payments to recipients based simply on a request for a draw against the grant award, or on an invoice to the State typed on the recipient's letterhead. These types of documentation provide no assurance that State moneys were spent on approved items.

Of the nine programs we reviewed, only one consistently had good documentation of how Fund moneys were spent. The Marketing Grants program in the Department's Travel and Tourism Development Division had invoices for every expenditure it reimbursed for the five recipients we reviewed. In three out of five cases, the files also contained copies of canceled checks.

The remaining programs made reimbursements based on a variety of types of documentation. Some programs had invoices to support the majority of the reimbursements they made, others had invoices for some expenditures, and one made payments based solely on requests for draws. (Staff of this program reportedly conduct an on-site close-out review of grantee expenditures before the last disbursement is made, but keep no documentation of the reviews).

The types of questionable documentation we found included:

- requests for draws
- travel expense reports for lodging and airfare, with no receipts attached
- invoices to the State on the company's letterhead, for items reportedly purchased from other vendors
- purchase orders or other order forms
- expenditure summary forms
- uncanceled checks

The problem with these types of documentation is that they provide no assurance the companies spent the money on approved items. For example, there is no way to know if a purchase order was ever processed, or what the item actually cost. Similarly, invoices rewritten on the grant recipient's letterhead do not provide assurance that goods or services actually were purchased from another company. Expenditure summaries and travel expense reports unsupported by receipts provide no proof that expenditures were made for these items.

Certified Development Companies are not expected to provide any documentation showing how they use State economic development moneys. Every year, Department officials award grants to Certified Development Companies based on a review of their performance the previous year. The money is provided to support Company operations, and the Department does not request any documentation of how it was spent.

Because the Department had no information on how Fund moneys were used in this program, we visited two Companies and reviewed their expenditures. The first Company we visited, Big Lakes Certified Development Company in Manhattan (which merged with another Company in mid-fiscal year 1994), did not separate its Fund moneys from its other sources of revenue. However, our review showed that the Company's overall expenditures were reasonable, with most its money spent on salaries. We also were able to trace a sample of fiscal year 1994 expenditures to receipts. This Company also has an annual audit, which is submitted to the Department.

The second Company we reviewed, Avenue Area, Inc., in Kansas City, has two functions—it is both a Certified Development Company and a downtown business association. The organization receives money from the State and from loan recipients in its role as a Certified Development Company, from members of Avenue Area, Inc., in its role as a business association, and from the City and the County for both its roles.

The Company maintains eight separate accounts at two banks to keep money for different purposes segregated. It put its Fund moneys in an account with loan fees, and used this account to pay staff and rent. We did not find any unreasonable expenditures from Fund moneys, but we had concerns about the Company's overall financial management. The problems we noted include:

- <u>inadequate bookkeeping procedures</u>. These included throwing away invoices and other supporting documentation after writing the checks, not having a single set of records that pull together the activity in the eight separate accounts the Company has, and not depositing State funds before disbursing part of the money, thereby not leaving a paper trail.

  Instead of depositing the full $47,800 State grant, and then writing checks against the deposit, the bookkeeper directed the bank to deposit only a portion of the State check. Of the $11,000 not deposited, $10,000 was given to the Director in certified checks as his approved annual benefit payment (he is an independent contractor, rather than an employee, of the Company), and $1,000 was paid to another individual for services. Because the transaction was handed this way, the bank statement provided no record of the $11,000. In addition, we found no records at the Company explaining these transactions.

  The situation was further complicated because bank records showed $10,000 paid to the Director later that month, which turned out to be a separate bonus/raise payment, authorized by the Board of Avenue Area, Inc. In all, the Director received $20,000 that month, in addition to his regular salary, of which only $10,000 was documented in Company financial records.

- financial records that are not audited. Instead, the Company relies on a year-end "compilation" created by a certified public accountant who is a member of the downtown business association. For fiscal year 1994, that compilation did not cover all the Company's accounts. Four of the eight bank accounts for the Company were not included in the report.

In the Company's role as a downtown business association, it spends money on such things as memberships in other organizations, downtown cleanup, holiday lighting, and bands and supplies for events such as lunchtime concerts. In addition, private companies give charitable donations through Avenue Area, Inc., to organizations and community events. The Company paid $100 to sponsor a hole at the Kansas City, Kansas, Chamber of Commerce golf tournament for advertisement purposes. However, this and other expenditures described above were made from accounts funded with City and County moneys.

One Agency We Reviewed Had Insufficient Documentation To Show It Funded The Most Highly Qualified Proposals

All the programs we reviewed had an application process and procedures for reviewing and rating requests for funding. In general, we did not look at the agencies' decision-making process for approving proposals. However, during our review of Applied Research Matching Fund files at the Kansas Technology Enterprise Corporation, several issues came to our attention.

The Corporation has a numeric scoring system to assist review committee members (who are on the agency's Board of Directors) in evaluating proposals. According to published program guidelines, proposals are evaluated on the following weighted criteria: commercial potential (50%), technical merit (30%), investment quality/return on investment (10%), and technological infrastructure development (10%). Each of these areas is further broken down into specific items to be rated. Agency officials told us committee members are to complete score sheets independently, discuss the proposals, then vote (in addition, applicants requesting more than $20,000 make a formal presentation to the committee).

We reviewed score sheets for a sample of projects that were funded and projects that were denied, to determine whether projects considered to be most worthy were being funded. However, many of the score sheets were incomplete or blank, making an accurate numeric comparison impossible. Looking at the scores that were filled in, we found no great disparity between ratings of projects that were funded and projects that were denied.

The score sheets also have room for the evaluators to make comments. Of the five funded projects in our sample, three proposals contained numerous negative (and very few positive) comments on the score sheets, including:

- project is very "iffy"
- project not likely to be successful
- not clear what advances over existing products would be
- trial and error is not an appropriate research plan
- commercial potential is mediocre

We asked agency officials why the committee approved projects it apparently had significant concerns about. Officials told us the committee often received additional information about such projects before making a final decision. We reviewed additional records at the Corporation for the three projects noted above and found that, in two of the three cases, there was evidence that committee members had received supplementary information. Presumably this information caused committee members to change their opinion of the projects before they voted to approve them, however most members did not complete the portion of the score sheet that asked how the company presentation affected their opinion of the project.

Although inadequate documentation of the type described above is sometimes viewed as simply a "paperwork problem," the fact is that without it, there is no assurance that public moneys have been spent on the projects that have the greatest chance of success. A consistent scoring system and notations of how decisions were made would provide much greater assurance that projects were funded on the basis of merit.

Conclusion

Both the Department of Commerce and Housing and the Kansas Technology Enterprise Corporation award considerable sums of Economic Development Initiatives Fund moneys to community groups and businesses for purposes that appear to be consistent with the State's economic development strategy. But, because of the types of documentation these agencies accept, the State has no real assurance that its money is being spent for the purposes intended.

Recommendations

1. To help ensure that Economic Development Initiatives Fund moneys given to community groups and businesses are spent on approved activities, the Department and the Corporation should require Fund recipients to submit invoices from external providers of goods and services in order to be reimbursed for those expenses. This is the same type of documentation State agencies and their employees are required to provide whenever State moneys are spent.

2. To help ensure that Economic Development Initiatives Fund moneys awarded through the Applied Research Matching Funds program go to the most highly qualified applicants, Corporation officials should require review committee members to fully score proposals and to document the reasons for their decision to approve proposals.

3. The Department of Commerce and Housing should ensure that records are maintained of close-out reviews and site visits conducted as part of the Strategic Planning Grants program.

4. To help ensure that State moneys received by Certified Development Companies are spent appropriately, the Department of Commerce and Housing should do the following:

   a. require Certified Development Companies to undergo a financial audit each year, and to submit the most recent audit with their application for funds

   b. enforce the provision of its contracts with Certified Development Companies that requires the Companies to maintain accounting records in accordance with generally accepted accounting principles. In enforcing this provision, the Department should withhold fiscal year 1996 moneys—generally awarded in October or November—from Avenue Area, Inc., (or any other Companies found to be lacking in this area) until the Company can demonstrate that it has developed an adequate accounting system.

APPENDIX A

Determining How Economic Development Initiatives Funded Programs At the Kansas Department of Commerce and Housing and Kansas Technology Enterprise Corporation Fit Into the State Economic Development Strategy, "A Kansas Vision"

The following is a list of Department of Commerce and Housing, and Kansas Technology Enterprise programs which are funded by the Economic Development Initiatives Fund. We also listed specific strategies from "A Kansas Vision" that each program works toward.

DEPARTMENT OF COMMERCE & HOUSING

The following programs fit with a specific strategy outlined in the Kansas economic development strategy, "A Kansas Vision."

Business Development Division

Small Business Development Centers (SBDCs)

Strategy #1: Increase the availability of advanced business assistance to small and medium-size firms.

Certified Development Companies (CDCs)

Strategy #39: Assist Kansas firms seeking private financing by strengthening their management, improving their financial capacity, and enhancing their ability to access private capital markets.

Strategy #42: Continue to provide State financial support to Kansas certified development companies, and increase their capacity to serve new and existing small firms.

High Performance Incentives Program (HPIP)

Strategy #7: Target attraction efforts toward high value-added companies in industries that build on the State's comparative advantage.

Strategy #12: Encourage private firms to increase the training and retraining of their workers, especially through consortia-based programs.

Strategy #21: Increase the competitiveness of the Kansas tax structure within the six-state region for existing, mature firms.

Strategy #24: Encourage the location and expansion of higher wage, value-added businesses in Kansas by directing the allocation of tax incentives and abatements.

Kansas Economic Opportunity Initiatives Fund (KEOIF)

Strategy #3: Support the development of new mechanisms for interfirm cooperation, including, where appropriate, sector based associations or consortia of small and medium-size firms.

Strategy #7: Target attraction efforts toward high value-added companies in industries that build on the State's comparative advantage.

Micro Loan Program

Strategy #42: Continue to provide State financial support to Kansas certified development companies, and increase their capacity to serve new and existing small firms.

Enterprise Zone

Strategy #22: Implement tax policies that encourage and reward the expansion of manufacturing and export-oriented service sector firms.

Strategy #24: Encourage the location and expansion of higher wage, value-added businesses in Kansas by directing the allocation of tax incentives and abatements.

Minority and Women-Owned Business

Strategy #1: Increase the availability of advanced business assistance to small and medium-size firms.

First Stop Clearinghouse

Strategy #2: Link firms to available expertise and specialized resources in the public and private sectors.

Kansas MATCH

Strategy #1: Increase the availability of advanced business assistance to small and medium-size firms.

Kansas Industrial Training Program (KIT)

Strategy #12: Encourage private firms to increase the training and retraining of their workers, especially through consortia-based programs.

Kansas Industrial Retraining Program (KIR)

Strategy #12: Encourage private firms to increase the training and retraining of their workers, especially through consortia-based programs.

State of Kansas Investment in Lifelong Learning (SKILL)

Strategy #12: Encourage private firms to increase the training and retraining of their workers, especially through consortia-based programs.

Trade Development Division

Kansas Trade Show Assistance Program (KTSAP)

Strategy #37: Develop customer-oriented export services for Kansas firms.

Mid-America World Trade Center (MAWTC)

Strategy #37: Develop customer-oriented export services for Kansas firms.

Community Development Division

Strategic Planning Grants

Strategy #49: Continue to provide State financial support and encouragement of regional and community-level strategic planning throughout Kansas and provide State financial and technical assistance to the continuing implementation of community strategic plans.

Strategy #50: Encourage inter-local problem solving and joint service delivery through geographic clusters of communities.

Main Street

Strategy #2: Link firms to available expertise and specialized resources in the public and private sectors.

Kansas Rural Development Council

Strategy #48: Increase private sector participation in, and financial commitment to, quasi-public economic development entities at the regional, state, and local levels.

In creating "A Kansas Vision", the developers excluded programs and activities in the Travel & Tourism Division, focusing instead on other programs that were expected to produce high wage jobs. For this reason, the following programs or activities do not fit with any strategy.

Travel & Tourism Division

Attraction Development Grants

Marketing Grants

Travel Information Centers

The following programs at the Department of Commerce and Housing did not fit with a specific strategy in "A Kansas Vision." These programs work toward a more general strategic objective.

Partnership Fund

Strategic Objective: Investments in public and private infrastructure enhance the expansion and competitiveness of Kansas businesses.

Community Development Block Grants

Strategic Objective: Kansas business and industry expand through accessible financial capital.

PRIDE

Strategic Objective: Kansas business and industry is supported by efficient local governments and dynamic communities.

KANSAS TECHNOLOGY ENTERPRISE CORPORATION

The following programs fit with a specific strategy outlined in the Kansas economic development strategy, "A Kansas Vision."

Applied Research Matching Fund

Strategy #31: Increase Kansas industry investments in research and development.

Strategy #34: Increase the access of small and medium-size manufacturing firms to research and development services.

Centers of Excellence

Strategy #32: Promote research and development partnerships between the State universities and industry.

Strategy #34: Increase the access of small and medium-size manufacturing firms to research and development services.

Strategy #36: Assist industry in developing new applications for existing technologies.

Commercialization

Strategy #5: Develop technology and community-based innovation centers linked to post-secondary educational institutions to support the development of new businesses.

Strategy #6: Facilitate the creation of networks to link start-up companies to entrepreneurial expertise and foster "mentor" relationships with existing firms.

Strategy #33: Accelerate the commercialization of university research and development to create new Kansas products and processes.

Experimental Program to Stimulate Competitive Research (EPSCoR)

Strategy #30: Increase federal and State funding for research and development to build the capacity and excellence of Kansas universities.

Industrial Liaison Offices

Strategy #2: Link firms to available expertise and specialized resources in the public and private sectors.

Strategy #32: Promote research and development partnerships between the State universities and industry.

Strategy #34: Increase the access of small and medium-size manufacturing firms to research and development services.

Small Business Innovation Research (SBIR)

Strategy #30: Increase federal and State funding for research and development to build the capacity and excellence of Kansas universities.

Small Business Innovation Research Bridge Financing

Strategy #30: Increase federal and State funding for research and development to build the capacity and excellence of Kansas universities.

Seed Capital (Ad Astra)

Strategy #41: Increase the availability of seed and venture capital to Kansas firms.

Training Equipment Grants

Strategy #12: Encourage private firms to increase the training and retraining of their workers, especially through consortia-based programs.

Kansas Value Added Center (KVAC)

Strategy #1: Increase the availability of advanced business assistance to small and medium-size firms.

Strategy #4: Redirect entrepreneurial assistance to the formation and support of higher value-added, high performance work organizations.

Mid-America Manufacturing Technology Center (MAMTC)

Strategy #1: Increase the availability of advanced business assistance to small and medium-size firms.

Strategy #4: Redirect entrepreneurial assistance to the formation and support of higher value-added, high performance work organizations.

APPENDIX B

Agency Responses

On June 26th, we provided copies of the draft audit report to the Department of Commerce and Housing, Kansas, Inc., and Kansas Technology Enterprise Corporation. Their responses are included as this Appendix.

In its response, the Department of Commerce and Housing took some exception to several of our findings and recommendations, primarily from the standpoint that they were too bureaucratic or restrictive. For example, the Department pointed out that assessing its grantees' performance, tangible results, or measurable outcomes might provide adequate assurances that State moneys are being spent for the purposes intended, and would be far less labor-intensive than requiring grantees to submit invoices documenting all their expenses.

We agree it's desirable to ensure that grantees are achieving the desired results--whether that means creating new jobs, training or retraining employees, or whatever--and we oppose excessive controls and bureaucracy as much as the Department. However, carrying out its programmatic responsibility to provide funds only to entities that demonstrate strong performance and tangible results doesn't relieve the Department of its fiduciary responsibility to ensure that State tax dollars aren't misappropriated or used for unreasonable or totally unallowed purposes. Our recommendation--requiring grantees to submit invoices from the vendors <u>they</u> received goods and services from before being reimbursed with State moneys--does not seem unduly burdensome to us. Indeed, it is what the State requires of its own agencies and employees.

In another area, the Department appeared to disagree with our recommendation to withhold funds from Certified Development Companies that couldn't demonstrate they had adequate accounting systems. Department officials indicated it may be counterproductive to withhold resources the Companies might need to meet these requirements. The problems we identified in this area were with one Company--Avenue Area, Inc.--and they included throwing away invoices after paying bills, failing to deposit State checks in their entirety, and not providing the accountant with information related to <u>all</u> checking accounts. These problems, which place State moneys at greater risk of loss or misuse, should cost nothing to correct.

KTEC KANSAS TECHNOLOGY ENTERPRISE CORPORATION

KTEC's mission is to create and maintain employment by fostering innovation, stimulating commercialization, and promoting the growth and expansion of Kansas businesses.

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JUL 6 1995
LEGISLATIVE POST AUDIT

July 6, 1995

Barbara J. Hinton
Legislative Division of Post Audit
800 SW Jackson Street, Suite 1200
Topeka, Kansas 66612-2212

Dear Ms. Hinton:

In response to the Legislative Division of Post Audit draft report involving EDIF projects, and in particular KTEC's Applied Research Matching Fund, I want to express that we are highly confident in the quality of projects being funded, the funding decision process, and the project tracking system. While we are pleased in the substantial results the program is providing to Kansas, we are happy to accomodate the recommendations of the report to improve documentation in two specific steps in the process.

Before addressing the report, I would first underscore the results of the program. Last year, \$1.26 million dollar EDIF investment attracted \$2.2 million in industry R&D funds, produced 304 new jobs, \$28.4 million in product sales, and \$10.8 million in venture capital attracted. Each company must show commitment to the project, evidenced by its matching funds of at least \$1.50 for each \$1.00 in state monies.

The process of evaluating and making funding decisions is driven by a highly qualified and dedicated committee of volunteer Kansans with business and technical backgrounds. The committee strives to fund the best projects (not simply the best written grant proposals) and takes its job very seriously. Of paramount importance in its decision of whether or not to fund a project are the final stages of review -- applicant presentations to the committee and discussions with the company of all concerns expressed during review. This procedure increases the quality of investments.

While highly confident in the review process, *we agree that two improvements can be made to close the loop in documenting that the proper decisions are being made*: (1) committee members will be encouraged to fill out their review forms more completely, with more emphasis on explaining their final recommendation; and (2) notes from the company's presentation and site visits (which currently reside on the computerized tracking system) will be copied to the paper file.

Payment documentation was also expressed as a concern in your report. KTEC funds projects on a milestone funding basis, through reviewing quarterly technical reports, and conducting site visits. Payments are made on a reimbursement basis, based on currency of milestone

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progress and a summary of expenses. Larger external expenses are documented via invoice.

We understand the concern expressed in the audit, regarding invoice documentation. *To improve expenditure documentation we will require consistent submission of invoices from external providers of goods and services prior to reimbursement.*

Adoption of these recommendations will hopefully meet the objectives of the report, and will not impede the Applied Research Matching Fund's ability to continue to provide successful outcomes for the Kansas economy. We have incorporated the report's suggested changes into our procedures effective July 1.

My staff and I look forward to the opportunity to discuss the program at the July 26 meeting of the Legislative Post Audit Committee. Please call me if you have any questions prior to then.

Sincerely,

Richard A Bendis

Richard A. Bendis
President

KANSAS
DEPARTMENT OF COMMERCE & HOUSING

RECEIVED
JUL 10 1995
LEGISLATIVE POST AUDIT

July 7, 1995

Bill Graves, Governor
Gary Sherrer, Secretary

Ms. Barbara Hinton
Legislative Post Auditor
800 SW Jackson, Suite 1200
Topeka, KS 66612

Dear Ms. Hinton:

We appreciate this opportunity to respond to your audit report, Examining the Use of Economic Development Initiatives Fund Moneys. It is most helpful for a new management team to have the benefit of an independent assessment of the Department's operation. Our response is based on careful consideration of your findings. The following comments are directed at your specific recommendations, which are summarized briefly before each response.

Recommendation: The Kansas Economic Opportunity Initiatives Fund (KEOIF) review committee should carefully consider legislative intent when approving projects.

Response: While we agree with this recommendation, we found no evidence in your report that legislative intent has been violated. We assume that reservations on the part of one review committee member about the scale of the King's Avionics project led to your recommendation. We expect all projects receiving KEOIF money to conform to the statutory requirements. However, we would urge extreme caution in establishing rigid criteria to define these requirements. The review committee needs the flexibility to assess the possible long-range and/or regional impact of each project. For example, a major employer in a large Kansas community is a far cry from what would be considered a major expansion in one of our smaller communities. If some kind of numerical threshold were required for project consideration, the Department fears that KEOIF would become a tool applicable only to the larger urban areas, or with implications only to major corporations.

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Recommendation: The Department should continue its efforts to recover program funds from a firm that did not fulfill its employment projections.

Response: The Department is actively pursuing recovery of these funds, but believes further comment is inadvisable since this matter could result in legal action. We will keep the Legislative Post Audit Committee informed of our efforts.

Recommendation: In development of its database, the Department should ensure that accuracy and consistency are a priority in providing unduplicated job creation and retention figures.

Response: Accuracy, consistency and unduplicated counts have been the goal of our database development project from the outset. It has proven to be a complex undertaking, complicated by the fact that both the entities that report to us and the reports we submit to others (primarily federal agencies) employ reporting periods that do not coincide with the state fiscal year. Another difficulty is resolving the discrepancies that occur when expenditures in one fiscal year yield results in the subsequent fiscal year(s). Overcoming these obstacles has been and will continue to be a priority. We should also point out that we are frequently required to produce reports on a program basis. Adding numbers from a variety of these reports can indeed result in duplicated counts, but we can only caution people outside the Department to resist that temptation.

Recommendation: Grant recipients should submit invoices from external providers in order to be reimbursed.

Response: This recommendation follows the Post Auditor's conclusion that the documentation currently provided by recipients..."provides the State...no real assurance that its money is being spent for the purposes intended." We frankly believe this finding is a significant misrepresentation of the controls that do exist and that, in our judgment, provide reasonable and adequate assurance that recipients are spending the grants for the purposes intended. We maintain that for some grant programs the intended purpose is not that the grant be used for specific items of expenditure, but rather job creation, business expansion, development of new export markets, re-location of out-of-state business, etc.

For example, we might grant KEOIF money to a firm as an incentive to move its operations to Kansas. At the time the incentive is offered, the company may express its intent to use the money to defray moving costs. In a very real sense, it makes no difference at all if the company instead ends up using the money for site preparation costs associated with facility construction. Nevertheless, we do now require that companies document their KEOIF expenditures, which was not the practice at the program's inception.

In other instances, such as grants to Certified Development Companies, the State is one of several contributors to the organization's general operating budget. While we agree that an independent audit is appropriate for this type of grantee, we question whether it is productive for the State to know that its money is being spent to pay specific bills. We are much more interested in whether this entity is performing at a level that justifies our investment in its operation.

In still other cases, where grants are provided for very specific projects with a well-defined budget, we agree that the documentation proposed in your recommendation is appropriate and we are strengthening our requirements for these grantees.

In short, we challenge the assumption that invoices from providers are the only, or even the preferred, method of ensuring that the State's money is spent for the purposes intended. Performance, tangible results or measurable outcomes may be equally valid and far less labor-intensive. The State should avoid overly bureaucratic processes, and the associated costs, when other approaches can provide appropriate and reasonable assurances.

Recommendation: The Department should ensure that records are maintained of close-out reviews and site visits conducted as part of the Strategic Planning Grants program.

Response: We agree that record-keeping and documentation of expenditures for this program need to be improved and we are strengthening those requirements. However, "site visits" in this program are really technical assistance visits provided at the communities' request. While a descriptive report of these visits could be produced, we are not certain they would be of any real value. Production of the plan itself, combined with submission of invoices from external providers, appears to offer the best documentation that grantee expenditures were appropriate.

Recommendation: The Department should require Certified Development Companies to undergo an annual financial audit.

Response: This recommendation will be implemented.

Recommendation: The Department should require Certified Development Companies to maintain accounting records in accordance with generally accepted accounting principles and should withhold funds until the Company(s) can demonstrate an adequate accounting system.

Response: While we agree that the Companies should demonstrate that they maintain an adequate accounting system, and will rely on the annual audit to verify that those systems are in place, we are not prepared to withhold FY96 grants on this basis alone. We believe the same ends can be accomplished by giving the Companies notice of this requirement and working with them, if need be, to develop appropriate systems. But we do not want to withhold the very resources that may be needed to achieve compliance with this requirement. We will consider more stringent enforcement procedures in the future, however, if the Company fails to make any progress in meeting this requirement.

Again, thank you for this opportunity to present our comments on your findings. We look forward to meeting with the Post Audit Committee on July 26 to discuss these recommendations and answer any questions the Committee members may have.

Sincerely,

Gary Sherrer

Gary Sherrer
Secretary

KANSAS, INC.

Charles R. Warren, President

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July 18, 1995

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JUL 19 1995
LEGISLATIVE POST AUDIT

Ms. Barbara J. Hinton
Legislative Post Auditor
Suite 1300
800 S.W. Jackson Street
Topeka, Kansas 66612-2212

Dear Ms. Hinton:

Thank you for sending me a draft copy of the performance audit report, Examining the Use of Economic Development Initiatives Fund Moneys.

I have reviewed the report carefully. In my opinion, the report is well-done and accurately describes the issues examined. I strongly endorse the audit team's conclusions regarding record-keeping and ensuring that database systems be established and maintained that accurately record client use and results of economic development programs.

I have no criticisms or suggestions regarding the performance audit. I commend the staff for the work that has been done.

Sincerely yours,

Charles R. Warren, Ph.D.
President

Board of Directors
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