

Approved: March 20, 1997

Date

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION.

The meeting was called to order by Chairperson Audrey Langworthy at 11:00 a.m. on March 18, 1997, in Room 519--S of the Capitol.

Members present: Senator Langworthy, Senator Corbin, Senator Lee, Senator Bond, Senator Donovan, Senator Goodwin, Senator Hardenburger, Senator Karr, Senator Praeger, Senator Steffes and Senator Steineger.

Committee staff present: Tom Severn, Legislative Research Department
Chris Courtwright, Legislative Research Department
Don Hayward, Revisor of Statutes
Shirley Higgins, Secretary to the Committee

Conferees appearing before the committee: Mark Beck, Director, Property Valuation Division
Bill Waters, Attorney, Property Valuation Division
Chris McKinzie, League of Kansas Municipalities
Cindy Lash, Legislative Division of Post Audit

Others attending: See attached list

The minutes of the March 14 meeting were approved.

Mark Beck, Director of the Property Valuation Division (PVD) briefed the committee on the effect of the Supreme Court decision defining retail cost when new. He distributed copies of the opinion which was given on March 7, 1997. (Attachment 1) Mr. Beck informed the committee that PVD plans to ask that the case be reconsidered.

In response to a specific request made by the committee, Mr. Beck discussed the estimated impact (through loss or shift) due to the removal of sales tax, freight and installation from commercial personal property assessments. As an aid, he distributed copies of a chart with pertinent information, emphasizing that the information shown is an extremely rough estimate because there is no hard data existing in counties on the subject. (Attachment 2) This type of information will not exist until the counties go through the entire process with the taxpayer. He noted that a heavier impact is estimated for counties with a large industrial sector such as Wyandotte and Sedgwick.

Bill Waters, PVD attorney, gave a brief history of the Supreme Court case. The case originated when two Leavenworth County taxpayers filed tax protests which were heard by the Kansas Board of Tax Appeals (KBOTA). The taxpayers raised a number of issues, one of which being whether or not sales tax, freight and installation are part of retail cost when new which is the starting point of the formula for valuing commercial and industrial property. In a four to one decision, KBOTA ruled that sales tax, freight and installation were not a part of retail cost when new. Leavenworth County Commissioners appealed the decision to the Leavenworth County District Court. The District Judge ordered PVD to be a party in the case. The District Judge affirmed KBOTA's decision. Leavenworth County appealed the decision to the Court of Appeals, and PVD asked the Kansas Supreme Court to transfer the case. The Supreme Court granted the motion to transfer.

Mr. Waters explained that the Supreme Court viewed the issue as a question of Constitutional construction instead of a question of statutory construction (K.S.A. 79-1439). He noted that this was an important point because, when courts interpret Constitutional provisions, they basically attempt to ascertain what a person of common understanding would think a term meant when voting on the provision. He noted that this provision was voted on in November of 1986. The basic argument made by PVD to the Court was that the case dealt with a modified cost approach to valuing property, reasoning that all the authority that exists on this subject holds that sales tax, freight and installation are part of cost. Mr. Waters explained that the problem lies with

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION, Room 519-S
Statehouse, at 11:00 a.m. on March 18, 1997.

the fact that no other state uses the phrase "retail cost when new." However, the Leavenworth County District Judge basically said that he did not find any dispute about the meaning of "retail" or "new"; he thought the only dispute was about "cost" because that term is common throughout the nation. The Supreme Court discounted the persuasive authority of the case law because it did not deal with the phrase "retail cost when new" and concluded that a person of common understanding would not believe that sales tax, freight and installation were part of cost when voting on the provision in 1986.

Mr. Waters noted that although there is no appeal to the Supreme Court decision, a rehearing can be requested within twenty days after the opinion is issued. Thus, PVD has until March 27 to request a rehearing; and as indicated by Mr. Beck, a decision has been made by PVD to file a motion for rehearing. The primary reason for the request for rehearing will be to ask the Court to spell out whether the decision applies prospectively or retroactively and to urge the Court to apply it prospectively (tax years commencing January 1, 1998). The essential arguments by PVD include: (1) the difficulty in implementing the Court's decision for the 1997 tax year and (2) all 1996 taxpayers who have commercial and industrial property would have an avenue to protest their taxes by protesting the second half. PVD also plans to ask the Court to reconsider its decision on the ground that the Court's indication that the phrase "retail cost when new" replaced "fair market value" was in error because "fair market value" is the end result of the valuation process, and "retail cost when new" is the beginning point of the evaluation process. Mr. Waters was not optimistic that this argument would hold and also noted that the Supreme Court rarely grants a rehearing.

In summary, Mr. Waters said the last two paragraphs of the Supreme Court's decision indicate that under no circumstances may sales tax be considered a part of retail cost when new and that retail cost when new may include freight and installation only when they cannot be separately determined (a situation that does not occur often). In general, Mr. Waters felt the Legislature had no remedy because the term in question is a Constitutional term, and definition of a Constitutional term is a Judicial function whereas the Legislature's function is to define statutory terms.

Chris McKenzie, League of Kansas Municipalities, observed that plans should be made in preparation for potential impacts of the Supreme Court's decision. One subject of concern is the retroactivity issue in regard to the second half payments coming in June of this year. If this becomes a large fiscal hit for a county, it may mean that there is revenue that was budgeted to be spent that cannot be spent. He emphasized, even if tax levies are not increased in counties that lose this value, there will be shifts from one class of property to another. He added that reaction to the shift should be tempered by the magnitude of the shift. He suggested that the committee explore the possibility of phasing in the changes. However, he noted that it is unclear how much the Court would allow the Legislature to address these issues. Finally, he suggested that the Court's decision may create incentives for recharacterizing the components of costs in the purchase of business equipment as a legitimate tax avoidance mechanism by companies negotiating for the purchase of equipment in the future. Furthermore, he cautioned that, if the attempt to persuade the Court to determine that its decision applies prospectively is unsuccessful, some commercial equipment owners will get an advantage and some who will not. With this, the briefing on "retail cost when new" was concluded.

Senator Langworthy turned the committee's attention to a Post Audit report on the state's annual sales-ratio study which compares the selling price of property to its appraised value. (Attachment 3) She explained that the report was requested by the Task Force on Property Tax after hearings held last December and January.

Cindy Lash, Legislative Division of Post Audit, briefed the committee on the report. (Attachment 4) She explained that the report answers two questions: (1) Is the methodology used in conducting the state's sales-ratio study mathematically sound? and (2) Is the state's method for determining which sales of property to include or exclude from the sales-ratio study reasonable, and has that method been applied appropriately? In answer to both questions, the report concluded that the Division of Property Valuation has done a good job of developing a ratio study to provide it with the basic information it needs to tell how well county appraisers are appraising properties. Ms. Lash noted that the Division of Post Audit made no recommendations to the Department of Revenue on either of the questions.

The meeting was adjourned at 11:57 a.m.

The next meeting is scheduled for March 19, 1997.

SENATE ASSESSMENT & TAXATION COMMITTEE
GUEST LIST

DATE: March 18, 1997

NAME	REPRESENTING
Pete Davis	PVD
Janice Johnson	PVD
MARK BECK	KDOR
Bill Waters	KDOR
Cindy Lash	Post Audit
RANDY TONGIOR	Post Audit
Brandon Hall	M J H
Bill James	BOEING
Jill Bridges	DOB
Judy Molen	KAC
Becky Swanwick	League of KS Municipalities
Callie Lee Denton	K. Peterson's Assoc.
Patricia	
Karen France	KS Assoc of R
Bob T. Han	KS Contractors Association
Robert Stockton	FSCC INTERN (SEN. DOROUGH)

IN THE SUPREME COURT OF THE STATE OF KANSAS

No. 76,097

BOARD OF COUNTY COMMISSIONERS OF
LEAVENWORTH COUNTY, KANSAS, *et al.*,

Appellants,

v.

MCGRAW FERTILIZER SERVICE, INC.,

Appellee,

and

BOARD OF COUNTY COMMISSIONERS OF
LEAVENWORTH COUNTY, KANSAS, *et al.*,

Appellants,

v.

GEIGER READY-MIX CO., INC.,

Appellee.

SYLLABUS BY THE COURT

1.

In ascertaining the meaning of a constitutional provision, the primary duty of the courts is to look to the intention of the makers (the legislature) and the adopters (the voters) of that provision.

2.

A constitutional provision is not to be narrowly or technically construed, but its language should be interpreted to mean what the words imply to persons of

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Attachment 1

common understanding. Words in common usage are to be given their natural and ordinary meaning in arriving at a proper construction.

3.

The power to levy taxes is inherent in the power to govern, but the exercise of that power is dependent upon the existence of legislation designating the kinds of property to be taxed. Nothing is taxable unless clearly within the grant of the power to tax.

4.

Taxing statutes will not be extended by implication beyond the clear import of the language employed therein; their operation will not be enlarged so as to include matters not specifically embraced.

5.

Uniformity in taxation implies equality in the burden of taxation, and this equality cannot exist without uniformity in the basis of valuation. Uniformity in taxation does not permit a systematic, arbitrary, or intentional higher valuation than that placed on other similar property within the same taxing district.

6.

In Kansas, the sales tax is a "debt" from the consumer to the retailer. Because the Kansas sales tax is, by statute, not a cost to the retailer, it cannot be considered as simply another cost of doing business.

7.

All costs normally passed on to the consumer in setting the retail sales price are to be included in the valuation of personal property.

8.

Although costs contributing to the retail price are part of the value of an item, add-on costs incurred by the consumer after the retail price has been set have less to do with the value of the item and more to do with how and where the consumer is going to use the item. As long as these add-on costs are charged separately and readily discernible from the actual sales price of the item, these add-on costs are based on a separate contract for services and are not included in the "retail cost when new" in determining ad valorem tax values.

9.

Applying the well-established principle of common understanding to the valuation standard "retail cost when new" contained in art. 11, § 1(b) of the Kansas Constitution, we find that for purposes of ad valorem taxation, the phrase never

includes sales tax and does not always include the addition of freight and installation charges to the purchase price of an item.

Appeal from Leavenworth district court; DAVID J. KING, judge. Opinion filed March 7, 1997. Affirmed as modified.

William E. Waters, of Division of Property Valuation, Kansas Department of Revenue, argued the cause and was on the briefs for appellant Director of Property Valuation.

Keyta D. Kelly, Leavenworth County Counselor, argued the cause and was on the briefs for appellant Board of County Commissioners of Leavenworth County.

Carol B. Bonebrake, of Cosgrove, Webb & Oman, of Topeka, argued the cause and was on the brief for appellee McGraw Fertilizer Service, Inc.

Linda Terrill, of Neill, Scott, Terrill & Embree, L.L.C., of Lenexa, argued the cause and was on the brief for appellee Geiger Ready Mix Co., Inc.

Clarence D. Holeman, assistant county counselor of Sedgwick County, was on the brief for *amicus curiae* Board of Sedgwick County Commissioners.

Robert J. O'Connor and *Dwight D. Dumler*, of Morrison & Hecker L.L.P., of Wichita, were on the brief for *amici curiae* certain Sedgwick County taxpayers.

The opinion of the court was delivered by

LOCKETT, J.: The Board of Leavenworth County Commissioners (County) and the Director of the Division of Property Valuation (Director) seek review of the Board of Tax Appeals' (BOTA) and the Leavenworth County District Court's construction of the valuation standard "retail cost when new" of art. 11, § 1(b), class 2 (E), of the Kansas Constitution implemented in K.S.A. 79-1439(b)(2)(E). BOTA and the district court held that the phrase "retail cost when new," as applied to the ad valorem taxation of commercial and industrial machinery and equipment, does not include charges for installation, freight, and sales tax. In addition, the County and Director claim that the appeal of Geiger Ready-Mix Co., Inc., (Geiger) to BOTA should have been dismissed for lack of jurisdiction.

Appellees McGraw Fertilizer, Inc., (McGraw) and Geiger are taxpayers in Leavenworth County who own commercial and industrial personal property required to be valued by the county appraiser pursuant to class 2(E) as set forth in subsection (b) of art. 11, § 1 of the Kansas Constitution and as implemented by K.S.A. 79-1439(b)(2)(E). Under the applicable constitutional and statutory provisions, the county appraiser is required to determine the "retail cost when new" of commercial and industrial personal property. Guidelines prescribed by the Director require county appraisers to include sales tax and freight and installation costs in the "retail cost when new" of commercial and industrial personal property when valuing such property for property tax purposes.

In 1993, the County contracted with an outside auditor to review and audit the commercial and industrial personal property renditions of various taxpayers, including McGraw and Geiger, on a contingent fee basis. As a result of that audit, the County determined that "retail cost when new" included sales tax as well as expenses associated with freight and installation of various items of commercial and industrial property owned by both taxpayers. The County assessed additional tax and penalties.

McGraw disputed the amount of additional tax assessed and filed an Equalization Appeal of Property Value pursuant to K.S.A. 79-1448 with BOTA. BOTA converted the equalization of tax appeal to a protest of payment of tax action pursuant to K.S.A. 79-2005. Following an evidentiary hearing, BOTA issued an order concluding that "add-on costs incurred by the consumer after the retail price is paid (such as sales tax, installation, and freight charges to the ultimate destination), are not included in the 'retail cost when new.'" The County filed a petition for reconsideration, which BOTA denied. The County appealed to the district court pursuant to K.S.A. 74-2426(c)(4).

In a separate action, Geiger also disputed the additional amount of tax assessed. The auditor claimed Geiger owed taxes of \$50,000. Although not completely clear from the record, it appears Geiger filed both a tax protest and a tax grievance with BOTA. Geiger raised numerous issues, but not the issue of the interpretation of the phrase "retail cost when new." During the grievance

proceeding, the County was granted permission to brief other legal issues, including the interpretation of the phrase "retail cost when new." On April, 5, 1995, BOTA, as in the McGraw action, again concluded that "add-on costs incurred by the consumer after the retail price is paid (such as sales tax, installation, and freight charges to the ultimate destination), are not included in the 'retail cost when new.'" In addition, BOTA determined that Geiger did not owe the County \$50,000; instead, Geiger was entitled to a \$4,000 refund.

The County appealed both BOTA orders to the district court. The district court consolidated the appeals and allowed intervention of the Director. The district court then affirmed BOTA's interpretation that the phrase "retail cost when new" did not include add-on costs for sales tax, freight, and installation. The County and the Director appealed, and the appeal was transferred to this court. This court granted certain Sedgwick County taxpayers and the Board of Sedgwick County Commissioners permission to file *amicus curiae* briefs. The Sedgwick County taxpayers presently have appeals pending in the Court of Appeals raising the issue of the interpretation of the "retail cost when new" standard.

STANDARD OF REVIEW

The County and the Director argue that BOTA "erroneously interpreted or applied the law." See K.S.A. 77-621(c)(4). BOTA is the highest administrative agency on property tax matters. BOTA has the power and authority to exercise its judgment anew and independent of the Director in determining the assessment of state

assessed property. See *Mobil Pipeline Co. v. Rohmiller*, 214 Kan. 905, 920, 522 P.2d 923 (1974). BOTA orders are subject to judicial review under the Act for Judicial Review and Civil Enforcement of Agency Actions, K.S.A. 77-601 *et seq.* K.S.A. 74-2426(c). Here, we are not asked to interpret a statute. We are required to interpret the Kansas Constitution.

In ascertaining the meaning of a constitutional provision, the primary duty of the courts is to look to the intention of the makers (the legislature) and the adopters (the voters) of that provision. *State ex rel. Stephan v. Finney*, 254 Kan. 632, 654, 867 P.2d 1034 (1994). A constitutional provision is not to be narrowly or technically construed, but its language should be interpreted to mean what the words imply to persons of common understanding. 254 Kan. at 654; *Colorado Interstate Gas Co. v. Board of Morton County Commr's*, 247 Kan. 654, 660, 802 P.2d 584 (1990). Words in common usage are to be given their natural and ordinary meaning in arriving at a proper construction. *Farmers Co-op v. Kansas Bd. of Tax Appeals*, 236 Kan. 632, 635, 694 P.2d 462 (1985).

There are well-established rules of construction applicable to tax matters. The power to levy taxes is inherent in the power to govern, but the exercise of that power is dependent upon the existence of legislation designating the kinds of property to be taxed. Nothing is taxable unless clearly within the grant of the power to tax. See *Robbins-Leavenworth Floor Covering, Inc. v. Leavenworth Nat'l Bank & Trust Co.*, 229 Kan. 511, 512, 625 P.2d 494 (1981). The right to tax is penal in nature,

and this right must be strictly construed in favor of the taxpayer. *J.G. Masonry, Inc. v. Department of Revenue*, 235 Kan. 497, 500, 680 P.2d 291 (1984). Tax statutes will not be extended by implication beyond the clear import of the language employed therein; their operation will not be enlarged so as to include matters not specifically embraced. *Director of Taxation v. Kansas Krude Oil Reclaiming Co.*, 236 Kan. 450, 455, 691 P.2d 1303 (1984). Where there is reasonable doubt as to the meaning of a taxing act, it will be construed most favorably to the taxpayer. *National Cooperative Refinery Ass'n v. Board of McPherson County Comm'rs*, 228 Kan. 595, 597, 618 P.2d 1176 (1980).

JURISDICTION

For the first time on appeal, the Director argues that BOTA had no jurisdiction, pursuant to K.S.A. 79-1702, to consider the property valuation issues raised by Geiger because no clerical error was alleged and the taxes were not paid in protest as provided by K.S.A. 79-2005. The Director asserts Geiger's grievance should be remanded to the district court with instructions to vacate BOTA's order for lack of jurisdiction. We note that even if Geiger's protest was dismissed for lack of jurisdiction because the Director has not challenged McGraw's protest, the question presented requires a decision of this court.

Although it is not totally clear from the record, it appears that Geiger paid its disputed taxes under protest and filed a tax grievance covering the identical issues

raised in the protest. Since Geiger paid the disputed taxes under protest, BOTA had jurisdiction to consider Geiger's appeal.

"RETAIL COST WHEN NEW"

In Kansas, only "tangible" personal property is taxable for ad valorem purposes. Kan. Const. art. 11, § 1. Under Kansas law, "personal property" includes "every tangible thing which is the subject of ownership, not forming part or parcel of real property." K.S.A. 79-102. "Tangible" is not defined in the tax statutes, but this court has adopted the view that "tangible" is "'descriptive of such things as have an objective, material existence; perceptible by the senses of sight and touch; possessing a real body.'" *In re Tax Protest of Strayer*, 239 Kan. 136, 142, 716 P.2d 588 (1986) (quoting Black's Law Dictionary 310 [5th ed. 1979]).

In 1985, the Kansas Legislature adopted House Concurrent Resolution 5018, which was submitted to the voters in the 1986 general election as a proposed amendment to art. 11, § 1 of the Kansas Constitution. The amendment changed the uniform and equal rate of assessment and taxation standard of the Kansas ad valorem taxation system and substituted a classification system. The subsection of the amended provision dealing with the classification of commercial and industrial equipment changed the concept of "fair market value" to "retail cost when new." Under art. 11, § 1(b), class 2 (E), of the Kansas Constitution, commercial and industrial property is to be valued at its "retail cost when new." The relevant section of art. 11 provides:

"Article 11. -- FINANCE AND TAXATION

"§ 1. (a) System of taxation; classification; exemption. The provisions of this subsection (a) shall govern the assessment and taxation of property until the provisions of subsection (b) of this section are implemented and become effective, whereupon subsection (a) shall expire. The legislature shall provide for a uniform and equal rate of assessment and taxation, except that the legislature may provide for the classification and the taxation uniformly as to class of motor vehicles, mineral products, money, mortgages, notes and other evidence of debt or may exempt any of such classes of property from property taxation and impose taxes upon another basis in lieu thereof. All property used exclusively for state, county, municipal, literary, educational, scientific, religious, benevolent and charitable purposes, and all household goods and personal effects not used for the production of income, shall be exempted from property taxation.

"(b) System of taxation; classification; exemption. (1) The provisions of this subsection (b) shall govern the assessment and taxation of property on and after January 1, 1989, and each year thereafter. Except as otherwise hereinafter specifically provided, the legislature shall provide for a uniform and equal basis of valuation and rate of taxation of all property subject to taxation. The provisions of

this subsection (b) shall not be applicable to the taxation of motor vehicles, except as otherwise hereinafter specifically provided, mineral products, money, mortgages, notes and other evidence of debt and grain. Property shall be classified into the following classes for the purpose of assessment and assessed at the percentage of value prescribed therefor:

....

"Class 2 shall consist of tangible personal property. Such tangible personal property shall be further classified into six subclasses, shall be defined by law for the purpose of subclassification and assessed uniformly as to subclass at the following percentages of value:

...

"(E) Commercial and industrial machinery and equipment which, if its economic life is seven years or more, shall be valued at its retail cost when new less seven-year straight-line depreciation, or which, if its economic life is less than seven years, shall be valued at its retail cost when new less straight-line depreciation over its economic life, except that, the value so obtained for such property, notwithstanding its economic life and as long as such property is being used, shall not be

less than 20% of the retail cost when new of such property.....20%.”

K.S.A. 79-1439(b)(2)(E), which was later enacted and follows the constitutional provision verbatim, requires the appraiser to use the “retail cost when new” of an item as the starting point when appraising commercial and industrial machinery and equipment.

A. Decisions Below

Does the phrase “retail cost when new” include variable add-on (post-acquisition) amounts for sales tax, freight and installation? To understand BOTA’s ruling on this issue, BOTA’s analysis in its March 15, 1995, decision is quoted in detail:

“11. The above referenced constitutional provision and statute does not define what it means by ‘retail cost when new.’ We have found no Kansas case law attempting to provide a definition. The Board notes, however, that there are other tax statutes that refer to what is included in the word ‘cost.’ K.S.A. 79-3602, 79-3602a and 79-3602b of the Kansas Retailers Sales Tax Act all define the term ‘selling price’ as: ‘. . . the total cost to the consumer exclusive of discounts allowed and credited, but including freight and transportation charges from retailer to consumer.’ Thus, for sales tax purposes, total cost includes

freight and transportation charges from retailer to consumer. Leavenworth County produced a memorandum from the Division of Property Valuation (PVD) dated March 25, 1993, adopting the sales tax definition for use in setting the ad valorem tax value of commercial personal property. County Exhibit #3. No authority or reasoning is provided by either the memorandum or the county as to why the sales tax definition is being adopted for ad valorem tax purposes.

"12. When a specific section of a tax statute does not provide a definition, there is some authority to look to other taxation sections within Chapter 79 of the Kansas Statutes Annotated for guidance. The Kansas Supreme Court examined this technique for ascertaining definitions within a legislative package such as Chapter 79. *First Page, Inc. v. Cunningham*, 252 Kan. 593, 600, 847 P.2d 1238 (1992). However, the Board notes that the high court (while not disapproving) did not specifically approve the use of this technique in interpreting Kansas statutes.

"13. The Board is reluctant to use the *First Page* technique to apply definitions found in the Kansas Retailers' Sales Tax Act to the statutes regarding ad valorem property tax. While both are found in chapter 79 of the Kansas statutes, these two kinds of

taxes have distinctly different characteristics and purposes. The sales tax is a tax on the privilege of engaging in the business of selling tangible personal property at retail in this state, and is levied on the gross receipts of sales transactions. K.S.A. 70-3603. Ad valorem property taxes, on the other hand, are taxes on the ownership of property and are levied on the value of property. Kan. Const. Art. 11, Sec. 1(a) and K.S.A. 79-1439 both state that commercial equipment shall be *valued* at its 'retail cost when new.' One is a tax on the transaction and the other a tax on the value of the item sold. It does not follow that what is included in one must also be included in the other. It is not clear to this Board that charges added to the retail price for freight, installation and particularly for sales tax are related to the value of the product sold. Therefore, the Board finds that the definition of 'sales price' for retail sales tax purposes is not the same as, and is not an appropriate definition for, 'retail cost when new' as applied to ad valorem taxation of commercial personal property.

- "14. Another troublesome feature of the proposition that freight, installation and sales tax be included in the 'retail cost when new' for calculating ad valorem property taxes is that ad valorem taxes must be based on valuations that are uniform and equal.

For example, suppose two companies, A and B, purchase the same piece of equipment with a retail cost of \$1,000. Taxpayer A has the equipment delivered by the same company they bought it from for a delivery fee of \$75. Added to the \$1,075 is a sales tax of 6.5% for a total of \$1,144.87. Company B, on the other hand, purchases the equipment from an out-of-state firm (thus paying no Kansas sales tax) and pays a third party to ship the equipment. On January 1 (and every year thereafter for the life of the equipment), Taxpayer A (cost = \$1,144.87) would have a higher valuation than B (cost = \$1,000) for the exact same item, purchased on the same day and for the same sale price.

"15. There are no Kansas cases directly on point. A review of case law from other jurisdictions since 1980 shows very little litigation on the issue at hand. What few cases were found have decided that the term 'cost,' when used for valuation of personal property for ad valorem taxation purposes, included all costs actually paid by the consumer. This includes installation costs *Crown Cork and Seal Co., Inc. v. South Carolina Tax Commission*, 394 S.E. 2d 315 (S.C. 1990); current data, transportation and set up costs, *IBM Credit Corporation v. Board of County Commissioners of the County of Jefferson*, 870 P.2d 535 (Colo. App. 1993); the foregoing, as well as the price of the

asset, site preparation and sales tax. *Xerox Corp. v. County of Orange*, 136 Cal. Rptr. 583 (1977); and *State Department of Assessments and Taxation v. Metrovision of Prince George's County, Inc.*, 607 A.2d 110 (Md. App. 1992). Critical to the reasoning in these cases was the law in these jurisdictions that the sales tax was a direct obligation of the retailer. As such, it was just another cost passed on to the consumer. Kansas statutes require a different result.

- "16. In Kansas, the sales tax is by statute not a cost to the retailer. K.S.A. 79-3604 provides that the sales tax shall be paid by the consumer; that sales tax shall be a *debt* from consumer to retailer; and that it is recoverable at law in the same manner as other debts. If the sales tax is not paid by the consumer, the director of taxation may proceed directly against the *consumer* to collect the full amount of the tax due. This statute has two important applications to the issue at hand. First, the Kansas sales tax is not a cost to the retailer which can be considered as simply another cost of doing business which is passed on to the consumer. Second, the Kansas sales tax is, by statute, a 'debt' from the consumer to the retailer. K.S.A. 79-3604. In Kansas, 'Money, notes and other evidence of debt are . . . exempt from all ad valorem and other property taxes levied under the laws of the

state. . . .’ By defining sales taxes as a ‘debt’ of the consumer, our statutes have specifically exempted sales taxes from ad valorem taxation.

“17. This Board understands and agrees that all costs passed on to the consumer in *setting* the retail price are to be included in the valuation of personal property. These costs will appropriately include intangibles such as import and export taxes, excise taxes, freight, labor, commissions, advertising and other overhead expenses. However, the Board also sees a point at which amounts paid by a consumer are beyond the retail cost of the item being purchased. The cost new to a consumer of an item with a retail price of \$100.00, for example, can reasonably be construed to be \$100.00. Such a cost includes all the costs of production and marketing as well as a profit to producers and retailers. It is not at all clear that additional costs paid after the retail price has been paid by the consumer should also be included in the words ‘retail cost when new.’ All costs contributing to the retail price are part of the value of an item. Add-on costs incurred by the consumer after the retail price has been paid, however, have less to do with the value of the item and more to do with how and where the consumer is going to use the item. As long as these add-on costs are separately listed

and readily discernible from the actual retail price of the item, there is no reason why these add-on costs cannot also be separated from the 'retail cost when new' in determining ad valorem tax values.

"18. The analysis in the previous paragraph is supported by Kansas tax statutes. The Board notes that the Kansas Retailers' Sales Tax Act defined the term 'selling price,' in part, as '... the total cost to the consumer. . . .' K.S.A. 79-3602, 79-3602a, 79-3602b. In explaining 'total cost to the consumer,' the above referenced statutes continue with these words: '... exclusive of discounts allowed and credited, but including freight and transportation charges from retailer to consumer.' Id. The first thing the Board takes from this statutory language is that the legislature must have understood the words 'total cost to the consumer' to not include freight and transportation costs; otherwise, there would have been no reason to specifically add these costs to the definition. The second thing the Board takes from the statutory language is that the legislature knows how to include the cost of freight and transportation in the words 'total cost to the consumer.' It did so in the Retailers' Sales Act. No such language can be found in the property valuation statutes. K.S.A. 79-1439 provides that commercial machinery and equipment is

to be valued at its ' . . . retail cost when new . . . ' In this statute, the legislature declined to include the cost of freight and transportation, as it had done in the sales tax act. The Board will not read into statutes words that are not there.

"19. As the Board considers this matter, it does so with the knowledge that strict construction is required as tax statutes are considered penal in nature. *In re Tax Protest of Strayer*, 239 Kan. 136, 141, 716 P.2d 588 (1986). One of the effects of strict construction is that:

'Tax statutes will not be extended by implication beyond the clear import of language employed therein, and their operation will not be enlarged so as to include matters not specifically embraced. The rule of strict construction means that ordinary words are to be given their ordinary meaning. Such a statute should not be so read as to add that which is not readily found therein or to read out what as a matter of ordinary English language is in it.' *In re Tax Appeal of Atchison, Topeka & Santa Fe Railway Company*, 17 Kan. App. 2d 794, Syl. ¶ 5, 844 P.2d 756 (1933).

Another effect of strict construction is that: 'If there is a reasonable doubt about the meaning of a taxing act, it will be

construed most favorably to the taxpayer.' *Executive Aircraft Consulting, Inc. v. City of Newton*, 252 Kan. 421, Syl. ¶ 4, 845 P.2d 57 (1992).

"20. For all the reasons stated above, the Board finds that add-on costs incurred by the consumer after the retail price is paid, (such as sales tax, installation and freight charges to the ultimate destination), are not included in the 'retail cost when new.' When separately listed so that they can be readily discerned from the actual retail price, these add-on costs should not be included in the tax valuation of commercial machinery and equipment."

It is noteworthy that this decision is contrary to BOTA's prior position on the issue. In *In the Matter of the Protest of Wickham Industries, Inc.*, Docket No. 88-3202-PR (June 14, 1989), BOTA ruled that the county appraiser had properly included freight and installation as a portion of the taxpayer's cost of personal property. In *In the Matter of the Protest of Northrock Lanes, Inc.*, Docket Nos. 88-6075-PR and 90-8223-PR (December 4, 1991), BOTA, relying on *Wickham*, ruled that sales tax, freight, and installation costs were assessable. The *Northrock* decision relied upon the Director's guidelines, which stated that sales tax, freight, and installation costs were to be included. However, in deciding *Wickham* and *Northrock*, BOTA did not undertake the depth of analysis subsequently undertaken in *McGraw* and *Geiger*.

The BOTA ruling in the *McGraw* case included a dissent. The dissent was premised, in part, on the Kansas Retailers' Sales Tax Act's definition of "selling price" as "the total cost to the consumer exclusive of discounts allowed and credited, but including freight and transportation charges from retailer to consumer." K.S.A. 1996 Supp. 79-3602(g). The dissent found no difference between the terms "selling price" and "retail cost when new." The dissent relied upon case law from other jurisdictions in concluding that the term "cost," when used for valuation of personal property for ad valorem tax purposes, includes all costs actually paid by the consumer. It reached this conclusion even though the other jurisdictions had not adopted Kansas' "retail cost when new" standard.

The Leavenworth County District Court, in affirming BOTA, did not engage in lengthy analysis, but stated in part:

"In my judgment, and this is my decision, ["retail cost when new" is] the amount necessary to acquire the property itself. It does not include incidental and optional charges for services in connection with the purchase of the item, such as freight and installation charges. And it, likewise, does not include sales tax. That is not a cost of the item; it is something that must be paid to acquire the item, but not a cost which is inherent in the item. It is not a common and understood item which would be included in what an ordinary person would understand an item to cost. If you consider, What does a television set

cost?, you may say \$375. You would not consider that cost to include sales tax.

"I do find, as well, that the opinion and the briefs which distinguish sales tax and note that it is considered in Kansas law as a debt and not a part of the value of property to be persuasive in that regard." *Board of County Commr's of Leavenworth County, Kansas v. McGraw*, No. 9504CV238 (Jan. 17, 1996).

B. Other Authority

The Director argues that BOTA's interpretation that "retail cost when new" of commercial and industrial machinery and equipment does not include taxes, freight, and installation charges is erroneous as a matter of law. The Director's point is that to "men of common understanding," the term "cost" means "total acquisition cost" to the consumer. The Director bases this contention upon the fact that the total acquisition cost of commercial and industrial machinery and equipment for accounting, federal income tax, and appraisal purposes includes sales tax as well as freight and installation charges. For authority, the Director relies upon I.R.S. Publication 551, Basis of Assets (1994); International Association of Assessing Officers (I.A.A.O.), Standard on Valuation of Personal Property, § 7.2.1. (1985); and Kieso & Weygandt, Intermediate Accounting 446 (6th ed. 1989); and Accounting Research Bulletin No. 43 (published by the Committee on Accounting Procedure).

I.R.S. Publication 551, Basis of Assets, p. 2, states that sales tax, freight, and installation charges are included in the basis of an asset for federal income tax purposes. The Director and the County argue that because freight and installation charges may be included in the cost basis of an asset and depreciated for federal income tax purposes, such charges must be included as state tangible personal property. BOTA properly found there was no similarity between "cost basis" for federal income tax purposes and the Kansas valuation standard "retail cost when new."

Amici curiae Sedgwick County taxpayers argue that depreciation allows the taxpayer to recover the total cost of acquiring and installing the asset by making allocations of this total cost to the tax periods benefitted over the useful life of the asset. However, a difference exists between the function of "cost basis" for federal income tax purposes and "retail cost when new" for Kansas ad valorem tax purposes. The fact that freight and installation charges may be capitalized and depreciated for federal tax purposes does not render such charges tangible property for purposes of Kansas ad valorem taxation. Freight and installation are depreciated not because they are tangible property, but because they benefit the taxpayer over more than one year.

The I.A.A.O., Standard on Valuation of Personal Property § 7.2.1., provides that "total acquisition costs including freight, installation, taxes and fees" are included in the basis of a depreciable asset for purposes of appraisal. Again, this

standard relates to the broader term "total acquisition cost" when determining fair market value and not "retail cost when new."

Kieso & Weygandt, Intermediate Accounting 446 and Accounting Research Bulletin No. 43 are not included in the record, and the court has not located these publications. However, it is unlikely that an accounting term has relevance in defining the term "retail cost when new." In the absence of evidence of legislative intent regarding the meaning of "retail cost when new," the court construes the words based upon what the words imply to persons of common understanding, not upon an accounting procedure.

I.R.S. publications, accounting research bulletins, and interpretations of the I.A.A.O. are not persuasive authority regarding "common understanding." Reliance upon these authorities is misplaced. It is highly unlikely that the Kansas Legislature intended the phrase "retail cost when new" to be synonymous with "cost basis" or "total acquisition cost for fixed assets" as set forth in these publications.

Amici curiae Sedgwick County taxpayers next urge that we rely on other jurisdictions which have held that freight, installation, and sales tax charges are an assessable component of the value of personal property. However, we have examined all of the cases cited by *amici curiae* and found that they have no persuasive authority, since none of those jurisdictions possesses a valuation standard similar to the "retail cost when new" adopted by Kansas. See, e.g., *Aptco Auto Auction v. City of Taylor and County of Wayne*, 1996 WL 172791 (Mich. Tax

Tribunal) (case did not consider whether freight and installation charges are tangible property; court analyzed issue under statutes inconsistent with Kansas law); *Mack Aviation Company, Inc. v. Scott Noble, King County Assessor*, 1993 WL 558024 (Wash. Bd Tax. App.) (Washington utilizes "true and fair value in money" as its valuation standard, defined by case law as market value; standard valuation approach, which adds charges over and above market value, is inconsistent with the Kansas "retail cost when new" standard); *Department of Revenue of the State of Montana v. World Wide Press, Inc.*, 1992 WL 275722 (Mont. Tax. App. Bd.) (all taxable property must be assessed at 100% of its market value, which is what a willing buyer would pay a willing seller); *Connecticut Mutual Life Insurance Company v. City of Hartford*, 1996 WL 367778 (Conn. Super.) (court did not consider tax status of freight and installation charges; property valued at "present and true value," which is fair market value and not value at a forced sale or auction); *Xerox Corp. v. County of Orange*, 66 Cal. App. 3d 746, 136 Cal. Rptr. 583 (1977) (property valued at "full value," defined as "fair market value, full cash value, or other such value standard" prescribed by California Constitution).

While various theories of market value appraisal have been used in other jurisdictions as a rationalization for considering components of expense such as freight and installation charges and sales tax, this does not dictate the same result in Kansas where "retail cost when new" has replaced "fair market value." No other taxing jurisdiction in the United States, including the I.R.S., uses the terminology "retail cost when new." This term is unique to the State of Kansas. It is not the

equivalent of "fair market value," "cost basis for federal income tax purposes," "cost basis for accounting purposes," or "cost approach to fair market value." The phrase "retail cost when new" contains words which are commonly used and understood. Persons of common understanding would not expect to have to refer to definitions utilized by other states and the I.A.A.O. and I.R.S. to arrive at a definition of the term. Based upon this analysis, statutory definitions and case law from other jurisdictions are not persuasive.

C. Legislative Inaction

Next, appellants argue that "retail cost when new" must include freight and installation charges as well as sales tax because the Kansas Legislature has considered but declined to define "retail cost when new" to exclude sales tax, freight, and installation. We note that House Bills 2108 and 2655, introduced in the House Committee on Taxation during the 1995 and 1996 sessions of the legislature, contained the following language:

"[F]or purposes of class 2(E) of subsection (b) of section 1 of article 11 of the Kansas Constitution, 'retail cost when new' shall mean the total cost to the consumer [purchaser] less the amount of any transactional taxes, installation costs and freight or transportation charges included in such cost."

In the 1995 session, this language was included in a proposed amendment relating to the exemption of certain business machinery and equipment from property taxes. While portions of the bill were subsequently enacted into law, the language was dropped from the amendment. In 1996, the language was added to a proposed amendment exempting personal property items costing \$250 or less. This 1996 bill died in committee. There is little legislative history to provide guidance to the court as to why this provision was dropped from the 1995 amendment. With respect to the 1995 bill, a report from the Kansas Legislative Research Department attached to the subcommittee report of the Minutes of House Committee on Taxation, March 13, 1995, approved March 31, 1995, stated in part:

“Since the bill would define ‘retail cost when new’ to exclude transactional taxes, installation costs, and freight or transportation charges for purposes of the bill and for purposes of the subclass of commercial and industrial machinery and equipment in the Kansas Constitution, is it appropriate for the Legislature to attempt to define ‘retail cost when new’ for purposes of the Kansas Constitution when a court might find that the people of Kansas thought the term meant something different when the classification amendment was adopted?

“How might a court interpret what the people of Kansas thought the term meant, since--according to testimony from appraisers--the IRS and IAAO both include the taxes, installation and transportation costs in their definitions.”

The Director argues that by failing to enact these bills into law, the legislature intended to acquiesce in the Director's interpretation that "retail cost when new" includes sales taxes, freight, and installation charges. The Director cites no authority for the proposition that the legislature's inaction was due to its acquiescence in the Director's interpretation of the Kansas Constitution. As McGraw states in its brief, the court can draw many contradictory inferences from the legislature's failure to pass these bills, including the fact that the legislature was aware of BOTA's order of March 15, 1995, interpreting the provision.

It is important to note that the essential difference between a constitutional provision and a statute is that a constitutional provision usually states general principles or policies, and establishes a foundation of law and government, whereas a statute must provide the details of the subject of the statute. A constitution, unlike a statute, is intended not merely to meet existing conditions but to govern future contingencies. When a question of interpretation of the Kansas Constitution arises, it is the function and duty of this court to define constitutional provisions. *State ex rel. Stephan v. Finney*, 254 Kan. 632, Syl. ¶¶ 2, 4, 867 P.2d 1034 (1994). Based upon these stated principles, we find that the more likely inference from the statement in the attachment to the Minutes of the House Committee on Taxation, "How might a court interpret what the people of Kansas thought the term meant, since--according to testimony from appraisers--the IRS and IAAO both include the taxes, installation and transportation costs in their definitions," is that the

legislature decided that interpretation of the constitutional provision was a judicial and not a legislative function.

D. Uniform and Equal Clause

This court has stated: "Uniformity in taxation implies equality in the burden of taxation, and this equality cannot exist without uniformity in the basis of valuation. Uniformity in taxation does not permit a systematic, arbitrary, or intentional higher valuation than that placed on other similar property within the same taxing district." *Board of Johnson County Comm'rs v. Greenhaw*, 241 Kan. 119, 127, 734 P.2d 1125 (1987). The Director contends that exclusion of freight, installation, and sales tax as an assessable component of "retail cost when new" violates the "uniform and equal rate of assessment and taxation" language of art. 11, § 1 of the Kansas Constitution. The Director maintains that its interpretation of "retail cost when new" is paramount and must be upheld, even if incorrect, because it is uniformly applied by the Division of Property Valuation through its appraisal guidelines.

By statute, the Director supervises work of all county appraisers and has the duty to publish personal property valuation guidelines. *In re Tax Appeal of Horizon Tele-Communications, Inc.*, 241 Kan. 193, 199, 734 P.2d 1168 (1987); see K.S.A. 75-5105a. K.S.A. 75-5105a(b) grants authority to the Director to devise guidelines. However, that grant of authority is limited to guidelines showing "fair market value in money," not "retail cost when new." K.S.A. 75-5105a(b). In any

case, the Director's authority to promulgate guidelines is not without limitation. As the Court of Appeals recognized in *In re Tax Appeal of Alex R. Masson, Inc.*, 21 Kan. App. 2d 863, 867, 909 P.2d 673 (1995): "To be valid, a regulation must come within the authority conferred by statute, and a regulation which goes beyond that which the legislature has authorized or extends the source of its legislative power is void."

Further, although decisions of the Director are conclusive upon subordinate taxing officials, the power exercised by the Director is not judicial, and the question of whether assessment schedules promulgated by the Director conform to a statute is a question of law not finally determinable by the Director. *Garvey Grain, Inc. v. MacDonald*, 203 Kan. 1, 12, 453 P.2d 59 (1969).

The valuation guidelines published by Division of Property Valuation are valid only insofar as values achieved reach the constitutionally mandated "retail cost when new" standard. The Director's reliance upon *Addington v. Board of County Commissioners*, 191 Kan. 528, 382 P.2d 315 (1963), and *Gordon v. Hiatt*, 214 Kan. 690, 522 P.2d 942 (1974), is misplaced. Neither case stands for the proposition that a faulty valuation methodology which fails to achieve a constitutionally mandated standard should be upheld if the methodology is uniformly applied. As McGraw points out, this statement in *Gordon* suggests otherwise: "If, however, the taxing officials do not perform their duties in accordance with the law the issue presented to the court is not the exercise of administrative judgment, but the legality of their acts. [Citations omitted.]" 214 Kan. at 694.

Although the Director asserts that his interpretation of "retail cost when new" achieves uniformity by including sales taxes, freight and installation costs, we note that the opposite, or lack of uniformity, is more likely true. First, the record supports an inference that the Director has not applied the guidelines uniformly, having changed them over time to include sales tax at a later date. Second, the record does not indicate that all counties applied the guidelines uniformly. In addition, Kansas is a self-reporting state, K.S.A. 79-301 *et seq.*, and because private citizens do not receive the Director's directives, there is no evidence that all taxpayers reported freight, sales tax, and installation costs. Further, if the method of valuing tangible personal property results in variation in the valuation of identical or similar property based upon arbitrary factors that have no relationship to the tangible personal property's actual value, the appraisal is not uniform and equal. Freight, installation, and sales tax charges can be arbitrary and may vary depending on the distance to delivery or the nature and difficulty of the installation, and may vary from vendor to vendor for the same service. Identical pieces of property can be assessed at different values having nothing to do with the "retail cost when new" of the tangible property.

The constitutionally mandated uniformity is achieved by construing "retail cost when new" to exclude variable add-on amounts paid for intangible services and privileges after the purchase. As Geiger states:

"We can tell a merchant who buys the forklift for \$20,000 from an out of state company, incurring a use tax of 4.9%, that the forklift will be taxed for ad valorem tax purposes at its 'retail cost when new' of \$20,000, not \$20,980. We can tell the merchant that buys the same forklift from an Overland Park dealer with a tax rate of 6.75%, that the forklift will be taxed at its 'retail cost when new' of \$20,000, not \$21,350. We can tell both of those companies that their 'retail cost when new' will be the same as the manufacturer that purchases the same \$20,000 forklift sales tax exempt."

E. Construction

Interpretation of a constitutional provision or a statute is a question of law. An appellate court's review of a question of law is unlimited. *Foulk v. Colonial Terrace*, 20 Kan. App. 2d 277, Syl. ¶ 1, 887 P.2d 140 (1994), *rev. denied* 257 Kan. 1091 (1995); see *Todd v. Kelly*, 251 Kan. 512, 515, 837 P.2d 381 (1992).

The legislative intention is to be determined from a general consideration of the entire act. Effect must be given, if possible, to the entire act and every part thereof. To this end, it is the duty of the court, as far as practicable, to reconcile the different provisions so as to make them consistent, harmonious, and sensible. *Todd v. Kelly*, 251 Kan. at 516. When a specific section of a constitution or a tax statute does not provide a definition, it may be possible to look to other taxation sections within Chapter 79 of the Kansas Statutes Annotated for guidance. As BOTA found,

the court examined this technique in *First Page, Inc. v. Cunningham*, 252 Kan. 593, 600, 847 P.2d 1238 (1992), but did not specifically approve its use.

The technique of applying definitions found in the Kansas Retailers' Sales Tax Act to the statutes regarding ad valorem property tax does not apply here. K.S.A. 1996 Supp. 79-3602(g), of the Kansas Retailers' Sales Tax Act defines the term "selling price" as "the total cost to the consumer exclusive of discounts allowed and credited, but including freight and transportation charges from retailer to consumer." Thus, for sales tax purposes, total cost includes freight and transportation charges from retailer to consumer. The sales tax is a tax on the privilege of engaging in the business of selling tangible personal property at retail in this state, and is levied on the gross receipts of sales transactions.

Ad valorem property taxes, on the other hand, are taxes on the ownership of property and are levied on the value of property. While both the retailers' sales tax and ad valorem property tax provisions are found in chapter 79 of the Kansas statutes, the two types of taxes have distinctly different characteristics and purposes. One is a tax on the transaction, and the other a tax on the value of the item sold. Article 11, § 1(b)(1) of the Kansas Constitution and K.S.A. 1996 Supp. 79-1439 both state that commercial equipment shall be *valued* at its "retail cost when new." If the legislature had intended the phrase to always include freight and installation in the value of the item sold for ad valorem property taxes, it could have so specified when adopting House Concurrent Resolution 5018 for submission to the voters.

CONCLUSION

Sales Tax

In Kansas, the sales tax is by statute not a cost to the retailer. Sales taxes are a governmental charge for the privilege of acquiring property and do not increase the value to the property purchased. K.S.A. 1996 Supp. 79-3604 provides that the sales tax shall be paid by the consumer, shall be a debt from the consumer to the retailer, and shall be recoverable at law in the same manner as other debts. If the sales tax is not paid by the consumer, the Director of Taxation proceeds directly against the consumer to collect the tax due. This statute has an important application to the issue at hand. Because the Kansas sales tax is, by statute, a "debt" from the consumer to the retailer, the tax is not a cost to the retailer which can be considered as simply another cost of doing business. K.S.A. 79-3604. By defining sales taxes as a "debt" of the consumer, our statutes have specifically exempted sales taxes from ad valorem taxation. In Kansas, "Money, notes and other evidence of debt are . . . exempt from all ad valorem and other property taxes levied under the laws of the state of Kansas." K.S.A. 79-3109c. Therefore, sales tax is never included in determining "retail cost when new."

Freight and Installation Charges

Because the legislature has not defined "retail cost when new" to include freight and installation charges, in order to determine the common understanding

of these common words, it is proper to examine the ordinary dictionary definitions of the words.

"Retail" is defined as "[t]he sale of goods in small quantities to consumers."

"Cost" is defined as "[a]n amount paid or to be paid for a purchase."

"New" is defined as "[h]aving existed or been made for only a short time," "[n]ot yet old" or "[n]ever used before."

Webster's II New Riverside University Dictionary 1003, 316, 792 (1988).

The analytical process for determining whether tangible personal property is taxable is set out in *In re Tax Protest of Strayer*, 239 Kan. 136, 716 P.2d 588 (1986). In *Strayer*, this court was required to determine whether a computer software program was taxable by virtue of being tangible personal property. 239 Kan. at 141-42. The taxpayer had asserted that computer software is intangible and not taxable. The *Strayer* court first observed that there were two types of computer software programs, operational and application. The *Strayer* court recognized that operational computer software programs, "without which a computer cannot operate, have value that is to be considered as essential portion of the computer hardware and are therefore taxable as tangible personal property in conjunction with the hardware." 239 Kan. at 143. Application software, "those which are particularized instructions adopted for special programs, are intangible property." 239 Kan. at 143. This court held that (1) application programs which provided

particularized instructions are intangible and not taxable and (2) operational software, without which a computer cannot operate, is an essential part of the computer's hardware and is taxable as tangible personal property. 239 Kan. at 143.

Applying the *Strayer* analysis, freight and installation costs are more similar to intangible than tangible property. They do not have value which becomes an essential portion of the tangible property. They are merely costs which may or may not be incurred to adapt the property to the taxpayer's particular use. Freight and installation charges are vendor charges for services provided to an owner of personal property in connection with the owner's acquisition of the property. If an item of equipment is subsequently resold or otherwise disposed of, the charges incurred to transport and install the item have no value. They are merely the vendor's service charges for adapting the property to the taxpayer's particular use and never become an essential part of the tangible property.

Using these definitions and the *Strayer* analysis, we conclude that persons of common understanding would not believe that "retail cost when new" always includes charges for freight and installation, but rather would understand the term to refer to the sticker price of an item. It is doubtful that, when approving art. 11, § 1(b), Kansas voters intended that the valuation starting point for new commercial and industrial machinery and equipment would include charges for intangible services such as freight and installation. It is more likely that Kansas voters understood the phrase "retail cost when new" to mean the price paid for the

tangible personal property being purchased. They did not intend that the "retail cost when new" would change depending upon how the purchaser used the equipment or whether the purchaser used his or her own labor force for transportation and installation.

All costs normally passed on to the consumer in setting the retail sales price are to be included in the valuation of personal property.

Although costs contributing to the retail price are part of the value of an item, add-on costs incurred separately by the consumer after the retail price has been set have less to do with the value of the item and more to do with how and where the consumer is going to use the item. As long as these add-on costs are charged separately and are readily discernible from the actual sales price of the item, they are based on a separate contract for services and should not be included in the "retail cost when new" in determining ad valorem tax values. For example, if A purchases a television set for \$100, and then has the seller deliver and install the television set for a separate charge of \$50, although the total cost to the purchaser is \$150, the "retail cost when new" for purposes of ad valorem taxation is \$100. Applying the well-established principle of common understanding to the phrase "retail cost when new," we find that the phrase does not always include the addition of freight and installation charges to the purchase price for purposes of ad valorem taxation.

BOTA and the district court correctly determined that the valuation standard "retail cost when new" never includes the sales tax of an item. However, "retail cost when new" may include charges for freight and installation.

Affirmed as modified.

Estimated Impact due to Removal of Sales Tax, Freight and Installation from Commercial Personal Property

1996 November Assessed Value Certification - 1996 Statistical Abstract

County	1996 Commercial Personal Property Assessed Value	Comm As A % of All 1996 Taxable Assessed Value	% of Com Per Prop Value Counties Est. Will Be Removed Due to Sale, Frt, Instal	Estimated Amount of Assessed Value Removed	1996 Avg. Urban Mill Levy Less Sch Fin Portion	Estimated Tax Dollars Shifted to Other Property	** Tax Dollars Lost for School Finance (.033 mills)	Total Tax Dollars Shifted or Lost
Douglas	48,727,275	9.2%	15.0%	7,309,091	0.08328793	\$608,759	\$241,200	\$849,959
Johnson	299,281,165	8.8%	15.0%	44,892,175	0.08902352	\$3,996,459	\$1,481,442	\$5,477,901
Sedgwick	309,179,886	14.0%	20.0% <i>estimate subject to change</i>	61,835,977	0.08173195	\$5,053,975	\$2,040,587	\$7,094,562
Shawnee	102,729,203	11.4%	15.0%	15,409,380	0.12861262	\$1,981,841	\$508,510	\$2,490,350
Wyandotte	<u>107,197,677</u>	17.3%	40.0%	<u>42,879,071</u>	0.14247006	<u>\$6,108,984</u>	<u>\$1,415,009</u>	<u>\$7,523,993</u>
Subtotal	867,115,206			172,325,694		\$17,750,018	\$5,686,748	\$23,436,766
All Other	<u>481,197,456</u>		10.0% <i>estimate by PVD</i>	<u>48,119,746</u>	0.09799499	<u>\$4,715,494</u>	<u>\$1,587,952</u>	<u>\$6,303,446</u>
Statewide	<u>1,348,312,662</u>	8.1%		<u>220,445,440</u>		<u>\$22,465,512</u>	<u>\$7,274,700</u>	<u>\$29,740,212</u>
						<i>estimated shift</i>	<i>estimated lost</i>	<i>total</i>

* There will be greater increases in tax units which lose proportionally more value. Estimates do not include payment under protests for prior years.

** K.S.A. 1996 Supp. 72-6431 provides for 35 mills for the '96-'97 school year; 33 mills for the '97-'98 school year; and 31 mills for the '98-'99 school year.

Senate Assessment Taxation
 3-18-97
 Attachment 2

school financed & locally assessed



LEGISLATURE OF KANSAS
LEGISLATIVE DIVISION OF POST AUDIT

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March 10, 1997

To: Members, Legislative Post Audit Committee

Representative Eugene Shore, Chair
Representative Richard Alldritt
Representative Doug Mays
Representative Ed McKechnie
Representative Dennis Wilson

Senator Lana Oleen, Vice-Chair
Senator Anthony Hensley
Senator Pat Ranson
Senator Chris Steineger
Senator Ben Vidricksen

This report contains the findings and conclusions from our completed performance audit, *Reviewing the Methodology Used in Conducting and Analyzing the State's Sales-Ratio Study*. The audit found that the sales-ratio study's methodology is reasonable and consistent with professional standards.

The report also contains an appendix showing the price-related differential for residential and commercial property in each county. For an individual county, this statistic shows whether lower-value property is relatively more over- or under-appraised than higher-value property.

We would be happy to discuss the findings presented in this report with any legislative committees, individual legislators, or other State officials.


Barbara J. Hinton
Legislative Post Auditor

Senate Assessment + Taxation
3-19-97
Attachment 3

EXECUTIVE SUMMARY
LEGISLATIVE DIVISION OF POST AUDIT

**Question 1: Is the Methodology Used in Conducting
The State's Sales-Ratio Study Mathematically Sound?**

In most areas, the Division of Property Valuation's handling of the ratio study is reasonable and consistent with professional standards or guidelines. page 6
The basic steps the Division follows for validating sales and calculating various statistics are consistent with practices recommended by the International Association of Assessing Officers (IAAO). The Division's use of sampling for residential sales in 17 counties seems to work well, and is an efficient use of staff resources. The standard for measuring whether a county's homes are appraised at fair market value (an analysis of the "median ratio"), as well as the use of "confidence intervals" for that standard, is consistent with IAAO guidelines.

In two areas, the Division's methods aren't consistent with professional standards. page 11
In both areas, the Division's methods make it easier for counties to be in compliance with the requirement that property be appraised uniformly and equally at its fair market value. The Division's standard for measuring how uniformly properties are appraised (called the "coefficient of dispersion") is more lenient than professional standards. In Kansas, it's acceptable for individual property appraisal values to differ from their fair market values by up to 20%, on average, compared to the IAAO standard which limits acceptable deviation from fair market value to 10% to 15%, depending on the property. In addition, the Division uses a "confidence interval" to evaluate the uniformity measure (the coefficient of dispersion), while professional standards are silent on this issue.

Under the court order, the Division is likely to find different counties in compliance than it would based on its normal analysis. page 12
The court order requires the Division to base compliance solely on statistics generated by the ratio study—the median ratio and the coefficient of dispersion. The Division's normal determination of compliance takes into account not only the statistics generated by the ratio study, but also an evaluation of each county's appraisal procedures. Given this difference, the Division could arrive at different conclusions under the court order than it would using its normal procedures. For example, in 1995, the Division found only six counties out of compliance with State law. Under the criteria used in the court order, at least 18 counties would have been out of compliance.

Conclusion page 13

Question 2: Does the State Use a Reasonable Method For Determining Which Sales of Property To Include or Exclude From the Sales-Ratio Study, and Has That Method Been Applied Appropriately?

The Division of Property Valuation has established reasonable policies for identifying which properties should be included or excluded from the ratio study. page 14
The Division assumes that all properties that sell are valid sales and should be included in the ratio study, unless there's sufficient and compelling information to show otherwise. Kansas' laws and policies for excluding sales seemed reasonable, and take into consideration virtually all the factors the IAAO recommends for determining validity and adjusting sales prices.

Division staff properly handled 98% of the property sales we reviewed for the 1995 ratio study. page 15
We found only seven instances (2% of our sample of 359 sales) where the decision to include or exclude a sale—or to adjust the sales price—contradicted Division policy. These instances seemed to be the result of intermittent human error, and didn't suggest a pattern of poor decisionmaking. The ratio study has a strong quality control system, which likely helped bring about the low error rate.

Decisions following informal appeals were logical, and were based on Division policy. page 17
County appraisers can challenge any of the Division's decisions to include, exclude, or adjust property sales for the ratio study by making an informal appeal. We reviewed a sample of 50 appeals, and found that the Division's decisions seemed logical and followed the Division's policies in all cases. Slightly less than half the time Division staff approved the county appraisers' appeal, usually because the appraiser provided new information that wasn't available to Division staff when they made their original decision.

Conclusion page 18

APPENDIX A: Kansas Real Estate Sales Validation Questionnaire page 19

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Reviewing the Methodology Used in Conducting and Analyzing the State's Sales-Ratio Study

State law requires all taxable property to be appraised uniformly and equally at its fair market value. Fair market value means the amount a well-informed buyer is willing to pay and a well-informed seller is willing to accept for property in an open and competitive market. Uniform and equal valuation also requires the equitable appraisal of property within a classification. The two classes are real property (for example, residential and commercial property) and personal property, such as motor vehicles. County appraisers are responsible for appraising property, and the Department of Revenue's Division of Property Valuation is responsible for supervising the appraisal process.

In 1985, the Legislature ordered Statewide property reappraisal to be completed by January 1989. In September 1991, the Director of Property Valuation declared that only seven counties were in compliance with the appraisal laws. In June 1992, the Attorney General filed a lawsuit in District Court alleging the Secretary of Revenue and the Director of Property Valuation had failed to perform their duties to administer and supervise the Statewide reappraisal program. The resulting court order required the State to comply with the uniform and equal property appraisal requirement by 1998. Failure to comply could result in court-ordered Statewide reappraisal.

One of the ways the State measures compliance with the uniform and equal appraisal requirement is by conducting an annual sales-ratio study that compares the selling price of property to its appraised value. Legislative concerns have been raised about the mathematical soundness of the ratio study, because the court order measures compliance in terms of certain results generated by the study. Legislative concerns also have been raised about whether sales are appropriately included or excluded from the ratio study.

To address these concerns, this audit answers the following questions:

- 1. Is the methodology used in conducting the State's sales-ratio study mathematically sound?**
- 2. Is the State's method for determining which sales of property to include or exclude from the sales-ratio study reasonable, and has that method been applied appropriately?**

To answer these questions, we reviewed the methodology used in the ratio study; interviewed Division staff, professors on the Division's technical advisory committee, and other statistics specialists; and tested the Division's methodology on a sample basis. We talked with ratio study supervisors from other states, and reviewed the court order under which the Department is currently operating. Finally, we evaluated the Division's policies for including and excluding sales from the ratio study, and reviewed a sample of actual sales to see if these policies were followed. In conducting this audit work, we followed all applicable government auditing standards set forth by the U.S. General Accounting Office.

The audit's findings are presented beginning on page six, after a brief overview of the Kansas Real Estate Ratio Study.

Overview of the Kansas Real Estate Ratio Study

State Law Requires All Property Subject to Taxation To Be Appraised Uniformly and Equally as to Class, And at Its Fair Market Value

Property taxes fund a variety of activities. Nearly half the money is used for unified school districts. Real property taxes also help fund city, county, and township operations. In addition, a small amount of property tax moneys go into State building funds.

In 1995, Kansans paid \$1.3 billion in real property taxes. About \$1 billion of these property taxes came from levies on urban real estate. The other \$300 million came from rural real estate.

Because of the huge sums involved in property taxation, concerns always exist about whether taxpayers are being treated fairly, as required by State law. Uniform and equal valuation means that similar properties (urban residential, rural commercial, and the like) must be appraised at similar values. For example, if 10 similar houses within a county all sell for \$30,000, but have appraised values that range from \$20,000 to \$60,000, those properties haven't been appraised in a uniform and equal manner. In this example, people who own these houses are paying different amounts of county property taxes even though they should be paying the same amount.

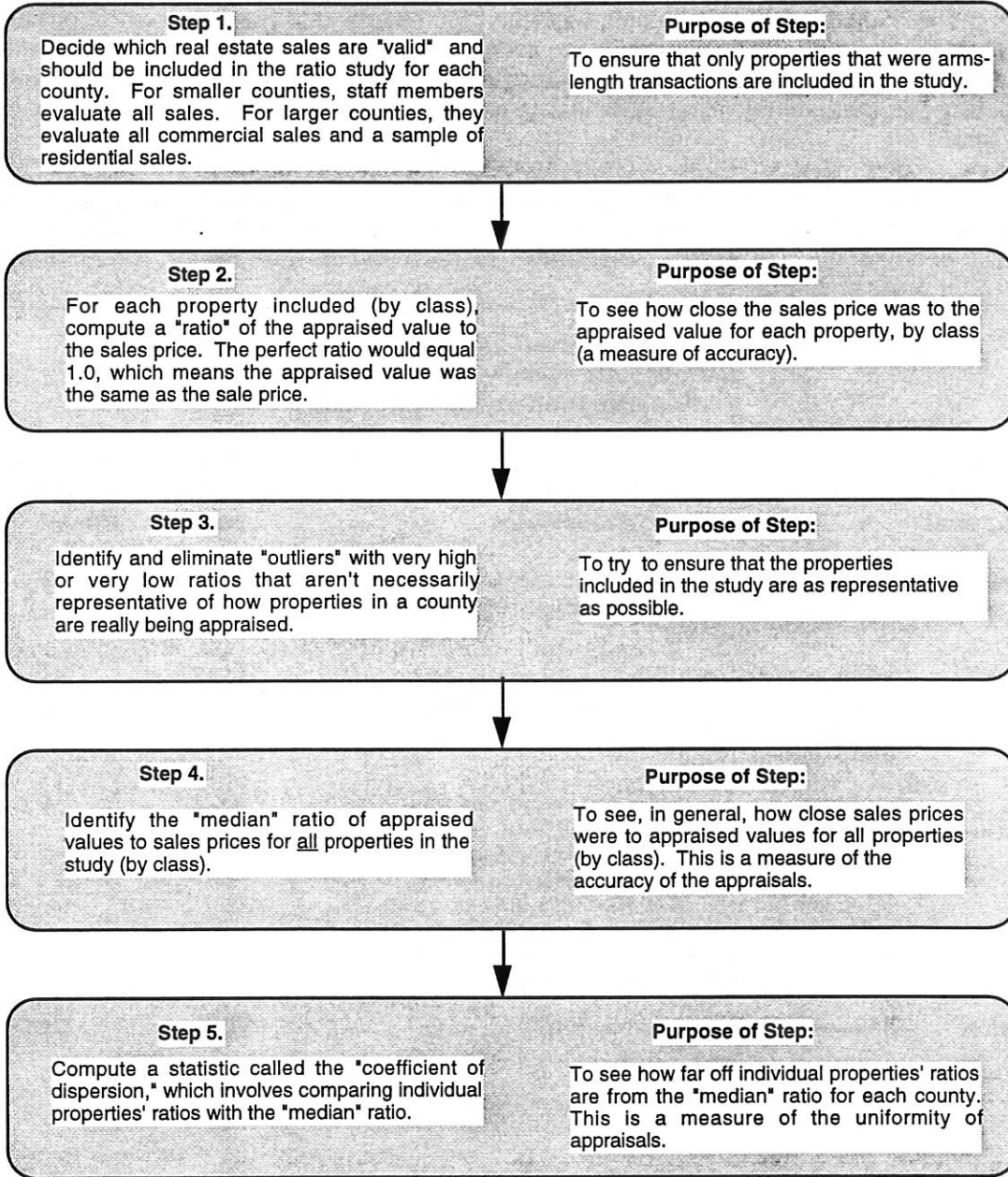
Fair market value means the amount a well-informed buyer is willing to pay and a well-informed seller is willing to accept for property in an open and competitive market. Generally, any "arms-length" transaction is considered to be a sale at fair market value. A property's sales price is an important element in establishing fair market value, but it isn't the sole criteria. Determination of fair market value also takes other elements into account, including location, any improvements, and comparisons with values of similar properties.

The real estate ratio study is one tool the Division of Property Valuation uses to determine whether property has been appraised uniformly and equally, and at its fair market value. Whenever a property is sold, the buyer, seller, or their agent must fill out the Kansas Real Estate Sales Validation Questionnaire before the deed can be filed with the county. That questionnaire asks a series of questions about the sale, including the sales price and whether the property was sold in an open market. A copy of the questionnaire is included in Appendix A.

Division staff use the information from those questionnaires and any follow-up information they may obtain to develop a list of properties sold at arms length each calendar year. (This process is discussed more fully in Question 2 of the audit.) These "valid" sales are included in the annual real estate ratio study.

The ratio study, described in K.S.A. 79-1485, provides statistical information about the relationship of the appraised value to the selling price of real estate. It also provides statistical information about how uniformly property has been appraised. These calculations are done by county and by type of property. The accompanying flowchart describes the main steps in conducting the ratio study. More detailed information can be found in Appendix B.

Steps followed by Division Staff to Conduct the Annual Real Estate Ratio Study



These are the main steps the Division of Property Valuation follows in conducting the ratio study. As part of the study, the Division also calculates other statistics. The final study presents the statistical information, by county and by property subclassification. The Division Director uses the information from the study to help determine whether counties are complying with the requirements that property be appraised uniformly and equally, and at fair market value.

The Division Director uses the results of the ratio study to assist in determining whether counties are in compliance with the statutory requirement that property be appraised at fair market value. Under the Division's current process for determining compliance, a county has to receive at least 75 out of a possible 100 points to be judged in "substantial" compliance with the requirement that property be valued uniformly and equally. Half the points are awarded based on the statistics from the ratio study. The other half are based on the adequacy of each county's procedures for conducting property appraisals. (Appendix C provides more information about this point system.)

The method for determining whether a county is in substantial compliance has changed over the past few years. As described in the profile box below, some of these changes made it easier for counties to be found in compliance, while others made it more difficult.

Changes in the Way the Division Has Determined Whether Counties Are Complying With Requirements To Appraise Property Uniformly and Equally			
Time Period Included in Ratio Study	Primary Method for Determining Compliance	Who Validated Sales	Number of Counties in Compliance
9-1-89 to 8-31-90	Counties had to meet statistical standards specified in State law, and limited legal requirements relating to reappraisal planning	counties	7
9-1-90 to 8-31-91	Same as previous year, except vacant lots and situations where there were fewer than 10 sales weren't included in the study. This change made compliance easier.	counties	91 (a)
9-1-91 to 12-31-92	By PVD policy, compliance was based partly on meeting statistical standards, and partly on the adequacy of the county's appraisal procedures. Also, the standards for one of the statistics was tightened, but confidence intervals were introduced to given the counties some leeway on the statistics. Vacant land was again <u>included</u> in the study. These changes made compliance both easier and harder.	PVD	65 (a)
1-1-93 to 12-31-93	The method has remained essentially the same, except the standard for one statistic was returned to its pre-1992 level. Also, vacant land was <u>removed</u> from the study again. These changes made compliance easier.	PVD	79 (a)
1-1-94 to 12-31-94	Same as the 1993 ratio study	PVD	99 (b)
1-1-95 to 12-31-95	Same as the 1993 ratio study	PVD	99

(a) For these years, five counties were not reviewed for compliance, because they were under orders to freeze their values or to reappraise.
 (b) In this year, three counties were not reviewed for compliance because they were under orders to reappraise.

**In June 1992, the Attorney General Filed a Lawsuit Against
The Department of Revenue Alleging the Property Tax System
Didn't Tax Kansans Uniformly and Equally**

The foundation of the lawsuit was the 1990 ratio study, which showed only seven counties were in compliance. The suit was heard in Shawnee County District Court.

The Court's initial order was amended in April 1996. It essentially establishes statistical standards counties have to meet to comply with the legal requirement that property be appraised uniformly and equally, and at fair market value. The order also says the determination of whether the statistical standards have been met will be measured by the ratio study only. There is no provision in the order to consider a county's procedures.

The court order gives the Division Director the authority to waive the statistical standards in any county if the standards don't fairly depict whether the subclass of property is valued uniformly and equally. If a county doesn't receive this waiver and doesn't meet the statistical standards, however, the order requires the Director to require the reappraisal or equalization of all or part of the real property in the county, or to assume control of the county appraiser's office until the statistical standards are met.

Is the Methodology Used in Conducting the State's Sales-Ratio Study Mathematically Sound?

We found that the methodology the Division of Property Valuation uses in conducting the ratio study is reasonable, and generally is consistent with professional appraisal guidelines. In addition, in most cases, the Division has adopted the standards established by professional guidelines to measure whether a county is in or out of compliance. However, it has adopted a more lenient standard for assessing the uniformity of residential sales than that recommended by the professional guidelines. We also found that under the court order, the Division is likely to find different counties in compliance than it would based on its normal analysis. These and other findings are discussed in the following sections.

In Most Areas, the Division of Property Valuation's Handling of the Ratio Study Is Reasonable and Consistent With Professional Standards or Guidelines

For the ratio study to be mathematically sound, we would expect the Division to have the following:

- a reasonable process for obtaining information about sales
- a reasonable process for making statistical calculations based on the sales information collected
- a reasonable interpretation of those statistics to determine whether counties are in or out of compliance with the requirement that properties be appraised uniformly and equally, at fair market value

To assess reasonableness, we compared the Division's mathematical processes and standards to the professional standards and guidelines adopted by the International Association of Assessing Officers (IAAO), and reviewed professional textbooks and literature. We also interviewed people with expertise in statistics, ratio studies, or both, including members of the Technical Advisory Committee, which was statutorily established to review the ratio study methodology. The Advisory Committee has three members, including professors from Washburn University, Kansas State University, and Wichita State University. Finally, we reviewed the Division's procedure for sampling residential sales in larger counties and, on a sample basis, tested data used in the 1995 ratio study to see if the Division followed its stated processes in preparing the study.

The table on the next page describes the statistical methods and standards the Division uses in the ratio study, as well as a brief summary of how they compare with professional standards and other states' practices. Our major findings in this area are as follows:

- the basic steps the Division follows in conducting the ratio study generally were consistent with practices recommended by the IAAO. As shown on page three of the Overview, these steps include:
 - validating sales

Kansas's Methods and Standards Compared to Professional Standards and to Other States

What is required of property appraisals?	What statistic is used to see if this requirement has been met?	What is the "perfect score" for this statistic?	What standard has the Division adopted to tell whether a county meets this requirement?	Is Kansas' requirement consistent with industry standards?	Is Kansas' requirement consistent with other states'? (a)	How does the Department decide whether a county meets requirements?
<p>ACCURACY: Property is to be appraised at fair market value</p>	<p>MEDIAN RATIO-- If the ratios of appraised values to selling prices for all individual properties sold in a county were listed from lowest to highest, the middle ratio would be the median</p>	<p>The perfect score is 1.0 (That means that a county's properties "on average" seem to be appraised at 100% of their fair market value.)</p>	<p>The Division looks for a median ratio of between .90 and 1.10 (The county's properties would seem to be appraised at between 90% and 110% of their fair market value.)</p>	<p>The standard used by the Division is the same as that adopted by the International Association of Assessing Officers</p>	<p>Three states have a similar standard. Two have a stricter standard. Three have a more lenient standard, and one state has no pre-set standard.</p>	<p>The Division statistically determines the range of values in which the county's median ratio is likely to fall, and compares this range to the median ratio requirements.</p>
<p>7</p> <p>UNIFORMITY AND EQUALITY: All properties should be appraised at the same percentage of fair market value</p>	<p>COEFFICIENT OF DISPERSION-- The average percentage difference between the individual property ratios and the median ratio for the county</p>	<p>The perfect score is 0 (That means that all of a county's individual property ratios are the same)</p>	<p>The Division looks for a coefficient of dispersion of 20 or less (This means that, on average, a county's individual property ratios would be no more than 20% from its median ratio)</p>	<p>The International Association of Assessing Officers has adopted the following standards, which are stricter than Kansas's standard of 20 for residential properties.</p> <ul style="list-style-type: none"> Single-family- <ul style="list-style-type: none"> • new 10 • older 15 Income property- <ul style="list-style-type: none"> • urban 15 • rural 20 Vacant 20 Other varies 	<p>One state has the same standard. Three states use the Association's standards (stricter than Kansas). Four states have more lenient standards. One state has no pre-set standard.</p>	<p>The Division statistically determines the range of values in which the county's coefficient of dispersion is likely to fall, and compares this range to the coefficient of dispersion requirements.</p>
<div style="border: 1px solid black; padding: 5px;"> <p>INDIVIDUAL PROPERTY RATIOS- A ratio is calculated for each individual property in the study. This ratio is calculated by dividing that property's appraised value by its sales price. For example, a home that is appraised at \$52,000, but sold for \$50,000, would have a ratio of 1.04. That means it is appraised at 104% of its market value. On the other hand, if that home had sold for \$54,000, its ratio would be .96, because it would have been appraised at only 96% of its market value.</p> </div>						

(a) more complete information about the other states we contacted can be found in Appendix E.

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- calculating appraisal/sales ratios for each property included in the study
- eliminating individual "outliers" (ratios that are unusually large or small)
- computing a median ratio for each county, for each classification of property
- using the individual and median ratios to compute a coefficient of dispersion for each county, for each classification of property

The Division calculates a number of other statistics as well. One of these, the price-related differential, was mentioned as a concern in a 1993 audit of the Division, and is addressed more fully in Appendix D.

- the Division follows its stated policies. We tested the raw data from a sample of five counties to see whether, using the Division's stated procedures, we would arrive at the same numbers for median ratio and coefficient of dispersion as it did. Our results indicated that the Division follows its stated procedures when preparing data for the ratio study.
- sampling procedures for residential sales in applicable counties work well and are an efficient use of the Division's time. By statute, the Division can sample residential sales in counties that have at least 15,000 parcels, rather than assess the validity of each residential sale. The State now has 17 such counties. The sampling process appears to ensure that the Division will end up with a sample of about 400 sold properties that closely represents the characteristics of the existing housing stock in the county. In 1995, Johnson and Sedgwick Counties each had more than 7,500 residential property sales, so the Division saved a considerable amount of time by sampling in these counties.
- the standard for measuring whether a county's homes are appraised at fair market value is consistent with IAAO professional appraisal standards. Because it isn't reasonable to expect that appraisals will match sales prices exactly, State law has set a standard for how much counties' median ratios can deviate from "perfection" before the scores indicate a problem.

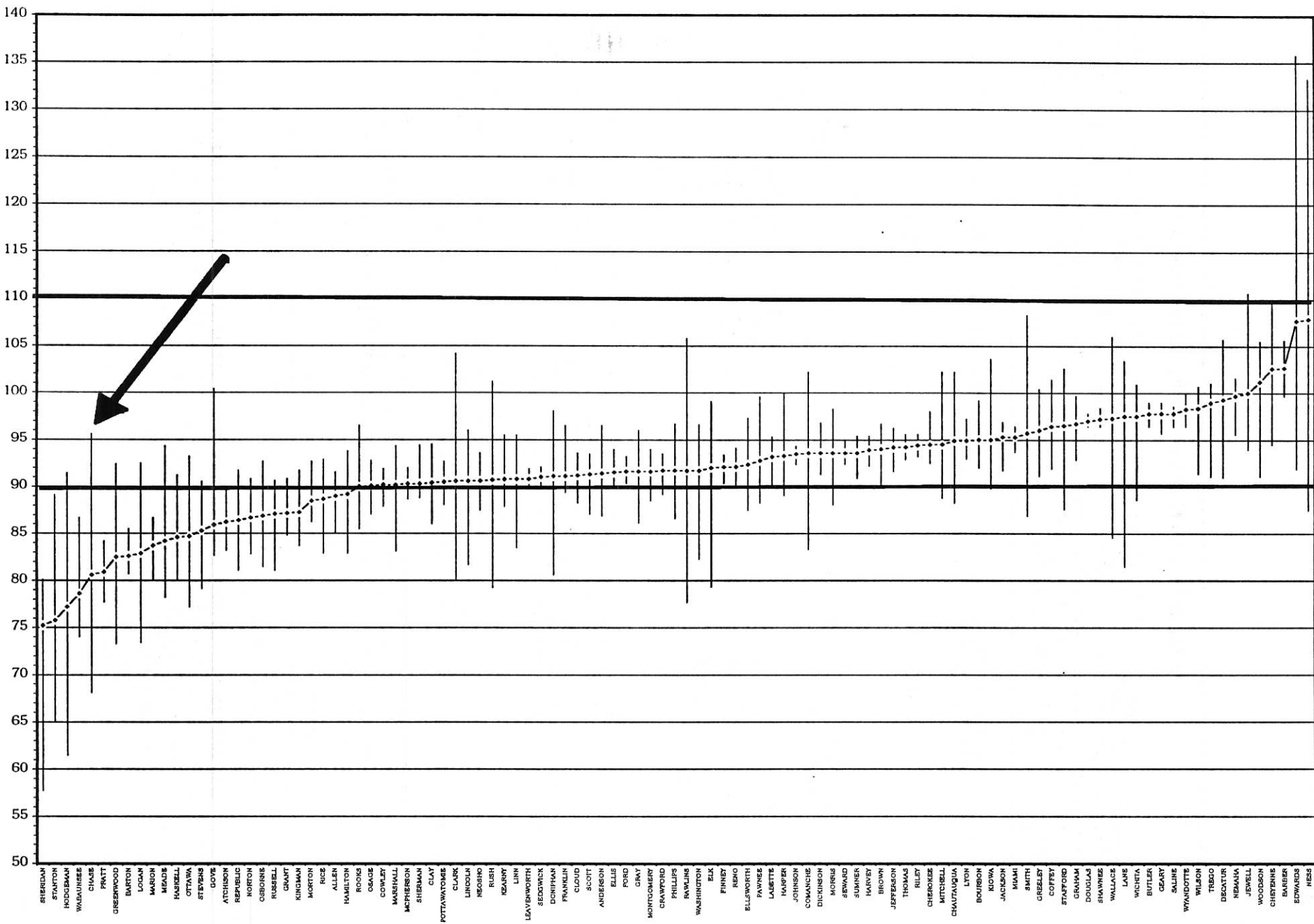
Kansas' standard allows a median ratio of between .90 and 1.10, which is identical to the standard suggested by the IAAO.

- the Division's use of "confidence intervals" for the median ratio is consistent with IAAO recommendations. The ratio study looks only at homes that have sold in a given year, but it is used to make a judgment about the accuracy of the appraisals of all homes in a county. While samples such as this frequently are used to make estimates about what is happening in a larger group, there is always the possibility that a given sample doesn't truly represent the group.

Because of this possibility, the IAAO recommends using confidence intervals for evaluating measures such as the median ratio. The graphic on the facing page shows confidence intervals established for residential sales in each county for the median ratio in 1995. To understand how confidence intervals work, look at Chase County (5th from the left on the graphic). The calculated median ratio is 80.6, which doesn't meet the standard. However, based on the confidence interval, the Division is 95% confident that the true median ratio for Chase County is somewhere between 68.1 and 95.6, which means the County might meet the standard.

Residential - Median Ratio Confidence Interval

9.



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What Does It All Mean, And Why Does It Matter?

The Division of Property Valuation performs a number of calculations to help determine whether counties are appraising properties uniformly and equally, and whether properties are appraised at or near their fair market values. The calculations involved in the court order and discussed in the report relate to ratios of appraised values to sales prices (which measures how close appraisals are to fair market value), and a statistic called the "coefficient of dispersion" (which measures whether individual ratios are clustered around the median ratio). The following example can help illustrate what these calculations tell you, and how they interrelate.

Assume two counties each have seven valid residential property sales during a given year, with the following appraised values and sales prices:

County A			County B		
Appraised Value	Sales Price	Ratio (appraised value + sales price)	Appraised Value	Sales Price	Ratio (appraised value + sales price)
\$ 85,000	\$ 125,000	.68	\$ 85,000	\$ 117,892	.72
72,000	101,408	.71	72,000	96,644	.75
46,000	58,974	.78	46,000	61,333	.75
50,000	50,000	1.00	50,000	66,667	.75
28,000	26,923	1.04	28,000	35,897	.78
49,000	40,164	1.22	49,000	62,420	.79
15,000	11,538	1.30	15,000	18,987	.79

In county A, the "median" ratio (or mid-point) is 1.00. (A median ratio of 1.00 means the appraised value was 100% of the sales price.) Half the properties in county A have a ratio below 1.00 and half have a ratio above 1.00. In county B, the median ratio is .75. Half the properties in the county have ratios below .75, and half have ratios above .75. Based on this statistic, properties in county A generally appear to be appraised closer to their fair market value than those in county B.

A further review also shows that the appraiser in county A is not appraising properties in that county very uniformly or equally: many homes were appraised either far above or below their sales prices and the county's median ratio. On the other hand, the appraiser in county B is appraising properties more uniformly, even though the properties generally are being appraised at less than their sales prices.

In county A, the ratios are spread out. Most are way below or way above the median ratio. In this county, the coefficient of dispersion, which measures how spread out the ratios are, would be a relatively high 20.0. Within the county, some people would be paying more than their fair share of taxes, while others would be paying less than their fair share.

In county B, the ratios cluster pretty close to the median. In this county, the coefficient of dispersion would be 2.7, which is very low. In this county, properties are being appraised uniformly. Thus, within the county, people all are paying their fair share of taxes, even though their properties tend to be appraised at less than their fair market values.

One other point can be made from this example. The overall level of appraisal is higher in county A than in county B. That is, properties in county A generally have higher ratios than properties in county B. This would suggest that, for those taxes that are levied on a Statewide basis, taxpayers in county A are paying a higher share of taxes than taxpayers in county B. This type of situation results in unequal treatment of taxpayers among counties.

In Two Areas, the Division's Methods or Interpretation Aren't Consistent with Professional Standards

In both areas, the Division's methods make it easier for counties to be in compliance.

The Division's standard for measuring how uniformly properties are appraised is more lenient than professional standards. Professional standards for the uniformity measure (coefficient of dispersion) for residential property range from 10 to 15, depending on the age of the neighborhood. The Division has set 20 as the standard for Kansas residential properties. (Up to 1991, the standard was set at 20 by Kansas statute. When the statute was repealed, Division officials lowered the standard to 15, but told us they increased it back to 20 to make it equal to the standard set by the judge in the court order.) Essentially, this means that in Kansas it is acceptable for individual property appraisal values to differ from their fair market values by up to 20%, on average, compared to the IAAO standard which limits acceptable deviation from fair market value to 15%. Of the eight other states we contacted that had standards for this measure, three used a standard of 15, and five used a standard of 20 or higher.

The example below shows what a sample of acceptable ratios would look like when the maximum coefficient of dispersion is set at 20 (County A) and when it is set at 15 (County B).

County A			County B		
<u>Appraised Value</u>	<u>Sales Price</u>	<u>Ratio (appraised value/ sales price)</u>	<u>Appraised Value</u>	<u>Sales Price</u>	<u>Ratio (appraised value/ sales price)</u>
\$ 85,000	\$ 125,000	.68	\$ 85,000	\$ 119,718	.71
72,000	101,408	.71	72,000	99,310	.73
46,000	58,974	.78	46,000	57,500	.80
50,000	50,000	1.00	50,000	50,000	1.00
28,000	26,923	1.04	28,000	27,451	1.02
49,000	40,164	1.22	49,000	44,344	1.11
15,000	11,538	1.30	15,000	13,043	1.15

In this example, County A has a "coefficient of dispersion" of 20. This is the largest amount of dispersion allowed by Kansas standards. In contrast, County B has a "coefficient of dispersion" of 14.9. This is just under the maximum amount of dispersion allowed by IAAO standards.

If you look at the differences between the two counties, you can see that the ratios in County B are closer to that county's median ratio than is the case for County A. Thus, properties in County B are appraised more uniformly—on average, their appraised values are closer to their sales prices than is true for County A.

The decision to deviate from professional standards has a large effect on the number of counties in compliance. In 1995, only four counties were out of compli-

ance with the standard for the residential uniformity measure used by the Division. If the Division had followed the recommended professional standard, 38 counties would have been out of compliance.

The Division uses a “confidence interval” to evaluate the uniformity measure, while professional standards are silent on this issue. As has been discussed earlier, the use of confidence intervals makes it much easier for counties to come into compliance. Division officials told us the IAAO plans to consider the use of confidence intervals for the uniformity measure in the near future. None of the other states we contacted use confidence intervals around the uniformity measure.

In 1995, the use of a confidence interval for the uniformity measure resulted in only four counties being out of compliance for residential property sales, and 18 counties being out of compliance for commercial property sales. If the Division hadn't used the confidence interval, 24 counties would have been out of compliance for residential property sales, and 53 would have been out of compliance for commercial property sales.

Under the Court Order, the Division Is Likely to Find Different Counties In Compliance Than It Would Based on Its Normal Analysis

The court has ordered the Division to rely solely on certain statistics generated by the ratio study to measure each county's compliance, and to meet the standard for all of those statistics. Those statistics are the median ratio for both residential and commercial property and the coefficient of dispersion for both property groups. If a county doesn't meet the requirement for any one of these four measures, the Division is to find the county out of compliance.

In contrast, the Division's normal determination of compliance with State law isn't limited to the statistical results. Rather, it takes into account both the statistics generated by the ratio study and an evaluation of each county's appraisal procedures. To be considered in compliance, a county must achieve 75% of its possible evaluation points. (Appendix C describes this process more fully.) Further, in some cases, the Division may consider one or more of the statistical results to be inconclusive. When that happens, the Division doesn't use the inconclusive results, and places greater weight on the other statistical results and the procedural evaluation.

The Division's Use of Sales-Ratio Statistical Results Gives the Benefit of The Doubt to the Appraisers

In interpreting the statistical results from its sales-ratio study, the Division has taken the viewpoint that the appraisers should be treated as “innocent until proven guilty.” That means the Division wants to be very confident that it's not making a mistake before it concludes a county doesn't meet the statistical requirements. The Division doesn't require the same degree of confidence that it's not making a mistake before it concludes a county does meet the statistical requirements.

Division officials pointed out that mistakenly concluding that a county doesn't meet the requirements could cost the appraiser his or her job when a new appraiser might not be able to do any better, and could result in the significant additional cost of reappraisal. While the impact of mistakenly concluding that a county does meet the requirements could result in inequitable taxes, individual taxpayers have the opportunity to review their appraisal values and appeal those values if they wish.

Given this difference, the Division could arrive at different conclusions under the court order than it would using its normal procedures. For example, in 1995, the Division found only six counties out of compliance with State law, even though 18 counties didn't meet the median ratio requirement for commercial property. Under the court order, all 18 of those counties would have been out of compliance with this requirement.

Conclusion

Ensuring that all properties in Kansas are appraised equally and uniformly, and at their fair market values, is a difficult task. The Division of Property Valuation has done a good job of developing a ratio study to provide it with the basic information it needs to tell how well county appraisers are appraising properties.

Evaluating property appraisal is not an exact science, however. The statistics used to determine compliance, including the median ratio and the coefficient of dispersion, won't always show the true situation in a county. That's particularly true in situations where there are only a limited number of sales each year. What this means is that counties may seem to be in compliance in one year and out of compliance the next, with no real change in how well properties were appraised.

To compensate for this imprecision in the statistics, the Division won't say a county is out of statistical compliance unless it can be confident that the county really is out of compliance. In all cases, the Division looks at counties' appraisal procedures to increase its confidence that a county is in compliance with legal requirements. The court order, on the other hand, bases compliance solely on the ratio study's statistical results.

Does the State Use a Reasonable Method for Determining Which Sales of Property To Include or Exclude from the Sales-Ratio Study, And Has that Method Been Applied Appropriately?

The Division's policies for including and excluding properties from the ratio study closely follow the standards established by the International Association of Assessing Officers. The Division's field appraisers did a good job of following these policies—only 2% of the 359 sales of properties we reviewed were wrongly included or excluded from the study. Our review of 50 property sales that county appraisers had informally appealed showed that Division staff who handled these appeals followed appropriate policies and made logical decisions in each case. Slightly more than half the time they upheld the decisions of the Division's field staff; the rest of the time they agreed with the county appraisers. These and other findings are discussed in more detail in the sections that follow.

The Division of Property Valuation Has Established Reasonable Policies for Identifying Which Properties Should Be Included or Excluded from the Ratio Study

Kansas law requires the Division to collect information about properties that sell each year, so that its staff can determine whether all these properties should be included in the ratio study. As described in the Overview, such information is reported on the Kansas Real Estate Sales Validation Questionnaire, which the buyer, the seller, or an agent acting on behalf of the buyer or seller must complete before the deed can be filed with the county.

Generally, a questionnaire is completed for all properties that sell, although Kansas law identifies 15 types of transfers of title that are exempt because they would never be included in the ratio study. These include such things as the sale of cemetery lots, gifts or donations of real estate, and repossessions of real property.

The questionnaire asks a series of questions Division staff use to determine whether each property sold at "arm's length," and should be included in the study. Based on the answers to some questions, Division staff may call the buyer or seller to obtain follow-up information or explanations.

Division staff then classify each property that sold as "valid," meaning it was sold at fair market value, or "invalid," meaning there is a compelling reason to think it wasn't. (The term "unvalidated" also is used in the 17 counties where only a sample of residential property sales is reviewed. It refers to property sales that weren't included in the sample, and so weren't judged to be either valid or invalid.) Only "valid" property sales are included in the study.

The Division's guidelines for determining whether properties are "valid" closely follow professional standards. The Division assumes that all properties that sell are valid and should be included in the sales-ratio study, unless there's sufficient and compelling information to show otherwise. The Division has an extensive, clearly written manual for its field staff that explains how to evaluate the variety of circumstances that can surround different types of property sales.

We compared the Division's policies and Kansas law to the International Association of Assessing Officers' standards for assessing the validity of property sales. Kansas' policies and laws take into consideration virtually all the factors the Association recommends for determining validity. Further, the reasons spelled out in the Division's policy manual as to why its staff would conclude a property sale was "invalid," or why the price a property sold for should be adjusted, seemed reasonable to us.

The profile at right gives examples of some property sales we reviewed during the audit that were judged to be invalid, and thus were excluded from the ratio study. In addition, the box on page 16 gives a Statewide picture of the number and reasons why property sales were excluded from the 1995 ratio study.

Division Staff Properly Included or Excluded 98% of the Property Sales We Reviewed for the 1995 Ratio Study

We looked at a random sample of 359 sales from nine counties, and evaluated the Division's decision to include or exclude each of these sales from the 1995 sales-ratio study, or to adjust the sale price before including a sale.

Overall, Division staff did a good job of following validation policies. We found only seven instances (2% of the sample) where the decision to include or exclude the property sale—or to adjust the sales price—contradicted Division policy.

These seven property sales, which are described on page 17, seemed to be the result of intermittent human error—they occurred in five different counties—and didn't suggest a pattern of poor decision making.

The Property Valuation Division Doesn't Include Questionable Property Sales in the Sales-Ratio Study

To determine which properties to include in the sales-ratio study, the Division's field appraisers review all or a sample of the properties that sold within a county. The Property Valuation Division has written policies and procedures outlining how county and State personnel should decide whether a property was sold on the open market. If it was, that property sale is considered to be valid, and it should be included in the sales-ratio study. However, many properties aren't sold through open-market transactions, and are considered to be invalid. The following examples highlight some of the property sales that the Division's staff decided were invalid during 1995:

- A home in an urban area was sold by mentally disabled people who weren't knowledgeable about the real estate market. Appraisers thought the sellers didn't obtain a fair market price for the property.
- Commercial property that sold in an urban area also included some personal property. The appraisers couldn't verify the value of the personal property, which was listed as 45% of the total sales price.
- A person offered to buy his neighbor's house, and the neighbor sold the property without advertising it on the open market.
- A new commercial property built in a rural area was sold through an exchange of properties, and wasn't offered for sale on the open market.
- A commercial property was sold in an urban area. The appraisers called the buyer and the seller to verify the details of the sale. One individual said the sale involved land only, but the other said the sale involved land and the business on it. The appraisers couldn't verify who was right.
- A commercial property in an urban area was given for free to the seller's brother, who owned the adjoining property.

Reasons Why Properties Were Excluded from the 1995 Sales Ratio Study

County appraisers and staff from the State's Property Valuation Division evaluate each property sale that's reported to decide whether it should be included in the sales-ratio study. In 1995, county and State personnel decided that more than 19,000 of the nearly 47,000 properties considered for the study (41%) were invalid. Their reasons are outlined below.

Total Property Sales Considered for Inclusion in the Study	46,867
Total Valid Sales	27,446
% of Total Sales Considered That Were Valid	59%
Total Invalid Sales	19,421
% of Total Sales Considered That Were Invalid	41%

Reasons why properties that sold were considered to be invalid:

•Not an Open Market Sale <i>These are sales that weren't advertised on the open market, or were offered to only one buyer. In these sales, the property often isn't sold at fair market value.</i>	7,961
•Property Split <i>These sales occurred when only a portion of an appraised property was sold. An appraisal is valid only for the entire property, not just a portion of it.</i>	4,407
•Property Sold Under Suspect Conditions <i>These properties were sold under conditions that made it difficult to decide whether the sales were valid. For example, a sale including personal property that can't be verified is considered suspect, and may not be validated.</i>	4,092
•Property Changed Since Appraisal <i>These sales involved property that had been changed since its last appraisal. Examples include new construction on the property, and remodeling of existing structures. For these properties, the existing appraisal is invalid, so it's hard to tell if the property sold at fair market value.</i>	1,989
•Property was a Discounted Vacant Lot <i>Appraisals on these properties are always less than market value, so such property sales are invalid.</i>	573
•Property Sold by a Governmental Entity <i>These sales were made by a governmental organization, which often sells property for less than market value.</i>	307
•Appraiser Judgment Required on Property <i>Although the available factual evidence suggests these sales are valid, the county appraiser has reason to believe they are not.</i>	92

In addition, some properties that sold were never considered for the sales-ratio study. The table below outlines why certain property sales were disregarded, and the number of each during 1995.

Total Property Sales Not Considered for the Ratio Study	36,101
•Residential Sales Not Included in Samples <i>In all, 17 of the State's counties evaluated only a sample of the residential property sales that occurred within their borders.</i>	22,947
•Multiple Sales <i>These sales involved more than one parcel of property that were sold for one price. In these cases, only the "parent" parcel counted as a sale, and the others weren't considered.</i>	8,548
•Sales From Previous Years <i>These sales occurred in previous years but weren't reported until 1995. Except in special circumstances, only those property sales that occurred in 1995 were considered for the sales-ratio study.</i>	4,606

- One property was sold through a private listing, and wasn't advertised on the open market. Division staff incorrectly concluded this property sale was valid when it wasn't.
- One property actually was traded or exchanged, rather than sold. Division staff said this property sale was valid when it should have been invalid.
- Two properties that were sold included the sale of personal property. Division policies require staff to contact both the buyer and the seller to verify how much personal property is included in a sale, if its reported value is between 6% and 25% of the total sales price. If the two parties don't agree, the sale is supposed to be invalidated. For these two properties, even though staff obtained verification from only one party, the sales were validated.
- The documentation for the sale of one property suggested the sale might not be valid. Division staff coded it as suspect, and called the seller to learn more about the conditions of the sale. According to Division policies, staff should make three telephone calls at different times of the day on different days. However, staff made all three calls on the same day. When they couldn't reach the seller, they classified the sale as invalid, rather than making more effort to gather information and decide if the sale actually was valid.
- The sale of one property was listed as a deed transfer rather than an actual sale, but also was reportedly listed on the open market. Division staff validated this sale without following up to see whether it was an actual sale.
- One sale originally was considered to be invalid, but during review staff decided it actually was valid. Because of a clerical error, the change wasn't entered into the computer system.

One reason for the relative lack of errors may be the Division's quality control system. As noted earlier, each field appraiser receives a detailed manual with guidance and examples for deciding whether a property sale is valid. In addition, supervisors routinely review a sample of the decisions made by field appraisers each month, and can review all of a field appraiser's work if they find many problems.

Finally, when information is entered in the computer, a series of edits cross-check individual pieces of information from the questionnaire against the final decision about whether the property sale was valid or invalid to look for logical inconsistencies. Less tangible, but equally important, is that staff in charge of the ratio study appear to place strong emphasis on quality, and require organized and convincing documentation from field staff.

Decisions Following Informal Appeals Were Logical, And Were Based on Division Policy

Twice a year, Division staff send county appraisers a list showing each property that reportedly was sold in the county, and the Division's decision to include, exclude, or adjust that property sale for the ratio study. County appraisers can challenge any of these decisions in what is called an "informal appeal."

In these cases, counties may send the Division additional information they have about the property sale, or they may simply ask the Division to review the basis for its original decision. Staff in Topeka who handle the sales-ratio study, process the appeals and decide whether to change or uphold the field appraisers' validations.

County appraisers who aren't satisfied with a decision can appeal further. They can ask Division management staff to review the appeal, they can file a formal appeal with the Board of Tax Appeals, and they can appeal the Board's decision to

district court. However, most cases are handled as informal appeals. In 1995, only two counties appealed validation issues to the Board.

We reviewed a sample of 50 informal appeals that had been filed by county appraisers across the State. In all cases, the Division's decisions seemed logical and followed the Division's policies.

In 23 (46%) of the cases we reviewed, the Division's sales-ratio study staff approved the county appraisers' appeal. In most of the successful appeals, the county appraiser provided new information that wasn't available to the Division field appraiser who made the original determination. Several examples of how this can happen are listed below:

- One county appealed the State's decision to validate a property sale because significant improvements had been made to the house after it had been appraised, but before it was sold. This information should have been included on the real estate questionnaire, but wasn't. Division officials approved the appeal because the improvements significantly increased the value of the house after it was appraised.
- A motel sold for significantly more than the appraised value. There was no indication on the real estate questionnaire or in the interview Division field staff conducted as to why the sales price was so high. Based on the available information, the Division validated the sale. In investigating this property sale, however, the county appraiser's office interviewed the director of the organization that bought the motel. The appraiser discovered that the motel was bought as a homeless shelter by a non-profit organization because it was near the organization's office, and it fit the organization's needs. Division officials investigated further, and found that the property also had not been on the open market.

Based on our reviews, we found that only four of the 23 successful appeals involved cases where the Division's field staff failed to follow the Division's policies in determining whether the sales were valid. (The appeal sample has a higher concentration of "errors" by field staff than we found in the random sample of 359 sales, because errors are likely to be appealed.)

Conclusion

The results of the ratio study can be significantly affected by the sales that are included in the study. With so much riding on the results of the study, decisions about which sales to include are very important to county appraisers. In the past this has caused problems. When the counties did the study, Division officials were concerned that counties inappropriately excluded sales that made them look bad. When the Division first took over the study, appraisers were concerned that the Division inappropriately included sales that didn't reflect fair market values. The only solution to such a situation is to have clear-cut policies specifying which sales to include and exclude, and to apply those policies consistently. It appears that the Division has accomplished that. The Division has a policy of including all sales unless they are proven invalid. Further, it has developed a list of policies for determining validity based on industry standards, and it appears to apply those policies objectively.

APPENDIX A

KANSAS REAL ESTATE SALES VALIDATION QUESTIONNAIRE

FOR COUNTY USE ONLY:		COV #	CO. NO.	MAP	SEC	SHEET	QTR.	BLOCK	PARCEL	OWN
DEED BOOK _____	PAGE _____									
RECORDING DATE ____/____/____	TYPE OF INSTRUMENT CR _____ RA _____ DE _____	SPLIT <input type="checkbox"/> MULTI <input type="checkbox"/>		MO YR TY _____		AMOUNT _____		S V _____		

SELLER (Grantor) NAME _____ MAILING _____ CITY/ST/ZIP _____ DAYTIME PHONE NO. (____) _____	BUYER (Grantee) NAME _____ MAILING _____ CITY/ST/ZIP _____ DAYTIME PHONE NO. (____) _____
---	--

BRIEF LEGAL DESCRIPTION _____ _____ _____	Property /Situs Address: _____ Name and Mailing Address for Tax Statements _____ _____
---	---

In reference to the sale of the property listed above, please answer the questions below. **(Read instructions on back of form.)**

1. CHECK ANY FACTORS THAT APPLY TO THIS SALE: <input type="checkbox"/> Sale between immediate family members: SPECIFY THE RELATIONSHIP _____ <input type="checkbox"/> Sale involved corporate affiliates belonging to the same parent company <input type="checkbox"/> Auction Sale <input type="checkbox"/> Forced, or distressed, sale in a bankruptcy settlement <input type="checkbox"/> Sale by judicial order (by a guardian, executor, conservator, administrator, or trustee of an estate) <input type="checkbox"/> Sale involved a government agency or public utility <input type="checkbox"/> Buyer (new owner) is a religious, charitable, or benevolent organization, school or educational association <input type="checkbox"/> Buyer (new owner) is a financial institution, insurance company, pension fund, or mortgage corporation <input type="checkbox"/> Sale was a foreclosure of a mortgage or forfeiture of a contract for deed (land contract) <input type="checkbox"/> Sale of only a partial interest in the real estate <input type="checkbox"/> Sale involved a trade or exchange of properties <input type="checkbox"/> NONE OF THE ABOVE	6. ARE YOU AWARE OF ANY CHANGES IN THE PROPERTY SINCE JAN. 1? <input type="checkbox"/> YES / <input type="checkbox"/> NO <input type="checkbox"/> Demolition <input type="checkbox"/> New Construction <input type="checkbox"/> Remodeling <input type="checkbox"/> Additions Date Completed _____
2. USE OF PROPERTY AT THE TIME OF SALE: <input type="checkbox"/> Single Family Residence <input type="checkbox"/> Agricultural Land <input type="checkbox"/> Farm/Ranch With Residence Mineral Rights Included? <input type="checkbox"/> Condominium Unit <input type="checkbox"/> Yes / <input type="checkbox"/> No <input type="checkbox"/> Vacant Land <input type="checkbox"/> Apartment Building <input type="checkbox"/> Other: (Specify) _____ <input type="checkbox"/> Commercial/Industrial Bldg.	7. WERE ANY DELINQUENT REAL ESTATE TAXES ASSUMED BY THE PURCHASER? <input type="checkbox"/> YES / <input type="checkbox"/> NO \$ _____
3. WAS THE PROPERTY SUBJECT TO AN EXISTING LEASE AT THE TIME OF SALE? <input type="checkbox"/> YES / <input type="checkbox"/> NO	8. METHOD OF FINANCING (check all that apply): <input type="checkbox"/> New loan(s) from a Financial Institution <input type="checkbox"/> Seller Financing <input type="checkbox"/> Assumption of Existing Loan(s) <input type="checkbox"/> All Cash <input type="checkbox"/> Trade of Property <input type="checkbox"/> Not Applicable
4. DID THE SALE PRICE INCLUDE AN EXISTING (GOING CONCERN) BUSINESS ENTERPRISE? <input type="checkbox"/> YES / <input type="checkbox"/> NO	9. WAS THE PROPERTY MADE AVAILABLE TO ANYONE OTHER THAN THE PURCHASER? <input type="checkbox"/> YES / <input type="checkbox"/> NO If not, explain _____
5. WAS ANY PERSONAL PROPERTY (SUCH AS FURNITURE, EQUIPMENT, MACHINERY, LIVESTOCK, CROPS, BUSINESS FRANCHISE OR INVENTORY, ETC.) INCLUDED IN THE SALE PRICE? <input type="checkbox"/> YES / <input type="checkbox"/> NO If yes, please describe _____ Estimated value of all personal property items included in the sale price \$ _____ Mobile Home Year _____ Model _____	10. DOES THE BUYER HOLD TITLE TO ANY ADJOINING PROPERTY? <input type="checkbox"/> YES / <input type="checkbox"/> NO
11. I CERTIFY THAT THE ADDRESS TO WHICH TAX STATEMENTS FOR THE PROPERTY ARE TO BE SENT IS CORRECT. I ALSO CERTIFY I HAVE READ ITEM NO. 13 ON THE REVERSE SIDE AND HEREBY CERTIFY THE ACCURACY OF THE INFORMATION AND THAT I AM AWARE OF THE PENALTY PROVISIONS OF K.S.A. 79-1437g.	12. TOTAL SALE PRICE \$ _____ CLOSING DATE ____/____/____
13. I CERTIFY THAT THE ADDRESS TO WHICH TAX STATEMENTS FOR THE PROPERTY ARE TO BE SENT IS CORRECT. I ALSO CERTIFY I HAVE READ ITEM NO. 13 ON THE REVERSE SIDE AND HEREBY CERTIFY THE ACCURACY OF THE INFORMATION AND THAT I AM AWARE OF THE PENALTY PROVISIONS OF K.S.A. 79-1437g.	PRINT NAME _____ SIGNATURE _____ 3-22 GRANTOR (SELLER) <input type="checkbox"/> GRANTEE (BUYER) <input type="checkbox"/>

APPENDIX B

Steps Taken To Conduct the Kansas Real Estate Ratio Study

Validate sales

Calculate appraisal/sales ratio for all valid sales or for a representative sample of all valid sales (ratio should be 1.0). See examples showing calculations of ratios in the box at right.

Trim outlier ratios (to reduce influence of unusual sales):

Determine the median ratio. The median ratio is the middle ratio in an array of values, listed in ascending order. In the example at right, after the trimming has been done, the median ratio of the remaining seven ratios is 96.4. (a)

Calculate the coefficient of dispersion (a measure of appraisal uniformity). (a) Add the absolute difference between each ratio and the median ratio, and divide by number of ratios. Divide this result by the median ratio and multiply by 100. Using the example at right:

Median ratio	ratio	difference
96.4	68.1	28.3
96.4	79.8	16.6
96.4	89.0	7.4
96.4	96.4	0.0
96.4	100.5	4.1
96.4	101.2	4.8
96.4	101.7	5.3
Sum of differences	66.5	= 9.5
No. of observations	7	

9.5 divided by the median ratio=
 $9.5/96.4 = .099 * 100 = 9.9$

Calculate the price-related differential.

Divide the mean ratio by the weighted mean ratio. Using the example at right:

Mean ratio: 90.96

Weighted mean ratio: (sum of appraisal values divided by the sum of sales prices): $656,400/701,588 = 93.6$

Price-related differential = .97

Example of how outlier ratios are trimmed:

1. Array the ratios from low to high

appraised value	sale price	ratio (as a %)
98,000	143,906	68.1
76,000	95,238	79.8
115,000	129,213	89.0
50,900	52,801	96.4
42,000	41,791	100.5
48,500	47,925	101.2
105,400	103,638	101.7
120,600	87,076	138.5

2. Locate the ratio that is at the 25th percentile:

No. of ratios divided by 4: $8/4 = \text{Ratio \#2}$

(If 25th percentile falls between two ratios, calculate the distance between them and add portion of that distance to the value of the lower ratio. In this example, if there were 9 ratios, the ratio in the 25th percentile would be $9/4$, or 2.25. The ratio at the 25th percentile would be found one-fourth of the distance between ratio #2 and ratio #3.)

3. Locate the ratio that is at the 75th percentile:

(No. of ratios divided by 4)*3: $(8/4)*3 = \text{Ratio \#6}$.

(If 75th percentile falls between two ratios, calculate the distance between them and add portion of that distance to the value of the lower ratio. In this example, if there were 9 ratios, the ratio in the 75th percentile would be $(9/4)*3$, or 6.75. The ratio at the 75th percentile would be found three-fourths of the distance between ratio #6 and ratio #7.)

4. Calculate the distance between these two quartiles by subtracting: $101.2 - 79.8 = 21.4$

The upper trim point is calculated as follows:
 $(21.4 \times 1.5) + 101.2 = 133.3$

The lower trim point is calculated as follows:
 $79.8 - (21.4 \times 1.5) = 47.7$

In this example, the highest ratio would be trimmed, and only 7 ratios would be included in the ratio study.

(a) because these "point estimates" are simply estimates of the true value of the statistic, the Department establishes confidence intervals around each measure to take into account the fact that the ratio study information came from a sample of parcels in a county, namely those parcels that sold in a particular year

APPENDIX C

Point System Used by the Division to Determine Compliance

•Sales Ratio Study	
Accuracy Measure-Median Ratio	25 Points
Uniformity Measure-COD	25 Points
•Appraisal Procedures	36 Points
<p>This is an evaluation of the procedures used by a county in developing good appraisals, such as its plan to maintain its appraisal system, and the methods it uses to establish property values. In reviewing methods, PVD does such things as verify that the county has developed good approaches to establishing commercial and residential property values, and evaluates the tools the county has developed to help establish those values.</p>	
•Agricultural Use Valuation	2 Points
•Mapping of Property Ownership	2 Points
•Constitutional and Statutory Compliance	10 Points
<p>This section deals with how well a county meets deadlines and maintains data.</p>	
Total	100 Points

APPENDIX D

1995 Price-Related Differentials and Confidence Intervals

Price-related differential (PRD) is a statistical measure designed to measure systematic differences in the appraisal of low-value and high-value properties. When low-value properties are appraised at greater percentages of market value than high-value properties, the appraisal system is called "regressive". When high-value properties are appraised at greater percentages of market value than low-value properties, the appraisal system is called "progressive".

The Division calculates price-related differential for each county for residential and commercial sales, but doesn't use this information in determining compliance. A 1993 audit by the Division of Post Audit recommended that the Division of Property Valuation begin to incorporate the PRD or a similar measure into its determinations of compliance. To-date this hasn't been done.

Although a thorough review of regressivity and progressivity was outside the scope of this audit, legislators expressed an interest in seeing basic, readily available information about price-related differential in Kansas. That information is presented in this appendix.

The International Association of Assessing Officers (IAAO) recommends that price-related differentials range between .98 and 1.03. In Kansas, the State median PRD for residential sales in 1995 was 1.02, and the State median PRD for commercial sales in 1995 was 1.04.

The tables in this appendix show the PRD and confidence intervals for each county for residential and commercial sales. Based on confidence intervals, commercial sales in 15 counties were above 1.03, which means these counties may have problems with regressivity, as were commercial sales in 11 counties. No counties appeared to have problems with progressivity.

Price Related Differentials and Confidence Intervals for Residential Properties, 1995

County	Price Related Differential	Confidence Interval
Allen	1.04	1.02-1.07
Anderson	1.01	0.99-1.04
Atchison	1.03	1.00-1.05
Barber	1.09	1.04-1.16
Barton	1.02	1.01-1.04
Bourbon	1.02	1.00-1.03
Brown	1.02	1.00-1.04
Butler	1.01	1.01-1.02
Chase	1.05	0.98-1.14
Chautauqua	1.13	1.08-1.20
Cherokee	1.03	1.01-1.05
Cheyenne	1.00	0.97-1.05
Clark	0.99	0.92-1.05
Clay	1.03	1.00-1.05
Cloud	1.00	0.98-1.03
Coffey	1.02	0.99-1.06
Comanche	1.02	0.97-1.08
Cowley	1.02	1.01-1.03
Crawford	1.01	0.99-1.02
Decatur	1.02	0.99-1.07
Dickinson	1.06	1.03-1.11
Doniphan	1.01	0.97-1.05
Douglas	1.00	1.00-1.01
Edwards	1.16	1.08-1.27
Elk	1.04	0.98-1.10
Ellis	1.01	1.00-1.02
Ellsworth	1.06	1.03-1.10
Finney	1.00	1.00-1.01
Ford	1.00	1.00-1.01
Franklin	1.02	1.00-1.04
Geary	1.01	1.00-1.01
Gove	1.05	1.00-1.12
Graham	0.99	0.98-1.01
Grant	1.00	0.98-1.01
Gray	1.03	0.99-1.08
Greeley	1.02	0.99-1.06
Greenwood	1.13	1.06-1.22
Hamilton	1.00	0.96-1.03
Harper	1.07	1.03-1.12
Harvey	1.01	1.00-1.01
Haskell	1.02	1.00-1.05
Hodgeman	0.91	0.85-1.03
Jackson	1.00	0.99-1.01
Jefferson	1.01	1.00-1.03
Jewell	1.22	1.09-1.44
Johnson	1.00	0.99-1.00
Kearny	1.02	1.01-1.04
Kingman	1.05	1.02-1.09
Kiowa	1.04	1.01-1.09
Labette	1.08	1.05-1.11
Lane	1.02	0.98-1.08
Leavenworth	1.02	1.01-1.03
Lincoln	1.04	0.99-1.09

County	Price Related Differential	Confidence Interval
Linn	1.04	1.01-1.08
Logan	0.98	0.93-1.03
Lyon	1.01	1.00-1.02
Marion	0.98	0.96-1.01
Marshall	1.05	1.01-1.10
McPherson	1.01	1.00-1.01
Meade	1.06	1.02-1.11
Miami	1.00	0.99-1.01
Mitchell	1.05	1.01-1.09
Montgomery	1.03	1.01-1.05
Morris	1.07	1.03-1.11
Morton	1.03	0.99-1.07
Nemaha	1.06	1.03-1.08
Neosho	1.06	1.03-1.08
Ness	1.16	1.07-1.30
Norton	1.06	1.03-1.11
Osage	1.02	1.00-1.04
Osborne	1.01	0.95-1.06
Ottawa	1.03	0.99-1.06
Pawnee	1.07	1.03-1.12
Phillips	1.09	1.06-1.13
Pottawatomie	1.00	0.99-1.02
Pratt	1.00	0.98-1.03
Rawlins	1.12	1.04-1.21
Reno	1.03	1.02-1.05
Republic	1.09	1.04-1.16
Rice	1.08	1.05-1.11
Riley	1.01	1.01-1.02
Rooks	1.11	1.07-1.21
Rush	1.12	1.06-1.23
Russell	1.06	1.03-1.11
Saline	1.00	1.00-1.01
Scott	1.02	1.00-1.04
Sedgwick	1.02	1.02-1.05
Seward	1.00	1.00-1.01
Shawnee	1.01	1.00-1.01
Sheridan	1.07	0.98-1.16
Sherman	1.03	1.00-1.06
Smith	1.06	0.99-1.15
Stafford	1.08	1.03-1.13
Stanton	1.01	0.96-1.08
Stevens	1.02	0.99-1.04
Sumner	1.02	1.01-1.04
Thomas	1.00	0.99-1.01
Trego	1.07	1.04-1.10
Wabaunsee	1.02	0.99-1.06
Wallace	0.99	0.93-1.11
Washington	1.07	1.02-1.16
Wichita	1.01	0.98-1.05
Wilson	1.05	1.02-1.08
Woodson	1.07	1.02-1.13
Wyandotte	1.05	1.04-1.07
State Median	1.02	

Price Related Differentials and Confidence Intervals for Commercial Properties, 1995

County	Price Related Differential	Confidence Interval
Allen	1.08	0.96-1.22
Anderson	1.72	1.11-2.74
Atchison	1.17	1.05-1.34
Barber	1.05	0.95-1.26
Barton	1.01	0.92-1.20
Bourbon	1.13	0.94-1.43
Brown	0.99	0.94-1.04
Butler	1.00	0.83-1.17
Chase	1.21	1.03-1.68
Chautauqua	1.05	0.87-1.28
Cherokee	1.04	0.95-1.16
Cheyenne	0.97	0.93-1.02
Clark	0.97	0.95-1.03
Clay	1.14	1.00-1.38
Cloud	1.25	1.01-1.64
Coffey	1.04	0.95-1.22
Comanche	1.10	1.01-1.21
Cowley	0.94	0.86-1.04
Crawford	1.02	0.85-1.30
Decatur	1.14	1.00-1.28
Dickinson	1.11	0.92-1.35
Doniphan	1.03	0.95-1.14
Douglas	0.99	0.94-1.04
Edwards	1.16	1.03-1.48
Elk	1.10	0.93-1.32
Ellis	1.03	0.99-1.08
Ellsworth	1.03	0.88-1.21
Finney	1.11	1.01-1.40
Ford	0.88	0.80-1.15
Franklin	0.87	0.81-1.03
Geary	1.16	1.07-1.26
Gove	1.01	0.96-1.06
Graham	1.02	0.99-1.08
Grant	1.01	0.99-1.03
Gray	1.01	0.95-1.15
Greeley	1.07	0.99-1.30
Greenwood	2.00	1.54-2.67
Hamilton	1.02	0.98-1.06
Harper	1.02	0.96-1.13
Harvey	1.03	0.90-1.15
Haskell	1.22	1.09-1.46
Hodgeman	1.03	0.92-1.11
Jackson	0.97	0.94-1.01
Jefferson	1.07	1.01-1.19
Jewell	0.91	0.84-1.21
Johnson	1.02	0.97-1.06
Kearny	0.98	0.96-1.04
Kingman	1.03	1.00-1.06
Kiowa	1.03	1.00-1.08
Labette	1.02	0.94-1.10
Lane	1.11	0.99-1.30
Leavenworth	1.02	0.92-1.19
Lincoln	1.29	1.05-1.75

County	Price Related Differential	Confidence Interval
Linn	1.04	0.96-1.16
Logan	1.03	0.91-1.15
Lyon	1.06	0.95-1.21
Marion	1.02	0.91-1.19
Marshall	1.13	1.01-1.40
McPherson	1.08	0.99-1.22
Meade	1.13	1.02-1.30
Miami	0.98	0.95-1.03
Mitchell	1.07	0.95-1.23
Montgomery	1.12	0.98-1.25
Morris	1.51	1.14-2.11
Morton	1.03	0.96-1.10
Nemaha	1.00	0.94-1.10
Neosho	1.13	0.98-1.53
Ness	0.97	0.85-1.09
Norton	1.15	1.02-1.44
Osage	1.04	0.94-1.16
Osborne	1.06	0.91-1.24
Ottawa	1.07	1.02-1.19
Pawnee	1.15	1.00-1.41
Phillips	1.04	0.90-1.23
Pottawatomie	0.93	0.87-1.11
Pratt	1.03	0.99-1.07
Rawlins	0.95	0.88-1.03
Reno	0.95	0.84-1.06
Republic	1.26	0.89-1.83
Rice	1.20	1.08-1.33
Riley	0.99	0.97-1.01
Rooks	1.22	1.01-1.88
Rush	0.98	0.86-1.15
Russell	0.94	0.85-1.09
Saline	0.97	0.87-1.09
Scott	0.98	0.93-1.08
Sedgwick	1.14	1.07-1.27
Seward	1.18	1.05-1.36
Shawnee	1.08	0.98-1.31
Sheridan	0.96	0.82-1.21
Sherman	0.92	0.86-1.07
Smith	1.07	0.98-1.41
Stafford	1.02	0.94-1.10
Stanton	1.02	0.99-1.05
Stevens	1.02	0.92-1.11
Sumner	1.03	0.96-1.13
Thomas	1.08	0.97-1.26
Trego	1.07	0.94-1.27
Wabaunsee	1.59	0.95-2.74
Wallace	1.03	0.95-1.12
Washington	1.13	1.03-1.28
Wichita	1.02	0.94-1.08
Wilson	1.08	1.01-1.25
Woodson	1.14	1.02-1.30
Wyandotte	1.18	1.06-1.33
State Median	1.04	

APPENDIX E

Comparison of Selected Features of the Real Estate Ratio Study in Kansas With Ratio Studies in Other States

We reviewed a 1994 national survey of real estate ratio studies, and contacted the 10 states that reported using confidence intervals in assessing compliance with state property appraisal requirements. Because Delaware didn't have a statewide property appraisal function--all appraisal activities were handled by counties--we didn't include it in our comparisons. Comparative information from the other nine states is presented in this appendix.

State	Median ratio standard	Is compliance on the median ratio required	Does the state use confidence intervals for the median ratio	Does calculated median ratio have to meet standard?	Penalty for non-compliance	Coefficient of Dispersion standard
Alaska	≥ .85	Yes. State has oversight respon. for the 25 of 150 jurisdictions that levy a property tax	No. County does the ratio study and gives results to state. State is trying to figure out ways to make study more meaningful.	Yes, but in some cases too few sales to make statistics reliable; can bring in additional years' data	May require county to raise assessment levels after conferring with assessor. County has 1 yr. to clear up problem, or state will take county to court.	residential ≤15 commercial ≤20
Arizona	residential range .74-.90 commercial range .73-.89	Yes. State does studies four times each year	Yes	Yes.	State will issue orders to require correction. Actions range from working with the appraiser up to a full reappraisal.	residential ≤20 vacant, commercial ≤25
Florida	≥ .90	Yes.	Yes, to provide additional info	Yes	County gets a letter from the state requiring them to redo their appraisals. If they don't, state will reject the tax roll.	residential ≤20 other ≤25
Idaho	.90 to 1.10	Yes	Yes	No. Idaho presumes the statistic is in compliance unless proven it is not	If county not in compliance, Bd. of Equalization corrects, or state will make adjustments	residential ≤15 vacant, commercial ≤20
Kansas	.90 to 1.10	Yes	Yes	No. If confidence interval brackets the standard, county not determined to be out of compliance	State will work with the county, it may take over appraisal activities within a county, or it can order reappraisal.	≤20
Kentucky	.90 to 1.10 or .95 to 1.05 depending on alternative used	Yes	In past, required that the confidence interval included 100%. Confidence intervals no longer used because they don't work well for small counties	Yes	Requires county appraiser to do some work to improve. May include doing more appraisals, could order reappraisal.	1997: ≤25 1998: ≤20
Minnesota	.90 to 1.05	Yes	No. Considered, but don't because sample sizes too small for some classifications. Uses trend analyses.	Yes	State can force local jurisdiction to raise or lower value. Board of Equalization usually does something if county out of compliance.	residential ≤15 commercial ≤20
Mississippi	residential: .80 to 1.20 other: .75 to 1.25 are moving to .90 to 1.10	Yes	The confidence interval is the "margin of error" allowed. Confidence levels are used to obtain sample sizes for appraisal ratio studies	Yes	Counties have 2 years to get into compliance. In 2nd yr, standard is tightened. if county not in compliance in 2nd year, state imposes severe financial penalties.	≤25
Oregon	.95 to 1.05	Yes	No, but are considering to verify county compliance	Yes	State will issue order and county has to do a trending process or reappraisal	Loose standard of ≤20, depending on area being examined
Texas	no pre-set range	Yes (for school districts)	Yes. State does confidence interval around total property value and school district's value has to be within that range	School district's value has to be within calculated range	Funding decisions are triggered	None. COD calculated for informational purposes - no standard exists

Is compliance on the coefficient of dispersion required	Does the state use confidence intervals for coefficient of dispersion	Does calculated coefficient of dispersion have to meet standard?	Penalty for non-compliance	Price-Related Differential standard	Is compliance on the Price-Related Differential Req'd	How else is compliance assessed
Yes. State has oversight respon. for the 25 of 150 jurisdictions that levy a property tax	No	Yes	County has 1 yr. to clear up problem, or state will take county to court.	.98 - 1.03	No, although state will do an audit if statistic is below .80 or above 1.15	Visit subdivisions, talk with assessors about their problems.
No. State law allows for compliance decisions based on the COD, but this has never been done	No	NA	Work with appraisers to get them to tighten up appraisals	NA	NA	For commercial, state has to do supplemental appraisals, consider specific factors in area.
Yes	No	Yes	State confers with county or issues admin. order. County has 1 year to come into compliance. After that, tax roll can be rejected.	.90 - 1.10	Yes	State reviews procedures although compliance first based on statistics. If ok, county mostly left alone.
No. COD used for informational purposes only	No	NA	NA	.98 - 1.03	No	Review records to ensure reappraisals done every 5 yrs, as required.
Yes	Yes	No. If confidence interval brackets the standard, county not determined to be out of compliance	State will work with the county, it may take over appraisal activities w/in a county, or it can order reappraisal.	.98 - 1.03	No	State reviews county appraisal procedures.
Yes	No	Yes	State works with county, identifies outliers, reviews whether appraisers making progress	NA	NA	State reviews appraiser activities: has tax roll gone up, is appraiser going into areas that need work, are procedures good
No. COD used for informational purposes only	No	NA	State hasn't used COD in assessing penalties, but is considering	.98 - 1.03	No	Work with local staff, compile, verify sales data
Yes	No	Yes	Counties have 2 yrs to get into compliance. In 2nd yr, standard tightened. If county out of compliance in 2nd year, state imposes severe financial penalties.	.92 - 1.08	Yes	State moving away from ratio studies. Ultimate goal is to do audits and appraisal ratio studies. Said focus on ratio studies a mistake: with wide ranges, counties think all's ok when it's not.
No. Information on COD used as an indicator of what's happening in a county	No, but may in future as additional info.	NA	NA	None. Statistic is used for informational purposes - no standard exists	NA	Reviews procedures, checks to ensure procedures being used. Does trends in areas not being physically reappraised.
No. COD used for informational purposes only	No	NA	NA	None. Statistic calculated for informational purposes - no standard exists	NA	NA

APPENDIX F

Agency Response

On February 24th we provided copies of the draft audit report to the Department of Revenue. Its response is included as this appendix. As a result of the Department's response, we made minor corrections and clarifications to the audit.

Mark S. Beck, Director
Kansas Department of Revenue
915 SW Harrison St.
Topeka, KS 66612-1585



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Division of Property Valuation

March 7, 1997



Ms. Barbara Hinton
Legislative Division of Post Audit
Mercantile Bank Tower, Ste. 1200
800 S.W. Jackson
Topeka, Kansas 66612-2212

Dear Ms. Hinton:

I am pleased to have the opportunity to review your draft audit report on the sales ratio study program and to thank you for the courtesy and professionalism your staff exhibited during this audit. I find the comments and recommendations set forth in your report helpful, and I am certain they will assist the division of property valuation in their constant quest of updating and improving. I am most pleased by the fact that in your professional and objective opinion, the Kansas sales ratio study program is nothing short of a national benchmark of excellence. I found your survey of other states most telling in this regard.

It may be of interest to you to know that the International Association of Assessing Officers (IAAO) has also recognized Kansas for the innovative ratio study research it has performed over the last few years. In addition, many of the new ideas and state-of-the-art techniques developed by Kansas are currently being incorporated into IAAO standards and IAAO textbooks that will be used throughout the United States and in many foreign countries.

I would like to respond to two issues raised by your report. First, there appears to be concern regarding the fact that we do not find a county to be out of compliance statistically unless we can be certain that is indeed the case.

As you are aware, the real world does not always provide all the data needed for applying an exact statistical measurement. These limitations in actual data are the reason the department uses confidence intervals in order to determine statistical compliance. The statistical compliance results set forth in the Kansas sales ratio study comprise a crucial tool for assuring statewide uniformity. However, it is also a tool that should not be misused. When a county is found to be out of compliance, there are tremendous costs to that county in terms of resources and reputation. Taxpayers are best served when tax dollars are not devoted to "fixing" problems that may not exist. Furthermore, taxpayers should not be given the impression that a county's valuations are suspect, unless the county is truly out of compliance.

Second, your report notes that the department measures a county's performance using a combination of statistics and procedural reviews, while the court's primary emphasis is statistical results.

Common sense tells us that even when the statistics are reliable, statistics alone do not provide the whole story about whether a county is out of substantial compliance *or why*. In those instances when there is not sufficient data to responsibly draw conclusions from statistical results, the procedural review becomes a very important tool for evaluating and assisting a county.

Furthermore, while the sales ratio study relates to the bulk of property valued by county appraisers, i.e., residential and commercial real property, it does not measure all of the valuations made by the county appraisers. For example, county appraisers must value agricultural land based upon its use, and commercial and industrial machinery and equipment based upon a formula in the constitution.

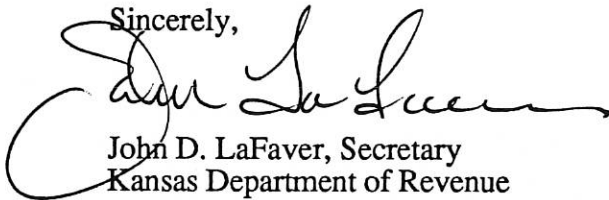
Finally, there are functions besides valuations performed by the county appraisers which can effect uniformity and compliance. The procedural review allows an opportunity to evaluate that performance as well.

In summary, it is very important to the department that its overall performance evaluation of the counties be as accurate as possible to promote uniformity. It is also important that the performance evaluation be a useful tool to help the counties pinpoint their overall strengths and weaknesses. I believe that the department's leading edge statistical measurements combined with its traditional procedural evaluation provides an overall very reliable means for measuring if a county is truly out of compliance. It is also a useful tool for a county to determine where to devote its limited resources in order to best achieve uniformity for its taxpayers.

Again, thank you for recognizing the excellence of our sales ratio study program in terms of quality and innovation. I commend my staff for this accomplishment and I further commend those individuals on the Ratio Study Technical Advisory Committee, the Kansas County Appraiser's Association and the International Association of Assessing Officers who unselfishly devoted their time and expertise towards helping develop our program.

Attached, please find additional points my staff has compiled regarding your audit report. Thank you again. If I can be of further service, please let me know.

Sincerely,

A handwritten signature in cursive script, appearing to read "John D. LaFaver".

John D. LaFaver, Secretary
Kansas Department of Revenue

Attachment

Mark S. Beck, Director
Kansas Department of Revenue
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Topeka, KS 66612-1585



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Division of Property Valuation

MEMORANDUM

TO: John D. LaFaver, Secretary
Kansas Department of Revenue

FROM: Division of Property Valuation
Kansas Department of Revenue

DATE: March 7, 1997

SUBJECT: Final Comments regarding the LPA Review of the Ratio Study Program

Page 2:

Caption:

The auditor notes that "State Law Requires all Property Subject to Taxation To Be Appraised Uniformly and Equally at to Class, And at Its Fair Market Value" This is true with respect to the residential and commercial real estate the sales ratio evaluates. However, state law does not require *all* property subject to taxation to be appraised *at its fair market value*. Article 11, Section 1, of the Kansas Constitution provides for the following exceptions: recreational vehicles, passenger motor vehicles, land devoted to agricultural use, and commercial and industrial machinery and equipment.

Paragraph 3:

The auditor states, in the last sentence, that "people who own these houses are paying different amounts of property taxes even though they should be paying the same amount." The auditor is probably aware that this statement is true provided that these homes are in the same tax unit and are therefore subject to the same exact mill levy. The mill levy varies from location to location depending upon the cost of the local services and the value of property in the tax base. For example, a location supporting a community college may have a higher mill levy. A location benefiting from a wealth of commercial property valuation may have a lower mill levy. However, the auditor is making the valid point that the properties should carry no more than their fair share of the local tax burden.

Paragraph 4:

In paragraph 4, the auditor correctly notes that a property's sales price (assuming it is a valid, arms length transaction) is an important element in establishing fair market value, but it isn't the sole criteria. One additional example not addressed in the report that is noteworthy is **inflation**. As the Kansas Supreme Court has put it, substantial weight should be given to a sales price from a willing buyer to a willing seller; however, other factors set forth in K.S.A. 79-503 are important, *such as inflation*. *Board of County Comm'rs v. Brookover*, 198 Kan. 71, 77, 422 P.2d 906 (1967). This point was more recently recognized by the Kansas Court of Appeals in *Wolf Creek Golf Links, Inc. v. Johnson Board of Co. Comm'rs*, 18 K.A.2d 263, 266, 853 P.2d 62 (1993).

Page 3

Step 1:

The auditor notes that for larger counties, the division of property valuation (hereinafter "PVD") evaluates a sample of sales. Actually, PVD evaluates a sample of sales only in the **residential** property category, in compliance with K.S.A. 1996 Supp. 79-1488.

Page 5

Paragraph 2:

In paragraph 2, the last sentence, the auditor states that the order in Shawnee County District Court Case No. 92-CV-796 "says the determination of whether the statistical standards have been met will be measured by the ratio study only, *without considering a county's procedures.*"

The court order does not contain a statement that the determination will be made "without considering a county's procedures." The court order is silent as to that point. It is not possible to predict how the courts will address this issue.

Page 7

Caption: "What is required of property appraisals?"

The auditor correctly notes that the goal is to appraise all property at its fair market value. The auditor is probably aware that in a mass appraisal setting, perfection is never achieved. It is not possible for every single property in Kansas to be appraised exactly at its fair market value at a single point in time. There are simply too many properties and too much movement in the market. The courts have recognized that fact, and do not require absolute perfection in uniformity. For example, in *Allegheny Pittsburg Coal Co. v. Co. Comm'n of Webster County*, 488 U.S. 336, 109 S. Ct. 633, 638 (1989). Thus, accuracy, as used in this report, refers to the *level* of the appraisals in the state.

Caption: "Is Kansas' requirement consistent with industry standards?"

For income property, the categories recognized by IAAO should be • **urban** and • **rural**, not new and old.

Page 10

The auditor uses a simple example for illustrative purposes on page 10. The auditor is probably aware that in real life, either a much larger sample must be drawn and evaluated, or confidence intervals must be used in order to draw responsible conclusions.

Page 11

Graphic at bottom of page:

The auditor also uses a simple example for illustrative purposes on page 11. The auditor is probably aware that in real life, either a much larger sample must be drawn and evaluated, or confidence intervals must be used in order to draw responsible conclusions.

Page 13

Paragraph 1:

The auditor states in the last sentence that "Under the court order, all 18 of those counties would have been out of compliance." It is not possible to predict how the court would address this situation. In addition, it should be noted that the analysis is more complex than presented.

The court order addresses statistical performance measures for the commercial and residential classes of property in each county. If one of those classes is out of compliance, that class or even a mere portion thereof may be considered defective, **but the entire county may not be found out of compliance.**

The PVD Substantial Compliance Review requires a comprehensive evaluation of statistical measures, appraisal procedures and statutory functions. The annual PVD substantial compliance evaluation rates overall county performance. It should be noted that a county with acceptable statistical measures for both residential and commercial property may still be found in non-compliance under the PVD substantial compliance review.

Page 14

Paragraph 2:

The auditor states that the buyer, seller or **real estate agent** must complete the real estate validation questionnaire before a deed can be filed. Actually, any **agent** acting on behalf of the buyer or seller can sign. (K.S.A. 1996 Supp. 79-1437c).

Appendix D

Here, the auditor is using real data to draw conclusions about statewide appraisal performance. In order to draw responsible conclusions, confidence intervals must be used.

Without the use of confidence intervals, the inferences made about the PRD problems in Kansas are misleading. Using the confidence intervals in the residential class, the statistics suggest that only 15 counties may have problems with regressivity (no progressivity problems can be demonstrated). The median residential PRD statewide is 1.02. Counties with PRD problems are typically rural with low parcel counts. They represent approximately 6% of the *residential* value statewide, and even less of the overall value statewide.

Using the confidence intervals in the commercial subclass, the median PRD statewide is 1.04 and the confidence intervals suggest that only 11 counties may have some regressivity problems (no progressivity problems can be demonstrated). Two of the problem counties were under reappraisal in 1995 with frozen values. The other 9 counties represent only about 9% of the *commercial* value statewide, and even less of the overall value statewide.

PVD Presentation

The Constitution and State law require most real property to be appraised uniformly and equally at its fair market value. — AND

one of the major tools for assessing whether that requirement is met is the sales-ratio study. Done annually, it compares the appraised value to the sales price for different types of property within a county that sold during the year.

need two measures to evaluate groups of sales ratios
median ratio-accuracy
coefficient of dispersion-uniformity

eg. take all the individual ratios for residential sales in your county and lay them out from low to high... *The one in the middle would be the median ratio, + that is a measure of how accurate the appraisals are. But you also need to know how those ratios are spread out.*

Question 1: Is the methodology used in conducting the State's sales-ratio study mathematically sound?

In most areas, methodology is reasonable and consistent with professional guidelines.

- basic steps Div follows in conducting the study are generally consistent with practices recommended by the IAAO *p3 flowchart*
 - validating sales
 - calculating sales ratios for each property in the study
 - eliminating outliers before calculating *stats* statistics
 - computing a median ratio for each class of property in each co.
 - computing a coefficient of disp. for “

•Div. follows its policies - we tested raw data/calculations for 5 counties and came up with same results

•Sampling residential sales in the most populous counties is efficient

•The standard used for the median ratio is consistent with IAAO stds. appraisals can't be perfect, statute says .90 to 1.10 is OK

•Use of confidence intervals for median ratio is consistent with IAAO

106.8

good practices

Check

p9 ←

*Senate Assessment + Taxation
3-18-97
Attachment 4*

1

We found two instances, **methodology wasn't consistent** with prof. standards. Not major problems, but both of these practices make it easier for counties to be in compliance.

coefficient of dispersion
•The standard for the COD (uniformity) is more lenient than IAAO 20 instead of 15. This means it is acceptable for values to deviate from fair market value by 20% on average, as opposed to 15%. Other states: 3=15, 5 \geq 20

•The Division uses confidence intervals to evaluate whether counties are in compliance with the COD. Standards silent on this issue. Other states we contacted didn't use. Professors say "why not"

Finally, since 1992 the Division has been operating under a court order that requires all counties to be in compliance on or before Jan.1, 1998. Court order discusses compliance solely in terms of the ratio study, (median ratio and coefficient of dispersion). Div., when it reports substantial compliance each year to the Governor, makes its decisions on 100 pt scale where 50 points assigned to ratio study results, 50 points to co. appraisal procedures. Likely to be some differences between the two.

Question 2: Is the State's method for determining which sales of property to include or exclude from the sales-ratio study reasonable, and has that method been appropriately applied?

~~Ratio study a large part of determining whether in compliance~~
Not every sale is in the study- only want arms length sales

When a piece of land is sold, sale is filed with the Register of Deeds. In nearly all cases it must be accompanied by a Real Estate Sales Validation Questionnaire (completed by the buyer, seller, or their agent) which provides ^{most of the} information the Division uses to decide if the sale was an arms-length transaction See Appendix A

State law sets out 15 types of exempt sales...cemetery lots, deed

4 - R 2

transfers, foreclosures, etc. for which the questionnaire doesn't need to be filed. (not wanted in the ratio study)

Division developed extensive criteria, based closely on professional guidelines, for deciding whether remaining sales should be included. Policy is that all sales are valid unless there is sufficient and compelling evidence to indicate they aren't.

Table on page 16 shows that in 199~~7~~⁵, about 60% of the sales considered for inclusion in the study ended up being included, and about 40% didn't. Most common reason excluded was because not open market sales; were private transactions.

Looked at a random sample of 359 residential and commercial sales in 9 counties (3 small, 3 medium, 3 large). Found only 7 instances (2%) where decision didn't follow Division policy. Probs appeared to be random human error. (359/6263=5.7%)
A 2% error rate

Appraisers can appeal any decision by the Division. Start with an informal appeal to Div. staff, can make formal appeal to BOTA, on to district court.

Looked at a sample of 50 informal appeals from across the State. In all cases, Division's decisions on the appeals seemed logical and followed policies. (50/658=7.5%)
 $658/46,867 = 1.4\%$

Slightly less than half the time (46%), they agreed with the county appraiser, usually because the co. appraiser provided additional information that wasn't available to Division field staff who made the original decision. (Nothing on questionnaire that would make it seem like a questionable sale, but local appraiser probably knew something that didn't get reported).

Really have done a very good job on making sure appropriate sales get into the study.

Anderson
Barton
Sedgwick

Barber
Crawford
Shawnee

Cheyenne
Finney
Wyandotte

4 → 3 (3)