

SCOPE STATEMENT

Department of Revenue: Evaluating the Revenue Impact of Machinery and Equipment Classification and Valuation

In an effort to stimulate economic growth, the 2006 Legislature exempted commercial and industrial machinery and equipment from all Kansas property and ad valorem taxes. This property can include office furniture, trailers, hand tools, computers, copiers, and a wide variety of other equipment used to produce income.

Although machinery and equipment is defined in the Kansas Constitution as personal property (as opposed to real property), it is sometimes difficult to classify. The primary difference between the two classifications is that personal property is moveable, whereas real property is fixed. In some cases, that distinction is subtle. For example, large manufacturing plants often require large and complex combinations of both real and personal property to operate. Depending on how those plants are configured, some personal property might become a relatively fixed part of the plant. In such cases, it might be classified as real property, which is not tax exempt.

To help determine whether items should be classified as real or personal, county appraisers rely on a commonly accepted three-part test. That test is used to determine whether an asset is permanently attached to real estate, whether it is an integral part of the real estate, and whether it is intended to be a permanent fixture. If all three conditions are met, a property is generally classified as real, not personal, property.

Legislators have expressed concern that commercial machinery and equipment used in large manufacturing operations are not being properly or consistently classified and valued across the state. Additionally, legislators have expressed interest in knowing what affect different classifications and valuation methods might have on local and state tax revenues.

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

- 1. Has machinery and equipment used in manufacturing plants been appropriately and consistently classified and valued across the State?** To answer this question, we would work with Department of Revenue staff to better understand constitutional and state classification requirements for this type of property, as well as any relevant department regulations. We would determine what methods are used by local governments and the state to classify and value machinery and equipment, and would also talk to officials in other state's revenue agencies and appraiser offices to determine how they help ensure that property is classified and valued consistently. Further, we would determine what steps the department takes to ensure that machinery and equipment are classified and valued consistently across the state. We would select a sample of machinery and equipment at various manufacturing operations such as power, cement, and fertilizer plants across Kansas. For that sample, we would determine whether the property has been reclassified since 2006, and how it has been valued. For property that was reclassified or valued using different methods, we would interview county appraisers

Senate Ways and Means Committee
Date: 01-22-2013
Attachment #: 4

and plant owners to understand the reasons why. Further, we would determine whether reclassified property was altered in a way that might justify its classification (e.g. physically bolting moveable equipment to the ground). We would perform additional work in this area as needed.

2. **How do differences in classification and valuation methods for equipment and machinery used in manufacturing plants affect local and state tax revenue?** To answer this question, we would interview department staff to identify legal actions or court decisions that could affect our estimates. For the sample of machinery and equipment identified in Question 1, we would estimate the effect of re-classifying that property and applying different valuation methods. We would perform additional work in this area as needed.

Estimated Resources: 3 LPA staff

Estimated Time: 5 months (a)

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

SCOPE STATEMENT

K-12 Education: Efficiency Audit of Selected School Districts

During fiscal year 2010, the Legislative Division of Post Audit conducted voluntary efficiency audits of school districts. Officials from several school districts volunteered for the audits as a way to help them identify ways they could reduce costs without affecting the education they provide students. In total, seven school district efficiency audits were conducted. Among other things, these audits found potential savings related to food service programs, high school scheduling, and consolidating administrative functions into a single building.

During the 2011 legislative session, legislators expressed an interest in having us perform an efficiency audit similar to those performed in 2009 and 2010. As a result of that interest, the Legislature included a proviso in the fiscal year 2013 appropriations bill requiring an audit of three school districts by the end of the fiscal year.

This school district performance audit answers the following question:

- 1. Could selected school districts achieve significant cost savings by improving resource management, and what effect would those actions have?** To answer this question, we would select three school districts for review (one small, one medium, and one large), with preference given to districts that voluntarily requested an audit. We would interview district officials, tour facilities, and compare each district's staffing and expenditures to its peers to identify areas where the district could potentially save money. We would evaluate each district's practices in the areas we identified to see if there are ways the districts could use fewer resources without significantly affecting their ability to educate students. Further, we would interview school district officials and others to identify the potential effect those actions might have on the local community, teachers, parents, and students. Finally, we would survey school districts to identify what types of efficiency measures they have already taken to reduce costs. We would perform additional work in this area as necessary.

Estimated Resources: 3 LPA staff

Estimated Time: 6 months (a)

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

SCOPE STATEMENT

Kansas Commission on Veterans' Affairs: Evaluating Selected Financial Controls at the Kansas Soldiers Home and the Kansas Veterans Home

The Kansas Commission on Veterans' Affairs (KCVA) oversees two residential facilities for Kansas veterans. These two facilities provide long-term nursing and domiciliary care to veterans and their spouses in independent living cottages, residential units, and a nursing care center. Both homes each housed approximately 130 veterans in fiscal year 2011. The Kansas Soldiers Home was established in 1889 in Fort Dodge and the Kansas Veterans Home was established in 1997 in Winfield.

In recent years, the Department of Administration has identified several financial issues at both homes. In July 2011, the department sent KCVA a letter detailing several issues it had identified during a recent review of the agency's capital assets and local funds. Specifically, both homes had not entered assets into the state's new accounting system and the Kansas Soldiers Home was unable to provide an inventory of capital assets to support the \$7.3 million it had previously reported. In April 2012, the department also found that the Kansas Soldiers Home's procurement card transactions had not been reconciled on a timely basis and that detailed transactions receipts were not available for a number of transactions.

Legislators have expressed concern that these issues might indicate more systemic problems with the financial controls implemented at KCVA's two veterans' homes.

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

- 1. Do the Kansas Soldiers Home and the Kansas Veterans Home have adequate financial controls to prevent or detect accounting errors?** To answer this question, we would review and evaluate selected controls at both homes' related to relevant financial processes including procurement cards. We would further determine whether those controls adhere to best practice and whether they are being followed. For controls that were deficient or were not followed, we would interview staff to determine the reasons why. Additionally, we would review transactions and other documents to determine the financial effect of any errors created because controls were deficient or because existing controls were not followed. We would perform additional work in this area as necessary.

Estimated Resources: 3 LPA staff

Estimated Time: 3 months (a)

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

