

# Public Finance Module

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# Speaker

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# Test Material

- 80% from the Study Guide - 38 pages
  - All pages
- 20% from
  - Glossary - 43 pages
    - All pages
  - Study Guide for Texas State Law - 42 pages
    - Page 22 - Miscellaneous Financial Provisions
    - Page 33 - Purchasing

This test covers the material



# Test Statistics

- Since April 2012
  - 63 have taken
  - 47 have passed
  - 75% pass rate
  - 79 average score



# Test Taking Techniques

- Whatever works best for you



# Major Topics

- Revenue for Local Government
- Purchasing
- Risk Management
- Public Pension Fund Administration



# Revenue Administration – Page 1

- Basic concepts and criteria for assessing revenue instruments
- Issues of administration
- The revenue sources relied on by local governments



# Other Topics – Page 1

- Purchasing
- Risk Management
- Public Pension Fund Administration





# Basic Concepts – Page 1

- Local Government Revenues - 2 Major Groups
  - Taxes
    - Property
    - Local Option Sales Tax
  - Non-Taxes
    - Fees, Fines, Forfeitures
    - Charges
    - Grants
- Tax Levy
  - Amount of revenue derived from a tax
    - Tax rate x Tax base
    - Property tax levy - ad valorem tax levy
    - Mills - one-tenth of one cent
    - Tax levy rarely the same as actual collections



# Basic Concepts – Page 2

- Impacts to the Tax Levy
  - Tax Avoidance
    - Legal Reduction to the tax base
    - Example - contribution to an IRA
  - Tax Evasion
    - Illegal reduction to the tax base
    - Example - retailer fails to record taxable sales
  - Tax Expenditure
    - Legal reduction typically initiated by Government
    - Example - homestead exemption



# Basic Concepts – Page 3

- Equity - Two Competing Principles
  - Benefits received
  - Ability-to-pay
- Benefits Received
  - Service must be
    - Divisible
    - Measurable
    - Excludable
    - Examples - water usage
- Ability to pay
  - Greater ability to pay should pay larger percentage of their income
  - Most appropriate for public goods
  - Example - excise taxes on certain luxuries



# Basic Concepts – Page 3

- Equity - Two Types
  - Horizontal
  - Vertical
- Horizontal
  - Similar economic conditions are charged equally
  - Example - Similar sized house, similar property taxes
- Vertical
  - Greater ability to pay bear a greater portion of the burden
  - Example - graduated federal income tax



# Basic Concepts – Page 4

- Three Types of Tax Structures
  - Regressive
  - Progressive
  - Proportional
- Regressive
  - Lower income pay a higher percentage
- Progressive
  - Higher rates to those with greater ability to pay
- Proportional
  - Same rate applies to all properties



# Administrative Feasibility – Page 4

- Administrative Feasibility
  - Critical for the efficient operation
  - Primary concern is security of public funds



# Administrative Feasibility – Page 4

- Five Steps to Administer a Tax
  - Determine the tax base
  - Set the tax rate
  - Administer the tax, issue bills & collect payments
  - Process payments
  - Audit for compliance
- Estimates to Administer tax
  - Property tax - 1 to 3%
  - Sales tax - less than 1%
  - Lotteries - 15%, 50% to winners, 35% general fund
- Piggybacking
  - Levying a tax on a tax base identified, maintained and taxed by another entity



# Economic Efficiency – Page 5

- Economic Efficiency
  - What effect does a tax have on consumer or business behavior
  - If economically efficient should not alter decisions in the market
- Five Areas of Economic Activity that may be Distorted by Taxes - Mikesell
  - Work versus leisure - high taxes on extra income
  - Business operations - abnormal business practices to avoid a tax
  - Consumption choice - high taxes encourage purchases in other locations
  - Personnel management - travel expenses are deductible hold in resort locations
  - Productive investment - choosing investments to avoid taxes





# Laffer Curve – Page 6

- Successive increase produce a higher rate to a point
- Highest point revenue is maximized
- Any move beyond this point actually reduces tax revenue
  
- Inelastic demand
  - Alcohol, tobacco - higher tax rates
  
- Elastic demand
  - Sporting event at some point stay home and watch



# Laffer Curve – Page 7



# Revenue Sources – Page 7

- Property Tax
- Non-property Tax



# Property Tax – Page 7

- Steps of the Operation
  - Assess
  - Establish tax rate
  - Bill
  - Collect



# Assessment – Page 8

- Conducted by Appraisal District
- Uniform Standards ensure Horizontal Equity
- Assessed on Fair Market Value
- Reappraised on a Regular Cycle - 3 to 4 years (biennial plan)
- Consistency through Random Sampling of Properties
  - Coefficient of dispersion
  - Example - page 10



# Tax Rates, Billings and Payments – Page 9

- Truth in Taxation
  - Publish
    - Effective rate
    - Rollback rate
    - Remember the test is on the materials in the handout



# Property Tax Relief – Page 11

- Direct Relief
  - Tax limitations
  - Rollbacks
  - Homestead
  - Other exemptions
  - Circuit breakers
- Indirect relief
  - Other revenue sources are developed



# Supplemental Reading – Page 12

- A Revenue Guide for Local Government
  - Chapter 4
- Fiscal Administration: Analysis and Applications for the Public Sector
- Management Policies in Local Government Finance
  - Chapter 10
- Texas Property Truth in Taxation
- Texas Local Government Code





# Non-property Taxes – Page 14

- General Sales and Use Taxes
  - Sales Tax - rate times transaction amount
  - Use Tax - major purchases of equipment and vehicles
- Tax expenditures related to sales tax
  - Food
  - Drug
  - Clothing for infants, children and other necessity items
- General sales tax is regressive tax
  - Tax expenditures, exemptions reduce the regressivity



# Non-property Taxes – Page 15

- Major Benefits of general sales and use taxes
  - Export tax burden to nonresidents
  - Elastic revenue source
- Disadvantages of general sales and use taxes
  - Regressivity
  - Compliance
  - Audit



# Non-property Taxes – Page 16

- Excise Taxes
  - Hotel/Motel tax
    - Ad valorem - taxes applied to the sale price
    - In rem - levied on each unit sold
    - Often earmarked for specific purpose
- Income Tax



# Non-tax Revenue Sources – Page 17

- User Fees and Charges
  - Closely resembles a private good and costs are easily determinable
  - Measurable and excludable
  - Based on the benefits received principle of equity
- Ways Used
  - Golf, Tennis
  - Solid Waste, previously funded through General Fund
  - Water, Sewer



# Non-tax Revenue Sources – Page 17

- Benefits of User Fees and Charges
  - Allow government to gauge demand for services
  - Keep tax property tax rate lower
  - Charges organizations that are exempt from property tax
- Drawbacks of User Fees and Charges
  - Regressive if implemented for necessary services
  - Full cost not always easily determinable
  - Local government use different pricing strategies depending on their objectives
    - Block pricing structure - water rate tiers, marginal pricing strategy



# Non-tax Revenue Sources – Page 19

- Licenses and Permits
  - Benefits received principle
  - Licenses
    - Grants the recipient a privilege to engage in an activity
      - Types
        - Attorney, doctor, realtor, insurance sales
        - Retail sales, hunting, fishing
    - Differs from franchise fee in franchise fee must provide service to entire population
  - Permits
    - Grants a privilege for a specific task or event
      - Types
        - Building
        - parade



# Non-tax Revenue Sources – Page 19

- Development Impact Fees
  - Help pay for infrastructure
    - Water, sewer, streets, parks
  - Adopt by ordinance
  - In conjunction with a comprehensive plan
  - Larger cities more likely than smaller cities
  - Charged an amount that is in proportion to the demand it creates
  - Planned facilities are built in a timely manner
- Two general methods of fee calculations
  - Inductive - cost of the project's impact
  - Deductive - demand on public infrastructure



# Non-tax Revenue Sources – Page 21

- Grants
  - Categorical Grants
    - More restrictions
    - The effect is to lower the cost of some task, price effect
    - Example - water treatment plant
  - Block Grants
    - Raise the income or available resources of the government receiving the grant
    - Recipient has wide discretion in the use of funds
    - Example - ground transportation





# Revenue Estimation – Page 23

- Process most use
  - Forecast non-property tax revenues
  - Determining spending needs for the budget year
  - Set the property tax rate
- 3 basic methods to forecast revenues
  - Best judgment - informed judgment of finance director
  - Trend analysis - recent patterns or simple linear regression
  - Econometric forecasting - multiple regression using different variables
- More Complex
  - Simultaneous equation models - predict values for each of the variables



# Assessing Tax Expenditures – Page 24

- Tax Expenditures
  - Changes to the Rate of Base that lowers the levy
  - Changes to the Rate
    - Fairly simple
      - Replace old rate with new
      - Predict change in behavior
  - Changes to Base
    - More Complicated
      - Exempt class of property, what impact
      - Will benefit of one class hurt another class



# Revenue System Administration – Page 24

- Revenue Administration
  - Minimize the cost of collection
  - Maximize the percentage collected
  - Protect the resources of the government from internal and external theft



# Purchasing – Page 26

- Buy goods and services that meet the needs of the organization or customers at the lowest possible costs
  - Locate qualified sources
  - Request proposals
  - Choose the best source
  - Negotiate
  - Monitor performance of their suppliers
- Two major differences
  - Conform to establish laws, procedures, and policies
  - Subject to media attention



# Characteristics of Government Purchasing – Page 26

- Should be centralized
- Develop historical data
- Open to public scrutiny
- Impartial
- Exception to impartial is local preference



# Recommended Procedures and Policies – Page 27 thru 31

- Policies should be in place and written to ensure laws are not violated
- Policies divided up into five categories
  - Vendor selection - flow from advertisements for bids
  - Bid structure and evaluation - based on requirements detailed in the instructions
  - Purchasing - two types of purchase orders, central and departmental
  - Material receipt and testing - reviewed for quantity and quality when received
  - Cooperative purchasing - acquisition of material for two or more jurisdictions



# Risk Management – Page 32

- Identification and control of events, forces or circumstances that pose danger to people or property
- Process of managing risk involves:
  - Identifying objects that are at risk
  - Assessing the dangers and the likelihood of loss
  - Taking steps to eliminate or minimize the chances of harm occurring



# Identifying Risk – Page 32

- Six Categories
  - Legal liability to others
    - Drives vehicle thru citizen's property
  - Property loss
    - Natural disaster
  - Extra expense
    - Cleanup expense
  - Loss of income
    - Damage to income producing properties, such as pools
  - Human resources loss
    - Higher medical and overtime expense
  - Crime and fidelity loss
    - Loss from theft, embezzlement





# Assessing Risk – Page 32

- Determines the probability and the consequences of the loss
  - Quantitative
    - Financial loss
      - should be used where possible
      - Provides precision
  - Qualitative
    - Impacts described generally
      - Loss of human life hard to quantify
- Combination



# Standards for Good Analysis – Page 33

- Box 5 Standards for Good Analysis
  - It is consistent with state-of-the-art scientific knowledge.
  - Any assumptions used are clearly explained, used consistently, and tested for reasonableness.
  - The analysis is verified for accuracy (e.g., of calculations).
  - Unnecessary assumptions are removed before the final analysis is reported, after verifying to ensure that the removed assumptions do not affect the results.
  - Any models used for calculation are well defined and, ideally, validated by testing against experimental results and observational data.
  - Data sources are identified in such a way that the data can be obtained by anyone interested in verifying them.
  - Calculations are presented in such a form that they can be verified by others interested in confirming the results.
  - Uncertainties are indicated, including those in data, models, parameters, and calculations.
  - Results are discussed clearly, indicating what conclusions they can support.

Source: National Research Council



# Analytical Techniques to Assess Risk– Page 34

- Cost-benefit analysis
  - Compare the cost to the benefit
- Multi-attribute utility analysis
  - Compare one outcome to another outcome



# Minimizing Risk – Page 34

- Reduce, transfer or retain risk
  - Reduce - address hazardous situations
  - Transfer - placing the burden of financial loss on another party
  - Retained - willing to assume
- Major types of insurance
  - Property insurance -- to protect against damage or loss of property;
  - Liability insurance -- to cover losses related to a government not meeting a responsibility;
  - Fidelity bonds -- to cover losses resulting from embezzlement, fund misappropriation, or other losses resulting from dishonest employees;
  - Workers compensation -- to provide employees with coverage for medical bills resulting from job-related injuries.



# Other Options – Page 35

- Self insurance
  
- Intergovernmental pool
  - TML



# Public Pension Fund Administration – Page 37

- Two general categories of benefit plans
  - Defined benefit - specific benefit when they retire
  - Defined contribution - employer sets aside a specific contribution given to employee
- Funding
  - Pay as you go
  - Reserve fund method
- Three methods of actuarial valuation
  - Cost - investment return as the sum of ordinary income plus capital gains and losses
  - Market -market price of investments
  - Moving average method - smooth short term fluctuations
- Pension trust funds in governmental fund accounting; GASB 25, 43 and 45



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# Questions

