

MINUTES

JOINT HOUSE AND SENATE COMMITTEES ON LOCAL GOVERNMENT

October 12, 1993
Room 313-S -- Statehouse

Members Present

Senate Committee

Senator Mark Parkinson, Chairperson
Senator Marian K. Reynolds, Vice-Chairperson
Senator Paul Feleciano, Jr.
Senator U. L. "Rip" Gooch
Senator Alfred Ramirez

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House Committee

Representative Nancy Brown, Chairperson
Representative Gary Hayzlett, Vice-Chairperson
Representative Richard Aldritt
Representative Barbara Ballard
Representative Carl Holmes
Representative Judith Macy
Representative Doug Mays
Representative Gayle Mollenkamp
Representative J. G. Novak
Representative Greg Packer
Representative Ted Powers
Representative Bob Tomlinson
Representative John Toplikar
Representative Robert Watson
Representative Gwen Welshimer
Representative Jack Wempe
Representative Bob Wootton

Staff Present

Mike Heim, Kansas Legislative Research Department
Theresa Kiernan, Revisor of Statutes Office
Shirley Higgins, Committee Secretary

Conferees

H. Edward Flentje, Wichita State University
Beverly Ciglar, Professor of Public Policy, Pennsylvania
Evan Golding, Executive Director of Colorado Special District Association
Charles Warren, Kansas, Inc.
Bill Ervin, Municipal Accounting Section, Division of Accounts and Reports

Morning Session

Special District Governments

The meeting was called to order in Room 313-S at 9:15 a.m., by Representative Nancy Brown, Chairperson, on October 12, 1993.

Representative Brown noted this meeting is for the purpose of discussing public policy with regard to special district governments.

First to testify was H. Edward Flentje, a professor at Wichita State University. (See Attachment 1.) Last year, Mr. Flentje was involved in a study of the ten to 12 fire districts in Reno County, which were formed with no particular logic, and related his experience in this area. He worked with a committee established by the City of Hutchinson and Reno County which was interested in consolidation of law enforcement and fire services. He noted that if he were to assess the fire districts by the standards listed in his written testimony, he would not have a positive report. For example, he witnessed a lack of efficiency at a meeting of volunteer firefighters who were unable to agree on the type of nozzle that should be used. As to effectiveness, he said that a fire station that might be near the location of a fire could not go to that fire until the other volunteers in that district arrive which, of course, causes a delay in action resulting in fire losses. With regard to equity, each district in Reno County has a different mill levy which creates a certain inequity of service. In the category of accessibility, he would rate this as good except in the kinds of jurisdictional situations he cited. As to accountability, it is there by state law, however, because of the local political dynamics, there is not much incentive for the county commissioners to upset the 150 volunteer firefighters involved. Mr. Flentje noted that Reno County does have a legal advisor, but he is too busy with other matters and also the laws in regard to fire districts were so confusing that the local attorney did not have the time to work on it.

Mr. Flentje addressed the five questions in his testimony as they apply to the State of Kansas in general:

1. Efficiency -- it is felt that the districts are efficient.
2. Effectiveness -- the service is inconsistent across jurisdictions.
3. Equity -- there is probably equity within a district, however, it is questionable across districts.
4. Accessibility -- the districts are very accessible.

5. Accountability -- at the state level, there is none. In some cases, fire districts are accountable to the county commission, but generally the question is not addressed.

Mr. Flentje called attention to studies done of three national districts which he included in his written testimony which are, to his knowledge, the only ones that have been done. In Mr. Flentje's opinion, the recommendations made by John C. Bollens are as relevant today as they were in 1957. As to the second study by the U.S. Advisory Commission on Intergovernmental Relations, Mr. Flentje called attention to number (5) as to consolidation, noting again that in Reno County it was determined that it was too onerous to attempt to consolidate. He then singled out number (7) regarding itemization of special district taxes, noting that this is being done at present. With regard to the recommendation for studies by states in number (9), Mr. Flentje noted this is also being done now. With regard to the recommendation by the Kansas Advisory Council on Intergovernmental Relations at the bottom of page three of his testimony, Mr. Flentje said the recommendation is still relevant even though it was made 20 years ago.

Mr. Flentje said the bottom line is that special districts are grass roots government at its best where citizens get together to tax themselves for specialized services which is the American way. On the other hand, the only point of accountability at the state level, to his knowledge, are the local government legislative committees. His recommendations, based on his experience and knowledge, would be to: (1) require special districts to report certain basic information annually to the Secretary of State; (2) give the county government more authority in this arena so that when a local district needs such things as a new road, it will not have to come to the state for it; (3) allow county government more authority to consolidate services or reorganize their special districts; and (4) request an in-depth study of the evolution of special districts in Kansas over the past 100 years by a state university.

Senator Gooch asked Mr. Flentje if he would recommend that a request be made to each county for an updated study on special districts and if he can give a reason as to why Kansas ranks second in the area of the number of special districts. With regard to the first question, Mr. Flentje commented that counties are presently looking at their special districts and are interested in finding better services at a lower cost. When counties do look for ways to consolidate services to reduce costs, problems arise because the state laws in this area are too complicated. With regard to the second question, Mr. Flentje answered that the high number of special districts in Kansas has to do with the political culture of this state in that Kansas does not accept centralized control easily and would rather tax for services independently. The downside of this approach, however, is that at some point, there has to be an assessment as to if it has gone awry.

With reference to the outstanding debt of \$449 million of special districts mentioned in Mr. Flentje's testimony, a representative asked what the indebtedness is for and who is responsible for it. Mr. Heim informed the Committee that it likely is from general obligation bonds and that the taxpayers within that district ultimately are liable. If it is from revenue bonds, the bond holder ultimately takes the risks if revenues fall short.

Representative Mollenkamp asked Mr. Flentje if the projected increase in special districts in the state would be bad. Mr. Flentje answered that it would not. Representative Mays began a discussion regarding the fact that not all special districts are taxing units. He noted that many states do not have townships and wondered if townships in Kansas could be consolidated as perhaps a means to get better service for less money. Representative Brown reminded the

Committee that the issue is not necessarily the number of special districts in Kansas but the accountability of the special districts. Representative Holmes added that if local people vote for special districts for desired services, the state government should not say it is bad but rather let the people decide for themselves, and also it should be a local decision to consolidate.

By means of a conference call, the Committee heard testimony regarding special districts from Beverly Ciglar, a professor of public policy at Penn State University, who has done an extensive study on the subject.

Two years ago, Professor Ciglar looked at literature nationwide on authorities on special districts and then concentrated on the State of Pennsylvania. She then developed a paper that was aimed at developing standards for the State of Pennsylvania and nationwide for improving organization and management of public authorities and special districts. Part of that was changing the enabling law in Pennsylvania. There were nine bills addressing this area in the Pennsylvania Legislature, eight of which came from her research. Out of that work, she has now framed a national guide for forming public authorities and special districts. Next week, she will be in Phoenix at the National Conference of State Legislatures' meeting because all the legislatures around the country are interested in this subject.

Another area in which Professor Ciglar is involved is a study of the bond market for public authorities, of particular interest lately because of the dramatic increase of bond market for public authorities and the issue of competitive bid verses negotiated bonds.

The broad issues that Professor Ciglar examined in her study include:

1. board accountability, from conflict of interest to reporting requirements of states;
2. board membership as to qualifications, conflict of interest, personal and political ties, and nepotism;
3. the appointment of qualified managers;
4. looking at the administrative management of the overall work force of the authority; and
5. financial management of authorities.

Representative Brown asked how many special districts there are in Pennsylvania. Professor Ciglar answered there are 2,600 local governments and roughly the same number of public authorities. Special districts are created under the Pennsylvania Municipal Authorities Act passed in 1945. After an authority is created, it sort of takes on a life of its own with very little control or oversight by the creating municipality. The majority of them are appointed, and the greatest number in Pennsylvania are water and sewer authorities. Financial accountability is very loose. Pennsylvania has a State Department of Community Affairs which has some reporting requirements for the authorities, but over two-thirds of the authorities do not send in the required data, and the data that was sent in was not looked at by anyone. Since her work, this is in the process of change and there are new reporting requirements.

Professor Ciglar said there have been a couple of scandals with authorities in Pennsylvania in recent years. One example is in the solid waste area, which was the initial reason for the hearings, and her study happened at the same time. The two areas meshed together last spring as she worked with the various authority associations and directors as they testified before the Legislature. The hearings were directed solely as a sounding board for anyone, were well attended, and were covered by the media.

Representative Brown asked Professor Ciglar to comment on concerns expressed regarding the loss of local control by adding additional control at the state level. Professor Ciglar answered that there have not been any published hearings on this subject as yet. At the hearings she attended in Pennsylvania, the Legislature seemed to be most interested in the lack of public accountability with the authorities. For the most part, citizens did not testify due to the technical nature of the subject. She feels the result of the hearings on financial accountability will be tighter financial management standards, tightening up on the appointments to the public board members, and, most of all, training sessions for authority board members and those officials who create the authority. Instead of massive mandates, the trend is toward more openness, more accountability, more visibility, and reporting requirements.

Representative Brown asked if the model legislation on which Professor Ciglar is working includes setting up more parameters for the establishment of any new special authorities. Professor Ciglar offered to send a copy of her proposal and explained that amendments to the major law in the State of Pennsylvania passed in 1945 is the method being used. The amendments appreciably overhaul the existing legislation on everything from appointing members to qualification of members. Some deal with the length of terms, compensation, and removal of members. Others deal with debt management and general financial accountability.

Professor Ciglar informed the Committee that in her recent study of the bond market she has found that there has been a dramatic increase in bonds issued for all local governments, including special districts and authorities. For example, in 1983, the amount was \$83 billion, and in 1992, that number is \$235 billion. Also, 65 percent of the bonds are revenue as opposed to general obligation bonds. Most of the activity is in authority bonds. There are big questions about the underwriters, and this is the subject of the latest research.

Senator Parkinson asked Professor Ciglar if she thinks there is anything inherently wrong with having a large number of districts. She answered that she has not taken a strong stand on this question. There are researchers who can be found on either side. Her feeling is accountability is more important than fragmentation. But no matter what side you take on this issue, the authorities are going to proliferate mainly due to the solid waste and environmental mandates issued by EPA. She added that the way to build the desired accountability is by educating the local community officials about the appointment of authorities and financial reporting.

Further testimony by conference call was heard from Evan Golding, Executive Director of the Colorado Special District Association. Mr. Golding explained that his Association represents all of the freestanding or independently created special districts with the exception of the districts in water management and soil control. There are approximately 875 special districts, not counting those in the irrigation, conservation, and water related districts. The districts his association represents range from park and recreation districts, fire districts, hospital districts, sanitation districts, and metropolitan districts which are any districts which are entitled to combine and provide two or more services related. Over 50 percent of the districts are in the Denver area. The districts have been

created by a vote by the population within a designated geographic area rather than as in the case of special improvement districts which are created by a city or county.

Mr. Golding was questioned as to any concerns or problems experienced in special districts in Colorado. To answer this, Mr. Golding gave a brief background regarding special districts in his area, stating that, starting ten years ago up to three years ago, special districts in Colorado were used by the development community to set up infrastructures and service for new subdivisions when the city or county was not prepared to do so. Unfortunately, the savings and loan situation created or exaggerated the problems of special districts by making them look like the culprits when in reality they were sort of a tool used by developers in overextending their developments with the backing of the savings and loan industry. A number of developers went to the savings and loan industry to buy land, then created special districts and issued bonds through those special districts for roads, sewer, water delivery and, in some cases, the fire protection service. Those bonds were issued based on projecting building and development over time. When the development did not occur at the projected rate when the bonds were issued, 16 special districts within the last four years went under Chapter 9 of the Federal Bankruptcy Code which allows governmental entities to restructure, much as in the case of a Chapter 11 bankruptcy. Only two of these special districts have not completed the restructuring, however, they are close to it and have been able to continue to provide services even though it has resulted in high taxes for residents.

Representative Brown asked if special districts are statutorily created in the State of Colorado. Mr. Golding said special districts are a creature of statute in the sense that state statutes set up the process for the creation of special districts and set up the powers and the procedures by which they can exercise those powers. All of the special districts go through the same process of creation which he briefly outlined. First, a petition of the landowners (by either a minimum number of landowners or by a percentage of the land owned) in a given territory is filed with the District Court in all the counties where the district may have territory. The District Court reviews the petition for legal sufficiency; then it sets a date for election. When the election is held, frequently there are very few voters because usually the districts are in the process of being developed and there are not many landowners. Creation of special districts in well-developed areas often involves the creation of park and recreation districts. This is done by a vote of any person living within the boundary of the district or any registered voter living in Colorado and owning land in that district.

If a majority of voters vote for the creation of the special district, the court certifies the election, the district is created, and a slate of directors is elected at, basically, the same time, and they serve until the next election. The special districts are governed by this elected board consisting of five or seven directors. Essentially, the governmental powers do the limited thing for which their service plan authorized them to be created. The service plan is filed at the same time the petition for the election is filed with the District Court. The service plan describes the territory, the service to be provided, the infrastructure needed, and the financial plan for providing the service. The district has the authority to issue bonds, both general obligation bonds and revenue bonds, and to budget fees and charges as well as to levy property tax. At one time a district could change its mill levy up to a certain limit by action of the board. However, as of last November, a tax limitation amendment to the constitution says no governmental entity can raise or increase a tax or impose a new tax without the vote of the people. Therefore, special district governments are now like all forms of government in that if they wish to impose a new property tax or increase the tax rate, they must put it to a vote of the people.

Mr. Heim asked Mr. Golding if there are separate associations providing services such as a hospital association or if his association is an umbrella association for special districts. Mr.

Golding said there are associations involved with various types of special districts such as The Colorado Hospital Association, The American Water Works Association, The Colorado Rural Water Association, The Colorado Fire Chiefs Association, and the Park and Recreation Association. The identifying feature of his association is that it represents the special district form of government across the board, confining its efforts to issues that are somewhat unique and apply to all special districts, for example, the property tax legislation of which he spoke which affected all special districts, no matter what their service.

Representative Brown asked if Mr. Golding's association has a relationship developed as far as accountability of special districts. Mr. Golding explained that at the time a service plan for a special district is filed, it must be approved by each county district court in which that special district enters before it goes to the voters. If the special district includes territory that is an incorporated municipality, then the municipality must also approve the service plan. If the special district in any way chooses to change its service plan, the amendment to the service plan also must go to those same governing bodies for approval. Additionally, as a result of the over extension by the savings and loan industry previously discussed, in 1990 legislation was adopted which provides that the county and/or municipality within the special district review and approve any special district's bonds creating indebtedness. And it provides that every five years the county must review and approve any authorized but unissued bonds of every district. In other words, the county must determine if the special district is still financially as stable as it was when the bond authority was authorized either when the district was formed or at a later election.

Next, the Committee heard testimony from Charles Warren, Kansas Inc., who came to give an overview of special districts. He focused on a copy of a chapter, "The Role of Special Districts and Authorities," from a handbook which he had prepared in 1980 for a local government study commission. (See Attachment 2.)

In response to questions asked Professor Ciglar regarding the large number of special districts in Kansas, Mr. Warren commented that the problem is not simply one of numbers, but one needs to look beneath the numbers to discover exactly what is going on. He believes that special districts are essential devices in providing special services. They are needed because they exhibit certain strengths. But they also have some weaknesses which must be balanced with the strengths that they possess.

There are some general principles to their reform, but it is wise to proceed on a case by case basis such as is discussed in his handout (page 64) with regard to the action taken by the Local Government Boundary Commission in Oregon which significantly decreased the number of special street lighting districts. He feels Oregon offers a good model and that a Kansas Advisory Commission on Intergovernmental Relations (ACIR) probably would be the best form to use in establishing both the general principles of fiscal accountability and a case-by-case review of these districts throughout the state.

Mr. Warren said the major strength of special districts is the ability to link financing with service, that is, to link taxes and the services received in the district; and there is a voter preference for that. However, one needs to be aware of the cumulative effect problem created as the need for several services creates several financial nibbles resulting in one big bite.

Mr. Warren noted that some of the statistics in his handout are outdated, and perhaps new numbers can be furnished by Legislative Research. He also noted that there is a problem with counting special districts and determining if they are active or inactive and what their relationship

to general purpose local governments, *i.e.*, whether they are dependent or independent. Independent special districts with their own taxing power are the districts which are of most concern. The two types of independent special districts are those that rely on property taxes and those that rely on revenue bonds and user charges. Mr. Warren continued with highlighting his handout out as to strengths of special districts, weaknesses, fragmentation, accountability, and policy and action alternatives. He concluded by reiterating that a state ACIR would be helpful in addressing the problems of special districts as outlined by Professor Ciglar.

Bill Ervin, Municipal Accounting Section, Division of Accounts and Reports, followed with testimony regarding issues relating to the procedures that local governments use in managing their finances. (See Attachment 3.)

Afternoon Session

Representative Brown called attention to copies of information she had distributed for the purpose of discussion regarding recommendations which had been made with regard to special districts. (See Attachment 4.)

With regard to the letter to Representative Shallenburger concerning rural water districts which was attached to the list of recommendations, Representative Mays stated that there were a number of factual errors in it, and that he feels no action should be taken based upon it. Representative Brown noted that the letter had been included only as a source of information.

With regard to recreation commissions, Representative Brown called the Committee's attention to copies of a suggested survey to gather further information. (See Attachment 5.)

Representative Tomlinson made a motion that the Revisor of Statutes draft legislation to bring all special districts under the cash basis law. Representative Ballard seconded the motion.

Representative Mays asked if the motion also was intended to include bringing special districts under the requirement of generally accepted accounting principles (GAAP). Representative Tomlinson stated that he feels the cash basis law should be addressed before including GAAP.

Senator Feleciano expressed his opinion that some form of accountability is needed, but it cannot be done by the cash basis law alone; the GAAP requirement should be included also.

Representative Tomlinson agreed that the GAAP requirement is important, however, at this time, he is not yet comfortable with it. He feels there may be an urgency to broaden the scope of the cash basis law.

Representative Brown asked Mr. Heim to explain the additional work that would be required to go under both the cash basis law and the Kansas budget law as recommended by the League of Kansas Municipalities. Mr. Heim said they go hand in hand. The budget law basically requires that an annual budget be prepared by fund, and that each fund be treated separately. The different funds are considered as trust funds, moneys within a fund can only be spent for those purposes, and if money is not budgeted, the money cannot be spent. The cash basis law, on the other hand, is what it says -- money cannot be spent unless there is cash on hand to cover the purchase at

the time it is requested. A bill can be drafted to put all special districts under the cash basis law, but he alerted the Committee that there may be some districts such as rural water districts, which are not taxing entities, which are not now subject to the cash basis law and may not want to be subject to it.

Representative Mays asked if Representative Tomlinson would object to confining his motion to entities that are tax supported to avoid having the legislation amended many times to exclude special districts which should not be included such as rural water districts which do not levy taxes. Representative Brown suggested that perhaps "instrumentalities of city and county government" could be used instead of "special units of government." Upon further discussion, Representative Tomlinson stated he was willing to restrict his motion to include tax supported entities only, thereby eliminating fee organizations. Representative Ballard felt that perhaps she could not second the motion in this case because it would result in different areas not being under the same reporting system. Representative Tomlinson stated that he was willing then to leave his motion as originally stated.

Representative Tomlinson restated his motion as, "To bring all special districts under the cash basis law."

Representative Wempe stated his opinion that the proposed legislation should be limited to those special districts who use taxpayers' money.

Representative Tomlinson said he would be willing to limit it to special districts that are tax supported, excluding anything that does not incur a public liability in its expenditures.

Representative Tomlinson restated his motion as, "Bring all tax supported special districts under the Kansas cash basis law."

Representative Mays stated that he felt this motion may be a little too narrow and suggested that "special entities" be used instead of "special districts." A short discussion followed with staff, and staff recommended "or other entities which receive tax funds" be added. It was the consensus of the Committee to do so.

Upon a call for a vote on Representative Tomlinson's motion that legislation be drafted to bring tax supported special districts or other entities which receive tax funds under the cash basis law, the motion carried. Representative Packer and Senator Reynolds voted "No."

Representative Wempe began a discussion regarding the formation of fire districts and if they could be dissolved and reformed under another statute. Representative Brown noted that this is a confusing issue sometimes. It depends on how the fire district is formed as to what it can do. Mr. Heim said most fire districts are formed under K.S.A. 19-3601 *et seq.*, and that there is no procedure for general consolidation of districts under this law. A Johnson County fire district law simplifies the consolidation procedure by a provision that allows for consolidation of adjoining districts. Many special district laws do not deal with dissolution or consolidation.

It was the consensus of the Committee that a recommendation be made to pursue the drafting of legislation to permit consolidation of fire districts, but that further information was needed so that a bill may be prepared in January.

Representative Brown said that she feels Mr. Warren's testimony should be further investigated along with pursuing more information as to what has been done in Colorado and Pennsylvania with regard to special districts as preparation for possible introduction of legislation when the Legislature convenes in January.

Representative Toplikar raised a question as to Mr. Ervin's testimony with regard to information on page 4 of his written testimony stating that only 10 percent of school districts comply with GAAP. He wondered why the percentage is this low. Mr. Heim said the State Board of Education has its own accounting system, and perhaps this is the answer, but he will research the subject further and report back to the Committee.

The meeting was adjourned.

Prepared by Mike Heim

Approved by Committee on:

November 29, 1993

(date)

Testimony to Interim Committee on Local Government
H. Edward Flentje
October 12, 1993

According to Mike Heim in Kansas Local Government Law, Kansas lawmakers have authorized local citizens to establish thirty-one distinct categories of special districts in Kansas. And Kansans, beginning as far back as the 1890s, have used these laws to establish 1,556 special districts, all with taxing powers, as of 1991, according to the Kansas League of Municipalities. If the Kansas League is correct, Kansas ranks second nationally in the number of special districts. In 1987, the U.S. Bureau of the Census found that special districts in Kansas raised \$305 million in revenues annually, had annual expenditures of \$281 million, and had outstanding debt of \$449 million.

Five basic questions commonly applied to any public agency or governmental unit may be raised concerning special districts in Kansas:

- 1) Efficiency. Do special districts provide an efficient method for managing and delivering public services?
- 2) Effectiveness. Do special districts provide a quality of service that is consistent and meets public expectations.
- 3) Equity. Do special districts allow the cost of service to be borne equitably by those receiving the service?
- 4) Accessibility. Are public services made accessible and convenient to residents through special districts?
- 5) Accountability. Do special districts ensure that elected and appointed officials are held accountable to the public for the delivery of services? Are services delivered through special districts responsive to citizen preferences?

To my knowledge, no systematic study of special districts has ever been conducted in Kansas. A number of states have performed such studies. Attached for your review are the recommendations in summary form of three national studies conducted over the past forty years and a recommendation of the now-defunct Kansas Advisory Council on Intergovernmental Relations that is relevant to special districts.

Local Government
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Attachment 1

Bollens, John C. Special District Governments in the United States.
Berkeley: University of California Press, 1957.

1) State laws should authorize general-purpose local governments to absorb special districts operating within or coterminous with those general-purpose governments. State laws should further authorize general-purpose local governments to create service and taxing districts in order to provide more intensive services.

2) State supervision of and reporting by special districts should be established.

3) The state should authorize county government to exercise budgetary control over special districts within the county.

4) The state should require uniformity in the basic characteristics and procedures of special districts.

5) State laws should require approval for the establishment of a special district by either county government or a designated state agency.

U.S. Advisory Commission on Intergovernmental Relations. The Problems of Special Districts in American Government.
Washington, D.C.: May 1964.

1) States should enact legislation to provide that no special district be created prior to review and approval of the proposed district by a designated agency consisting of representatives of the county or city within which the proposed district shall operate. Agency decisions involving districts which would undertake functions of statewide concern should not be created without state approval. The decision of the agency should be subject to court review.

2) State legislation should ascertain whether or not the unit of general local government or existing special district near the proposed district is willing and able to provide the service in a satisfactory manner. If the above proves to be the case, then the agency should not approve creation of the special district.

3) States should enact legislation to insure that the activities of existing and subsequently created special districts are coordinated with the activities of units of general government.

4) States should enact legislation requiring that a designated state agency (an office of local government or other appropriate agency), and the appropriate county governing body, be informed of

the creation of all special districts within respective county borders, and, to the extent applicable, that states require that budgets and accounts of special districts be formulated and maintained according to uniform procedures determined by an appropriate state agency. The state should be required to audit such accounts at regular intervals.

5) States should enact legislation: (1) providing a simple procedure for consolidation of special districts performing the same or similar functions; (2) permitting an appropriate unit of general government to assume responsibility for the function of the special district within the district area.

6) States should enact legislation to provide that service charges or tolls levied by a special district, which are not reviewed and approved by the governing body of a unit of government, be reviewed and approved by an appropriate state agency.

7) States should enact legislation requiring counties and municipalities, when sending out their property tax bills or providing receipts, to include in each individual property owner's bill or receipt an itemization of special district taxes and assessments levied against the property.

8) States should enact legislation authorizing counties to establish subordinate taxing areas in part of their territory to enable these governments to provide and finance a governmental service in a portion of the county.

9) States should undertake a comprehensive study of all governmental entities authorized by state law to ascertain the numbers, types, functions, and financing entities within the state defined as special districts by the Bureau of the Census.

Kansas Advisory Council on Intergovernmental Relations.
Modernizing Kansas County Government. Topeka: December,
1972.

1) Kansas should authorize county governments to create subordinate service areas in order to provide differential levels of service within designated areas of the county. This authority would allow county government to respond to special service needs within the county and at the same time have the cost of service borne by those receiving the service. County government could also be held responsible for efficient and effective administration of the service.

Hawkins, Robert B., Jr. Self-Government by District: Myth and Reality. Palo Alto, California: Hoover Institution Press, 1976.

1) Petition and voting requirements to form special districts should be designed to guarantee that significant interests exist within an area before a district is formed.

2) Consolidation of election dates would reduce citizen-participation costs and increase competition for district elective positions.

3) State policies should continue to recognize the positive and negative effects that can occur from exclusionary voting rules. In addition, further study is needed to understand the results stemming from the application of such rules.

4) State law should require special districts, either by themselves or through the county assessor, to furnish voters with their taxing rates and pricing policies.

5) Consolidation of existing statutes should be viewed with caution since the results may not be beneficial. The strength of a number of enabling statutes is that they allow both state government and local communities flexibility in designing institutions that respond effectively to local problems.

6) State policy should encourage special district pricing policies to guarantee that benefited parties pay the full and true cost of the service they consume.

7) Abridgements of citizens' rights to determine the structure of their local government should be abolished, and mechanisms to guarantee that new units of government will not create economic or other hardships on existing units of government should be retained.

8) Voting rules requiring a two-thirds majority for bonded indebtedness should be retained. Such rules guarantee that officials of special districts will have to gain sufficient community support for new undertakings that have considerable fiscal and policy impact upon the district.

Chapter 7

The Role of Special Districts and Authorities

Special districts and authorities are the most numerous form of government in the United States--and the least understood. In 1977, Census Bureau enumerated 25,962 special districts in every state except Alaska (see Table 1). That year, special district governments employed 402,000 persons, had total revenues of 14.4 billion dollars and total expenditures of 16.8 billion dollars.¹

The key questions are: When and under what circumstances are special districts warranted? What should be the role of special districts in the overall public sector? How, if at all, should they relate to general purpose units of government--states, counties, cities and towns?

Definition

Special districts are called--among other titles--agencies, districts, authorities, commissions. The local analyst should first define the type of district existing in an area or proposed as a service delivery unit. The most restricted type of district, in a financial, functional and administrative sense, are those

. . . special purpose agencies which are legally recognized (special act or local ordinance or general law) but have as their governing board either the City Council or County Commission acting in ex-officio capacity . . . or have their operating budget drawn up or approved by another unit of government (or are included in the budget of another unit of government).²

Thousands of these districts provide one function (e.g., street lighting) in a restricted area and are funded by a special assessment on citizens receiving the particular service. This type of district has very little authority and must constantly come back to the local government for funding approval, and other decisions.

The Independent Special Districts

It is the independent special districts that are of most concern to the citizen, for they constitute legal governing units. Each has governmental powers. As such, these independent special districts warrant the close scrutiny of the public. The problem in examining them is in their number and their varying functions and structure. There are some 9,580 independent special districts in metropolitan areas throughout the country, and 16,382 outside the Standard

Charles Warren
Local Government
10-12-93
Attachment 2

TABLE VII-1

Type of Special District	United States	Inside SMSA's	Outside SMSA's	Percent in SMSA's
Total	25,962	9,580	16,382	36.9
Natural resources	6,595	1,544	5,051	23.4
Other than natural resources	19,367	8,036	11,331	41.5
Cemeteries	1,615	212	1,403	13.1
Fire protection	4,187	1,738	2,449	41.5
Highways	652	141	511	21.6
Hospitals	715	186	529	26.0
Housing and community redevelopment	2,408	873	1,535	36.3
Libraries	586	224	362	38.2
Parks and recreation	829	427	402	51.5
School building authorities	1,020	613	407	60.1
Sewerage	1,610	955	655	59.3
Urban water supply	2,480	1,013	1,467	40.9
Other single-function districts	1,545	577	968	37.3
Multiple-function districts	1,720	1,077	643	62.6

2-2

ropolitan Statistical Areas. They range in responsibilities from a district which only operates a cemetery to a large port authority with a large staff and many operating projects.

Since the early 1960's, some scholars and government officials have grouped them on the basis of their sources of income.³ This system has assumed clearer meaning in the last few years as citizens have increased their concern about government finances from the standpoint of both taxation and expenditures.

Essentially, there are two categories of independent special governments according to their sources of income:

1. Those independent special districts that rely primarily on property taxes for their income;
2. Those independent special districts that rely primarily on revenue-bond and user-charges as their sources of income.

Those that rely on special assessments may be grouped in the first category, for the special assessment is a form of taxation which is mandatory on the owners of property who benefit from public improvements, such as sewer lines or curbing. The drawing of this distinction--based on income--reveals that the two groups operate in two very different intergovernmental fiscal and political frameworks.

The basic structure of special districts in the first category--those which rely primarily on property taxes for their income--does little violence to the normal pattern of local government in our federal system. A group of people inside or outside an incorporated area, desire a particular public function. Unless the State provides for special taxing districts, in order that they may receive this function, all residents in the county, city, or town would have to be taxed for it. Typically, the state charters the group's geographic area as a special district; then, as an incorporated unit of government itself, the special district can levy the tax for the function only on those who receive it. Commonly, a board of three or five members of the district govern the use of the function and its operation. This district is like a local government in that certain people, living in close proximity to each other, constitute a government in order to have it provide them with a particular public function that they are willing to pay for, usually by additional taxes on their properties. The principal difference between that type of unit and the more conventional local government lies in the fact that the special district concerns itself solely with that one function.

The second type of independent special district--those which rely primarily on revenue-bond and user-charges as their source of income--does not have the assurance of tax money to carry out its functions, and must do so by borrowing money in the open market by issuing "revenue bonds." The only security for that bond is the revenue to be collected by the special government from charges for the use of the facility that will be built, or operated, with the borrowed money. This can be thought of as an "in-bred" arrangement in which a governmental agency borrows money to build a road, or port terminal, or bridge, or other capital projects, and then, charges the public tolls for the use of that facility. The district then uses the toll revenues to repay the bond holders, with interest.

Both of these kinds of independent special governments have been established outside the "normal" framework of government, and often in default of action by general purpose governments. In order to classify them under the categories suggested above, their given designations of special districts or authorities should be ignored. Examine the basic method of income, and use that as the basic distinction. Commonly, those special governments that rely primarily on property taxes are referred to as "special districts," and those that depend on revenue-bonding as "public authorities." The primary income source of these special districts has significant meaning. A special government that draws most of its support from taxes may also receive federal or state grants. One that relies on revenue bonds may have some special taxing powers.

With these two basic types of independent governments as the beginning point for their understanding by citizens, closer examinations of individual special governments will reveal many variations from these two kinds. For example, housing authorities finance themselves principally by revenue bonding, but those bonds may sell at a lower interest rate in the market. Federal and state governments underwrite the bonds and thus reduce the bonds' risk. Instead of depending for their amortization solely on income from the housing projects, their debt is covered by such underwriting. In the case of public authorities for the building of school buildings, their financing, through revenue bonds, is secured through a "lease-back" arrangement. The school is built by the authority, and then bought back by the municipality over a period of years by regular payments to the authority.

Strengths of Special Districts

Special districts have been termed "ad hoc governments"--units created for a single, special purpose. In a sense, they have been used to "fill the cracks" in the patchwork system of American local government.

The special district has been relied upon largely to overcome the jurisdictional, legal and financial inadequacies of existing local governments. In many cases, the geographic area which is logical and appropriate for the provision of a service may not conform to jurisdictional boundaries of a municipality or county. In other cases, an area which needs services may lie outside the boundaries of a general purpose unit. Water and sewer districts are a good example; the topography of a watershed or river basin provide more compelling reasons for deciding the appropriate area of service than political boundary lines. Boundary considerations and economic factors may also dictate creation of a special district. For some services, it is necessary to aggregate a sufficient number of consumers to produce a public service on an economical basis. This may require combining a number of small municipalities in a district. An independent district supported by revenue bonds does not need to conform to local government boundaries at all. The tolls can be collected wherever the facility is provided; the district can thus "leap-frog" local government boundaries.

Fiscal Advantage. Financial limitations and restrictions on local government are often cited as a major reason for the establishment of special districts. A 1956 study of public authorities in New York State cited the following ways which special districts can be financed:

1. in the case of districts relying primarily on revenue bonds, they can finance public improvements without resort to additional taxes; and they can
2. finance improvements through charges upon the users thereof instead of upon the general taxpaying public;
3. finance improvements without conflict with constitutional debt limitations;
4. secure additional revenues and greater financial autonomy for certain activities of regular State agencies;
5. take advantage of Federal loans and grants;
6. finance improvements through revenue bonds without earmarking funds; and,
7. facilitate the financing of enterprises taken over from private ownership.⁴

It should be noted, however, that as a general rule, those special districts which rely primarily on property taxes and special assessments for their income cannot be as flexibly funded as the other type.

Federal support. Federal and state governments have encouraged the creation of special districts in recent years and are another major reason for their popularity. Federal grant programs in the fields of natural resources (water, sewer, soil conservation), transportation, and housing and urban renewal have often required the creation of a special purpose agency in order to be eligible for the receipt of federal dollars. From 1972 to 1977, special district revenue increased by 111 percent, yet during that period, special district revenue from the federal government increased by 207 percent. Interestingly, state government funds to special districts increased by an astounding 304 percent in the same period. Special districts received 36 percent of their total revenue from federal funds during fiscal year 1977, and 7 percent from state government. While these do not at first appear to be a dominant source of funds, they are significant when compared to the percentage of federal funds received by counties and municipalities. As Table 2 shows, 8.7 percent of total revenue to counties came from the federal government, and 12.1 percent of municipal total revenue was derived from that source. These data illustrate the fact that the ability of special districts to capture federal dollars is one of their prime advantages and a major reason for their continued growth.

Limits of Local Governments. ACIR lists three types of limitations on the powers of local government relating to the use and establishment of special districts:

1. strict construction of powers granted to local government;
2. inability of local governments to establish differential taxing areas within their boundaries; and

3. lack of authority to contract with each other or to undertake joint responsibility for providing services.⁵

TABLE VII-2

Local Government Revenues in 1977
(in millions)

	<u>Counties</u>	<u>Municipalities</u>	<u>Special Districts</u>
Total Revenue	42,732	73,461	14,408
General Revenue	41,736	60,599	11,350
Intergovt'l Revenue	18,816	23,998	4,332
Federal	3,738	8,864	2,462
State	14,347	14,077	842
(From Local Gov't)	--	--	1,029
From Own Sources	22,920	36,601	7,018
Taxes	16,048	26,050	1,718
Charges, Misc.	6,871	10,550	5,301
Utility Revenue	307	10,741	2,983

During most of our history, the kinds of services which local units could furnish and the means for financing them were strictly defined by state constitutions or laws. Such limitations, combined with state legislation allowing easy establishment of authorities, contributed greatly to their proliferation. A good example is the Portland, Oregon, metropolitan area which in 1969 had 116 lighting districts. In Oregon, a county must secure a petition of 70 percent of the property owners before it can provide street lighting; a simple majority vote can then create a street lighting district. (The number of lighting districts was reduced in 1975 to six, through the efforts of the Portland Metropolitan Area Local Government Boundary Commission, a state agency.) Similarly, there are 4,187 fire districts in Oregon in part because many counties are not authorized to provide that service for residents living in unincorporated territory.

Other significant reasons for the creation and continuance of special districts can be found in a region's particular political ambience, or in the attitudes of the general public. There are some functions which often are viewed as "business-like" services that should not be performed by general government. Hospitals, toll roads, convention centers and auditoriums are examples. Some

... argue in addition, that other functions, often those of a technical or specialized character, should be removed from "politics."

In sum, proponents of special district governments argue that the special districts are superior to general purpose local governments because:

1. They have greater flexibility in the financing of public services;
2. Because of their reliance on user charges and fees, they are more equitable in the financing of services (payments based on consumption rather than taxes);
3. They are better able to secure federal and state funds;
4. They are more easily created;
5. They have more flexible boundaries and can match their service area to the area of need;
6. They are able to attract qualified and professional staff;
7. Their single purpose character enables them to operate more efficiently; and,
8. They are often the only means by which a needed public service can be provided and financed.

Whatever the persuasiveness of these arguments, recent trends would indicate that special districts in one form or another will be part of the local governmental system in the foreseeable future.

Weaknesses of Special Districts

Even if the special governments bring public controls closer to the people, and even if they provide units that can concentrate totally on one function and perform it more efficiently, the overriding question today has to be: Can we afford them, or are they mostly luxuries? The weaknesses of districts relying primarily on revenue bonds and user fees are summarized below.

Political Accountability. The funding of special districts by revenue bonds and user fees raises unique problems. For example, instead of to taxpayers, the district is accountable to at least four different constituencies: (1) the bondholders, whose initial loan made possible the financing of the special government's functions; (2) the users of the unit's facilities, whose payments for services are to be used to amortize the bonded debt; (3) the people residing in the area of the special district, who may be directly affected by the constructed buildings; and (4) the parent government, who, having chartered the special governmental agency, or set it in motion by local legal action, may lose contact with this agency that acquires autonomy by financing itself without tax support.⁶

It should be noted, however, that the district relying on property taxes or special tax assessments has fewer accountability problems than the revenue-bond

supported district. Unlike the latter, its constituency is clearly those persons receiving and paying for the service, rather than an unidentified group of bondholders.

Special districts are often condemned as "invisible governments" whose operations are hidden from the view of the public. But their lack of political visibility is attributable to the small size and single purpose character of many districts. Such districts simply are not large or meaningful enough to attract the interest and attention of the voting public. As a result, elections for board positions are not hotly contested and voter turnout is minimal. This appears to be a common occurrence. For example, a special election for board members of a small lighting district was held in Hillsborough County, Florida, and not one voter came to the polls. In Oregon, a survey showed that the average voter turnout for special district elections was only three percent of the registered voters.⁷

Lack of public scrutiny of special district activities can lead to a club-like atmosphere where board members make decisions which may benefit themselves or their contractors more than the general community. A study of special districts in Texas decried the lack of citizen participation:

Special district boards seemingly make little effort to involve their citizens in district activities. Poorly publicized meetings and meager reporting of district activities are common, particularly among the smaller districts. Where such conditions occur, district residents are understandably bewildered about the process of special district government and not likely to take an active part in the political life of the district. Special district officials tend to be less responsive to their constituents under these circumstances and therefore inclined to act without giving full consideration to the needs of those they represent.⁸

The report cites several examples of the use of the special district device by private developers for personal gain, particularly in the case of water districts in new subdivisions.

Federal Accountability. While a number of states have passed new laws requiring more open and frequent financial reporting from local government entities, and especially special districts and authorities, public disclosure of financial transactions continues to be an area which needs improvement. This was highlighted by the Wagner Commission in New York State, and by similar commissions in Texas and Florida. The Florida Local Government Study Commission noted that despite recent financial reporting requirements, the law cannot be enforced and a large percentage of the districts have not complied.

The fiscal characteristics of these districts--e.g., their independent sources of revenue, and their primary obligations to bondholders--have led many of them to be exempted from the accounting, auditing and reporting standards traditionally imposed upon general purpose units. This low level of scrutiny by the general public and higher levels of government may, on the one hand, result in greater flexibility of operations and more efficient performance. But it can also lead to corrupt and wasteful practices, and to a lack of accountability to the general citizenry and involved elected officials.

Fragmentation. The sheer number of special districts in individual metropolitan areas is disturbing to some observers of the local government scene. The Denver SMSA, for example, had 264 special districts in 1977 (up from 165 in just five years); the Seattle SMSA had 180; Houston SMSA had 343; Louisville SMSA had 93; and Pittsburgh SMSA had 325. Such large numbers of special districts, it is said, further balkanize and fragment an already complex system of local government. It is argued that effective interlocal cooperation and the coordination of governmental policies and programs in a metropolitan area is impossible because of these units, most of which have only a small and limited role.

A main virtue of special districts--the alleged gains in efficiency resulting from single-minded dedication and concentration on one function--is also pointed to as a major drawback of single purpose authorities. With their limited scope, they rarely concern themselves with the wider impact of their decisions. For example, an independent sewer authority in its dedication to laying sewer lines, building pumping stations, and treatment plants, may ignore the role it is playing in shaping urban growth and increasing the burden on the general government. The general purpose government must build schools, fire and police stations, and roads to serve the new subdivisions and developments made possible by increased sewer capacity. Those who believe in comprehensive regional planning argue that special districts make the setting of priorities and the wise management of a region's resources difficult. They may also lead to conflicting capital improvement decisions leading to a wasteful use of taxpayer dollars.

Increased costs. Another frequent charge levied against special districts is that they result in more costly services because they cannot take advantage of economies of scale. This argument is probably relevant only to those smaller districts which have few employees and spend little money. The diseconomies of scale argument is timely for water and sewer districts. New laws and regulations on environmental quality and water purity have made it difficult for small sewage authorities to provide the kind of treatment necessary because of the expense of new technologies and larger plants. As a result of these higher standards in state and federal laws, many smaller water and sewer agencies have been consolidated. Washington County, Oregon, is a typical example, where a Unified Sewerage Agency was established to consolidate 17 separate sanitary districts.

Administrative and overhead duplications may also result from the proliferation of small districts. The separate purchase of computer systems, redundant personnel and payroll systems, and duplicative maintenance operations may occur. However, the argument that special districts lead to diseconomies of scale is one which must be made cautiously. Small authorities may avoid the expensive general and administrative services characteristic of large scale operations.

Suggested Methodology for Studying Special Districts

This section describes a suggested process for analyzing the role and impact of special districts within a system of local government in an individual metropolitan area.

Data Collection. As a first step, the local analyst should compile basic data and information on existing special districts. It is important that the data be as current and complete as possible, and that comparable information be gathered on each agency or unit. For example, employment information may have to be adjusted; it is unlikely that a simple count of the number of employees on the payroll of a special district will reveal the true level of operations. In researching this subject nationally, one report found that the most comprehensive picture of districts relying on revenue bonds was to be found in the prospectus issued for each offer of revenue bonds.⁹ The prospectus provides details on the organization, management and staffing of the district as well as its financial condition. Occasionally, such documents may also describe the relationship between the district and the bondholders, thus providing study commission members with a direct look at the accountability issue.

As stated elsewhere in this text, special districts are varied units. In researching them, it is important to keep the typology clear, that is, to keep the sources of revenue paramount when deciding what kind of district is being dealt with. One word of caution: few of these will be "purely" funded by one revenue source; the commission will have to determine whether the primary source of revenue is the bond-user charge pattern or the property tax pattern.

An historical profile of special districts should be developed to identify the factors which motivated their establishment, and to aid in understanding their past and current roles in the local government system. Relevant questions include: During which years were the current special districts established? Have their numbers increased or declined? What historical trends in level of revenues and expenditures are evident? What reforms vis-a-vis special districts have been attempted or implemented? Have the functions performed by special districts changed significantly over time? Has the pattern of relationships between special districts units changed significantly?

Planning and program issues. The impact of special district operations on comprehensive planning and programming in the metropolitan area should be analyzed. Suggested issues to be explored are:

1. What process exists to inform general purpose governments about special district plans and operations?
2. Do general purpose units review and comment upon, or review and approve, special district plans and operations either directly or through a regional planning agency?
3. What methods are used to coordinate related plans and operations of general purpose units with those of the special districts?
4. What conflicts currently (or recently) exist between special districts and general purpose units?
5. What are the perception of local elected officials toward the performance of special districts?
6. To what extent are general purpose governments prepared to accept responsibility for services now performed by special districts?

7. Does the special district exist because of a legal, political, or fiscal inability of the general purpose government to assume responsibility?
8. To what extent is the effectiveness of service performance by dependent special districts impeded by county or city administrative, personnel or fiscal practices?

Accountability issues. The accountability of special districts is one of the more difficult research questions to resolve. Measures of accountability should be developed for special districts tailored to the area under study. Such measures may include:

1. selection of governing boards, whether elected or appointed, and if elected, level of voter participation;
2. use of public meetings and hearings;
3. extent of media coverage;
4. citizen attitudes toward special district agencies; and
5. financial "constituency" (bondholders; bankers; taxpayers).

Fiscal issues. While research on the funding of special districts is generally easier to perform, care must be taken to properly identify the various data. Questions worth bearing in mind are:

1. What are the primary methods used to finance special district operations? User charges? Sales or income tax? General property taxes? Other?
2. What types of bonding authority do special districts possess? Revenue or general obligation? General obligation bonds are backed by a government's full faith and credit and taxing power; revenue bonds are paid back out of the financial revenues of the agency.
3. Is there voter review of tax levies?
4. To what extent is there public participation in the budget process of special districts?
5. Are special district budgets and tax notes subject to review by general purpose units?
6. Are special districts subject to audit or to fiscal reporting requirements of state or general purpose governments?
7. What proportion of local government revenues and expenditures are attributable to special districts? What is the financial relationship between special districts and general purpose governments?

Efficiency issues. Proponents of special districts argue that they are increasingly popular because they provide services more efficiently, and can

more readily obtain economies of scale than units of general purpose government. The local analyst should test this assertion. Realistic and valid measures of efficiency are not easily derived, however. The trade-offs between social values--such as accountability and responsiveness--and values of efficiency should also be weighed in judging the role of special districts. The measures of efficiency developed will depend, of course, on the types of public services delivered. Efficiency does not include quality of services or whether the services delivered achieve the goals sought.

Equity issues. The issue of equity is complex and controversial. It is not easy to determine a reasonable, useful set of measures of equity. For our purposes, equity means that services delivered should be related to the needs of those served, and that funds raised to pay for services should be related to ability to pay, as well as to use. Equity may mean either equal services or equal results. Special districts, it is argued, have the capacity to provide services on a more equitable basis. They have the geographic flexibility to adjust service delivery to the area of service demand, and they often employ user charges or levy taxes only on residents who are service recipients.

Preparation of Policy and Action Alternatives

The data collection and analysis should form the basis of a series of policy and action alternatives which can be applied to special districts and to their relationship with general purpose units of government. Policy and action alternatives should respond to specific issues and problems which have been identified. For example, if certain types of special districts seem to fail standards of accountability, the policy should recommend specific changes such as requiring a governing board to be appointed by a county or city council, or having an appointed board elected directly, or simply by requiring the governing body of a special district to hold public meetings. A wide range of action alternatives can be anticipated, ranging from procedural change (requiring review and approval of special district plans by a general purpose unit) to structural change. Structural change can take a wide number of forms:

1. consolidation of like districts into larger entities;
2. consolidation of related special districts into multi-purpose ones;
3. abolition of special districts with obsolete functions;
4. merger of special districts with general purpose units of government;
and
5. transformation of independent special districts to more closely resemble dependent agencies, by limiting funding alternatives, and increasing local officials' role in their operation.

Another issue which needs to be explored is the practicality of substituting subordinate county taxing districts for existing special districts, although in most states this would require special state legislation.

In developing these alternatives, it will be necessary to determine what steps or actions can be taken under existing legislative and constitutional provisions, and what changes or amendments to state laws would be required to implement the recommended reforms.

Endnotes, Chapter VIII - Special Districts

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3. Robert G. Smith, Public Authorities in Urban Areas (Washington, D.C., National Association of Counties Research Foundation, 1969), p. 246.
4. Quoted in Ibid, p. 246.
5. U.S. Advisory Commission on Intergovernmental Relations, The Problems of Special Districts in American Government (Washington, D.C., GPO, May 1964), p. 53.
6. Robert G. Smith, op. cit, p. 269.
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"MUNICIPAL FINANCIAL MANAGEMENT ISSUES"
JOINT SENATE AND HOUSE LOCAL GOVERNMENT COMMITTEES
William L. Ervin, Municipal Accounting Section
October 12, 1993, 11:30 a.m.

INTRODUCTION

We have been asked to address selected issues relating to the procedures that municipalities use in managing their finances. Our office, the Municipal Accounting Section, is usually the first state office a municipality will call if there is a question concerning accounting, budgeting, and auditing requirements. We design the budget forms, provide budget training, consult with budget preparers on how to fill out the forms, prepare 350 budgets for smaller municipalities, and review the 3,800 budgets filed annually. We coordinate the auditing of the 1,000 municipalities required to be audited. We provide on-site assistance for any municipality who requests it.

SOME LOCAL GOVERNMENTS
ARE NOT SUBJECT TO THE CASH
BASIS LAW AND BUDGET LAW

Both the cash basis law and the budget law were passed in 1933 as the country was recovering from the Great Depression. Because they are so closely related and were enacted at the same time, the two laws are applied to municipalities as companion requirements in many cases. The cash basis law provides that a municipality may not create indebtedness more than the amount of moneys on hand. The budget law provides various rules concerning the preparation and submission of the annual budget. Both the cash basis law and the budget law have exceptions.

"Taxing Subdivision" Exemptions

Recently, the Attorney General issued AGO 93-45 which held that a library formed under K.S.A. 12-1219 et seq. is not subject to the cash basis law nor to the budget law because such libraries are not "taxing subdivisions." These libraries do not have taxing power on their own--they must request the city (or other parent municipality) to levy ad valorem taxes for them. Because they are not taxing subdivisions, so goes the reasoning, they also are not subject to the budget law. Other municipalities that have similar characteristics include: extension councils, conservation districts, county fairs, and historical societies.

"Small Township" Exception

K.S.A. 79-2925 allows exemptions to the budget law for townships that project less than \$200 annual expenditures. It should be noted, however, that all municipalities (including townships) must file budgets with their county clerk if they request a tax levy whether it's for \$100 or \$200 million.

Possible Remedies

The cash basis law and the budget law are important laws which help enforce fiscal conservatism, and they have served the state well since their enactment in 1933. To include all municipalities in the coverage of the cash basis law, the law could be amended to change its application from the now-existing "taxing subdivision" to "municipality" as defined in K.S.A. 75-1117.

Even though the above mentioned (subordinate) municipalities are exempt from the budget law, the parent municipalities who levy the ad valorem taxes on their behalf could require the subordinate municipalities to provide them (parent municipalities) financial summaries in the form of a fund sheet for each fund. A fund sheet shows expected beginning balances, receipts, expenditures, and ending balances, by major categories, for three years: for the latest completed fiscal year, for the current fiscal year, and for the coming (budget) year. This requirement could be handled either by law or by the budget forms instructions.

AUDIT REQUIREMENTS FOR KANSAS MUNICIPALITIES

For most municipalities, there are tests for audit requirements in two broad areas: the \$275,000 level test and the revenue bond test.

The \$275,000 Test

K.S.A. 75-1122 requires a Kansas municipality to be audited if it meets any one of the following three criteria: (1) its annual gross receipts exceed \$275,000, (2) it has general obligation bonds outstanding in excess of \$275,000, or (3) it has revenue bonds outstanding in excess of \$275,000. These are commonly called municipal audits which encompass all of the municipality's funds.

The Revenue Bond Test

K.S.A. 10-1208 and K.S.A. 12-866 also require a municipality to be audited if it has any outstanding revenue bonds. These audits are commonly called "revenue bond" audits. The revenue bond audit, in contrast to the audit required under K.S.A. 75-1122, is an audit of only the utility which is legally obligated to pay off the outstanding revenue bonds.

If a municipality meets the criteria for both a municipal and a revenue bond audit, only a municipal audit is required. Because a municipal audit includes the entire municipality, such an audit would encompass all utilities.

There are other statutory municipal audit requirements. For example, all conservation districts are required to be audited per K.S.A. 2-1907. Recreation commissions have an audit threshold of \$150,000, as compared to the \$275,000 for other municipalities. I don't plan to discuss these other requirements today.

Why Do Audits Cost So Much?

There are two questions a municipality is likely to ask when facing the audit requirement for the first time: "How much is all this going to cost?" and "Is it really worth the expenditure of so much of our scarce resources?" The answers are: "More than you were planning on" and "Yes!"

There are many factors that make up audit costs. First, auditing is tough, demanding work that requires intelligent, well-trained men and women. The persons in charge of the municipal audits must be CPAs (college degree, minimum number of accounting/auditing courses, passed a rigorous 2 1/2 day examination, served a two-year apprenticeship, completes 40 hours continuing professional education annually). You can't hire these people for \$10/hour. Second, the accounting profession (including the American Institute of Certified Public Accountants, the U.S. General Accounting Office, and the Governmental Accounting Standards Board set rigid standards under which the audits must be conducted. These professional rules, which have always been tough, are becoming even tougher. For example, in the last 10 years, auditors have been subjected to "peer review" and the "expectation gap." Peer review requires accounting firms to have an independent outside review to determine that the firms are conducting their practice by recognized professional standards. The expectation gap is the term assigned to the requirement for additional audit work to increase the likelihood of detecting fraud (if fraud exists).

There is no way for me to clearly demonstrate the cost benefit of all municipal audits conducted in Kansas, but I believe the benefits are there. The benefits include improvements in accounting systems, internal controls, and investment practices.

What can a municipality do to hold down audit costs? First, establish and maintain a sound accounting and reporting system. This, obviously, has its own costs: personnel, equipment, and training. Second, the municipality can save the auditors' time by preparing many of the audit workpapers ahead of time.

COMPLYING WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

In 1978, the GAAP requirement for municipalities was enacted into law. However, the law provides for exemptions from GAAP. Our office grants waivers from the statutory GAAP requirement on request of the municipality. If a waiver is granted, the municipality is required to present its financial statements in a special, non-GAAP, format which demonstrates compliance with the cash basis and budget laws of the State of Kansas.

Of the 1,000 municipal audit reports submitted to our office every year, about 50 percent of the cities and counties are GAAP. In contrast, school districts are only 10 percent GAAP. Most of the other audits (for example, rural water districts, hospitals, and community colleges) are GAAP. The appeal of non-GAAP reporting probably stems from its simplicity.

There is no question that reporting in accordance with GAAP offers more and better information to the public than does non-GAAP reporting. This is particularly evident in the preference of bond rating companies for GAAP financial reports. However, non-GAAP reporting is easier to understand because it deals almost exclusively with cash activity--it may also be slightly less costly. We encourage all municipalities, if they are able to, to adopt GAAP as at least a long-term goal.

When we are asked by a municipality or an auditor what presentation is best for them my advice is to consider the municipality's needs, as well as the related costs and benefits. For very small municipalities, such as townships, fire districts, and the smaller third class cities, I would probably recommend a non-GAAP accounting system. For larger municipalities, such as counties, first and second class cities, and school districts, I think the cost and expertise to maintain a GAAP accounting system are less important compared to the benefits of GAAP reporting.

My biggest concern in this area is the use of non-GAAP financial reporting for municipal-owned utilities. It is difficult, if not impossible, to operate a utility effectively using a non-GAAP accounting system because it fails to provide important information such as accounts receivable and depreciation. Maybe a solution here is to not allow a GAAP waiver for municipal-owned utilities.

GASB STATEMENT NO. 14,
THE FINANCIAL REPORTING ENTITY

The Governmental Accounting Standards Board (GASB) is the standards-setting body of municipal accounting and reporting. GASB Statement No. 14, The Financial Reporting Entity, probably the statement with the largest impact to date, was issued in June 1991 and is to be implemented by January 1, 1994.

In writing this statement, the GASB was concerned that municipalities were being audited and reported on, yet the audit report did not include related entities that the municipality was accountable for. For example, an elected governing body such as a county commission may appoint a board of trustees to oversee the operation of the county hospital. And the county may even provide annual operating subsidies to the hospital. Yet, an audit of the county might not even disclose the existence of a county hospital. The GASB saw this as a big problem--a county not reporting in its audit report a major operation that it was accountable for.

GASB 14 set up new, strict guidelines for defining the financial reporting entity. It starts at the top with the primary government, that is, the elected governing body. Included within the reporting entity are all related entities for which the primary government is financially accountable. Clearly, the new reporting entity definition will better inform the public on who its elected governmental body is accountable for. Also, the public will be better informed on who certain governmental entities are accountable to.

The new reporting entity guidelines will have significant impact in Kansas, as they will in the other states. Our office has already done some work to assist municipalities in implementing the new guidelines. We first identified all of the different types of municipalities in Kansas (there are about 50 in all). We then determined which of them were primary governments, that is, those that were "independent," and had elected governing bodies. For all of the other types of municipalities (i.e., non-primary governments), we had to determine who they were financially accountable to.

For each type of municipality we had to determine such things as:
Is it a separate legal entity (i.e., a body corporate or a body corporate and politic)?,

What corporate powers does it possess, if any?

Is the governing body elected or appointed?

How is it financed (taxes, fees, etc.)?

What are the financial and authoritative inter-relationships between the appointed governing body and the appointing governing body?

All of these questions, and more, must be answered to properly define the financial reporting entity. One major problem we encountered was interpreting the statutes for the purpose of applying the new guidelines. This was particularly difficult in determining if the municipality was a separate legal entity. In most cases, the statute says something to the effect that "any municipality created under this act is a body corporate (or body corporate and politic)." However, if the statute didn't say the municipality was a body corporate, we had to review the municipality's corporate powers to make a judgement as to whether or not the municipality was a separate legal entity.

While we are still in the early stages of implementing the guidelines of GASB Statement #14, we are committed to doing what we can to assist in the process. We believe the new guidelines properly start with the elected governing body and then focus on financial accountability. This is a giant step in classifying municipalities in a meaningful and consistent way.

COMMITTEE DISCUSSION/CONSIDERATIONS

- Special Districts -

Numerous special districts discussed, but no specific recommendations made, except the following:

Library Districts: (Made by League of Municipalities)

"... that library boards either be made independent taxing districts with their own independent elections and procedures, or that elected city governing bodies be given clear authority to limit the tax levies of appointed city library boards."

"... that the library board statutes be amended to make all tax levies on behalf of libraries subject to scrutiny and modification by the elected city governing body. In the alternative, the city library boards should be made independent taxing subdivisions, directly accountable to the voters."

Beyond taxing authority, libraries can also exempt themselves from the tax lid through charter resolution.

Cash Basis Law: (Made by League of Municipalities and Division of Accounting)

"... that library boards, recreation commissions and all instrumentalities of city and county government be made subject to the Kansas cash basis law and the Kansas budget law."

Drainage Districts: (Made by League of Municipalities)

"... amendments to the drainage district statutes to allow the deannexation of incorporated areas at the option of any city, provided that the property in the city remains liable for any bonded indebtedness incurred prior to the separation."

I talked with Chris McKenzie regarding the above and he said this is not a burning issue with the League and does not necessarily make any recommendations for immediate action. I suggest that the Flooding Task Force look at this area when it begins its work in December.

Rural Water Districts: (Attached letter to Rep. Shallenburger from constituent)

Expressed concern about accountability, lack of control by governing body.

Dennis Schwartz mentioned at last meeting that the Rural Water Districts are proposing an amendment dealing with annexing land to an existing system (?) I am not familiar with it.

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Water Assurance Districts:

Mr. Pelton of the District I said that the possibility of legislation is being explored currently by them.

No recommendations for this committee. Sen. Feleciano had some concerns.

Fire Districts:

General discussion and conferees from last meeting suggested statute review and possible codification. Allow for easier consolidation in statutes.

Recreation Commissions:

Some changes in law were made last time. Information about Recreation Commissions is lacking. Consequently Laura Kelly worked on a survey which I am suggesting we send out under this committee to obtain additional information. No changes are suggested at this time, however, I am having a bill drafted for the Blue Valley District to make them elected.

I recommend we send out the survey, which will be reviewed during the Legislative session.

Public Policy Issues:

Several public policy issues have been raised by numerous conferees, as well as in writings from as long ago as thirty years. After hearing a day and a half of testimony, I believe this committee would be remiss if they did not at least address the accountability issue of existing special districts and specifically parameters for newly created special districts.

The questions that could be addressed in legislation have been outlined in numerous memos, as well as in discussions from Professor Cigler and others.

My recommendation is to gather information from Ms. Cigler next week on what has been done in Pennsylvania, obtain the legislation and any pertinent information from Colorado, and see how they have or are addressing the creation of special districts/authorities.

I then recommend a consensus from this board that a draft bill be initiated, but no action taken even on introduction until January. The draft would be distributed in December for comment prior to the session; it would be revised and brought back before the committee before introduction.

conclusion.

Irregardless of the outcome of this particular situation, IN REGARD TO THE PUBLIC GOOD, I would like to touch on some other points regarding Rural Water Districts in general:

1. Many times the people who govern a newly created water district have never been in a position of power or authority before, and the first time they are placed in such a position, it goes to their head. (Loss of Common Sense)
2. Most have no knowledge of Public Meetings or Public Records.
3. Most have no knowledge of government organization or Laws.
4. Most have no knowledge of Corporate Requirements such as:
 - a. By-Laws
 - b. Minute Book and how to record resolutions and binding actions
 - c. Setting of Policy and Procedures
 - d. Budgets
 - e. Agendas
 - f. Parlimentary Procedure and Order of Business
5. Many times, Rural Water Districts inhibits Business Development and Growth. I think Business Development and Growth should be encouraged because Business creates jobs and expands our Tax Base.
6. After a period of time, when urban areas and Rural Water Districts come together, because of lack of financial foresight and facility planning, a Rural Water District's capacity is strained and this impedes community growth and creates other problems.
7. Water is going to become a very precious commodity in the near future.

As the Law has been explained to me, the County Commissioners incorporate and create Rural Water Districts and then turn it over to the people to govern, in other words, after creation, you all wash your hands of it, and have no control or say so in the governing or operation of said district. After giving some thought to the above points, I would ask you to give some consideration to the following:

1. Since the County Commissioners create Rural Water District's, they should retain some control over the governing of the district to see that the new district is properly organized and operating.
2. Creation of an Administrator or Manager position to manage all the Rural Water Districts as one entity within a county.

If you concur on these thoughts, I would urge you to contact your State Senator and State Representative about getting a Bill together to carry out such a proposal.

Thanks for reading this, and with best personal regards, I am

Sincerely yours,

Richard Mallatt, Jr.
Box 173
Galena, Kansas 66739

KANSAS RECREATION COMMISSION SURVEY

Return to: Mike, Heim, Legislative Research, State Capitol, Topeka, KS 66612

Contact Person's Name _____ Title _____

Agency Name _____

Street Address _____ City, Zip _____

Phone Number _____ Fax Number _____

1. Is your recreation system organized under K.S.A. 12-1901, et seq.? _____ Yes _____ No
2. Is the recreation system operated by a recreation system? _____ Yes _____ No
3. If yes, how many members serve on the commission? _____
4. How many serve from each of the following: _____ School Board _____ City Commission
Other (please specify): _____
5. In what year was your commission established? _____
6. Is your commission a _____ city, _____ school district, or _____ joint commission?
7. What is the current population served by your commission? _____
8. Does your recreation commission operate programs:
_____ Year Round _____ Summer only _____ Summer and school holidays
9. If yours is a jointly established system, how many cities and school districts participate in the system? _____ Cities _____ School Districts
10. Under which taxing authority is the recreation commission tax levy made? _____ City _____ School District
11. What is the current tax levy (in mills)? _____ For general operating expenses.
_____ For Employee benefits/ general liability insurance.
12. How much revenue does one (1) mill currently generate? _____
13. What is the total operating budget for FY 1993/1994? _____
14. What percentage of your budget is generated by fees and charges (not tax \$)? _____
15. Does your recreation commission hold a budget hearing? _____ Yes _____ No

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16. Does the recreation commission submit its budget to the (check all that apply):

_____ School Board _____ City Commission _____ County Clerk
Other (please specify) _____

17. How does your recreation commission receive its funding?

_____ Taxes _____ User Fees _____ Donations _____ Other

18. Who audits your commission?

_____ No audit
_____ Independent Auditor _____ School/City Auditor

19. Which entity pays for the audit, and how much does it cost?

\$_____ School \$_____ City \$_____ Recreation Commission

20. Does the Recreation Commission submit its audit to (check all that apply):

_____ School _____ City _____ County Clerk _____ State

21. Does the Recreation Commission report annually to the city or school? _____

22. What form does the report take? _____ Written annual _____ Oral Annual

23. In what year was your tax levy last increased? _____

24. Has your levy ever been decreased? _____ Yes _____ No If yes, please explain:

25. Does your Recreation Commission operate facilities? _____ Yes _____ No

Please List: _____

26. Does your recreation commission (check all that apply):

_____ Own facilities _____ Lease Facilities _____ Borrow at no cost?

27. If you lease or borrow, from whom? (Check all that apply) _____ School District

_____ City Other (Specify): _____

28. If you own, how did the recreation commission obtain the facilities (check all that apply):

_____ Donation _____ Purchase Other (specify): _____

29. Have any bonds (certificates of participation) been issued in your community to build or purchase facilities or lands?

_____ Yes _____ No Please Explain: _____

30. What entity issued them? _____ School District _____ City _____ County
Other (specify): _____
31. Has your Recreation Commission ever carried any debt? _____ Yes _____ No
If yes, please explain: _____

32. How many staff are employed by the commission?
_____ Full Time _____ Permanent Part time _____ Seasonal Part Time
33. Does your Recreation Commission provide the following employee benefits?
_____ Family Health Insurance (____ % paid by commission ____% paid by employee)
_____ Single Health Insurance (____ % paid by commission ____% paid by employee)
_____ Dental Insurance _____ Life Insurance _____ Disability Insurance
_____ Workers Comp _____ FICA _____ Unemployment Ins.
_____ Retirement (____ KPERS _____ Other)
34. Does your Recreation Commission provide any other employee benefits? _____ Car
_____ Mileage Allowance _____ Housing _____ Tuition Reimbursement
Other (please specify): _____
35. Which types of insurance policies does your recreation commission carry?
_____ General Liability (Cost of annual premium \$_____)
_____ Directors and Officers Insurance (Cost of annual premium \$_____)
_____ Participants Accident Insurance (Cost of annual premium \$_____)
36. Has your recreation commission ever had unemployment claims filed by Seasonal employees (Summer only hires)? _____ Yes _____ No
If yes, did your commission contest any of the claims? _____ Yes _____ No
If yes, were you required to pay? _____ Yes _____ No
37. Has your Commission ever dismissed a member for cause? _____ Yes _____ No
Please explain: _____

38. Have you experienced any difficulties interpreting or complying with the requirements of K.S.A. 12-1901, et seq.? If so please describe below:

39. Have you had any difficulty complying with the Open Records Act? ☐ Yes ☐ No

40. How would you feel about an amendment to the statutes that would allow commissions to increase in size from 5 to 7 members on a voluntary basis?

☐ In Favor ☐ Neutral ☐ Opposed

41. Does your Recreation Commission operate year-round programs? ☐ Yes ☐ No

42. Types of programs offered by your Recreation Commission (check all that apply):

☐ Youth Sports ☐ Adult Sports ☐ Senior Sports

☐ Fine Arts ☐ Aquatics ☐ Arts/Crafts

☐ Adult Fitness ☐ Before School ☐ After School

☐ Day Camps ☐ Extended Day Camp Programs

☐ Lifelong Learning Programs (Adult Education) ☐ Others (Specify):

Optional Information: If you don't mind, please submit copies of the following information:

- Rental and/or lease agreements
- List of Program/league fees and charges
- Job Description and salary ranges

No identifying information (such as name of community or commission) will be released without permission.

Please include on a separate sheet of paper the names, addresses, phone and fax numbers of Recreation Commission Members, local park superintendents, and/or public works directors so they can be added to the Kansas Recreation & Park Association Mailing List for relevant continuing education programs:

Need help in completing this survey? Contact:

Laura Kelly, Executive Director
Kansas Recreation and Park Association
700 SW Jackson St., STE 705
Topeka, Kansas 66603-3758
913/235-6533

or

Mike Heim
Legislative Research
State Capitol
Topeka, Kansas 66612
913/296-3181