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# REPORT TO THE CONGRESS

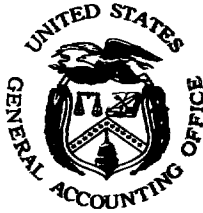
UNITED STATES  
GENERAL ACCOUNTING OFFICE

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OCT 29 1975

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## Adjusted Taxes: An Incomplete And Inaccurate Measure For Revenue Sharing Allocations

Departments of the Treasury and Commerce

GAO reviewed the completeness and accuracy of adjusted taxes--the total taxes of a local government unit as determined by the Census Bureau, excluding taxes for schools and other education purposes--as a measure of fiscal effort and local tax burdens. Adjusted taxes, population, and per capita income are used in a formula to allocate revenue sharing funds to local governments.

GAO found that adjusted taxes are an incomplete measure of local governments' fiscal efforts. Many governments receive revenues from publicly owned utilities as a substitute for taxes, which are presently not included in adjusted taxes. GAO estimated that, if such revenues had been included, 137 cities in Kansas and Missouri would have received increases of over 10 percent in their revenue sharing allocations. In 10 cities the increase would have been over 100 percent.

GGD-76-12

OCT. 28, 1975

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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-146285

To the President of the Senate and the  
Speaker of the House of Representatives

This report presents our findings on the use of adjusted tax data as an element in the allocation of revenue sharing funds. The report deals with the completeness of adjusted taxes as a measure of a government's effort to meet its need and as a measure of local tax burdens. It also deals with the accuracy of the data.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53); the Accounting and Auditing Act of 1950 (31 U.S.C. 67); and the State and Local Fiscal Assistance Act of 1972 (86 Stat. 932, 934).

We are sending copies of this report to the Secretary of Commerce; the Acting Director, Office of Revenue Sharing; and the Director, Office of Management and Budget.

A handwritten signature in black ink, reading "James P. Stacks".

Comptroller General  
of the United States

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ABBREVIATIONS

GAO	General Accounting Office
ORS	Office of Revenue Sharing

D I G E S T

After reviewing the adjusted tax data used in calculating revenue sharing allocations, GAO recommends that the Congress consider including as part of adjusted taxes:

- Profit transfers and payments in lieu of taxes from publicly owned utilities. (See p. 11.)
- Sanitation service charges collected by governments. (See p. 15.)
- Taxes levied by special districts. (See p. 23.)

Adjusted taxes are the total taxes of a unit of local government as determined by the Census Bureau for general statistical purposes, excluding taxes for schools and other education purposes.

The Congress should direct the Office of Revenue Sharing, in cooperation with the Bureau of the Census, to study the desirability of including service charges for purposes other than sanitation as part of the measure of a government's effort to meet its need. (See p. 15.)

GAO also recommends that, to improve data accuracy, Census Bureau officials publicize their availability to answer local government officials' questions concerning forms on which local government taxes are reported. (See p. 40.)

GAO encouraged the Bureau to continue its program of using data centrally collected by State governments and to continue assisting States to establish a means for collecting the data centrally. (See p. 39.)

Adjusted taxes, population, and per capita income are used in a formula to allocate revenue sharing funds to local governments.

- Population is used to measure a government's size.
- Per capita income is used to measure a government's need.

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--Adjusted taxes are used to measure a government's effort to meet its need.

A local government's revenue sharing allocation depends on the relationship of its data elements to the data elements of competing governments.

GAO reviewed the adjusted tax data element (which is based on a statistical series that has been used for the past 70 years for general information) to determine how well the element served in a competitive formula to allocate funds. Specifically, GAO reviewed the completeness and accuracy of adjusted taxes as a measure of fiscal effort and local tax burdens.

GAO concluded that adjusted taxes are an incomplete measure of local government's fiscal effort. Many governments own electric, gas, water, and transit utilities and collect payments in lieu of taxes and profit transfers from these utilities to substitute for taxes because the utilities are publicly rather than privately owned.

These revenues are presently not included in adjusted taxes. GAO estimated that, if such revenues had been included, 86 cities in Kansas and Missouri would have received increases of over 10 percent in their revenue sharing allocations. In 10 cities the increase would have been over 100 percent. (See p. 9.)

Also, adjusted taxes are an incomplete measure of fiscal effort because they exclude service charges. Of 55 cities with populations exceeding 250,000, 26 finance sewer maintenance by service charges, 12 with taxes, 9 a combination of service charges and taxes, and 8 have the maintenance provided by special districts or county governments. (See p. 13.)

Adjusted taxes are also an incomplete measure of local tax burdens because of the exclusion of special district taxes. (See Ch. 3.)

GAO tested the accuracy of adjusted taxes for 111 local governments in 4 States and found that the Office of Revenue Sharing used inaccurate data to compute allocations for the 4th and 5th entitlement periods. Data for about 40 percent of the governments tested was inaccurate by more than 5 percent in each entitlement period. (See p. 27.)

The largest numbers of errors occurred with governments whose populations were under 2,500. GAO noted that constraints built into the formula would lessen the effect of these errors on revenue sharing allocations. (See p. 35.) However, data accuracy can and should be improved.

CHAPTER 1

INTRODUCTION

Title I of the State and Local Fiscal Assistance Act of 1972 (Public Law 92-512) established the general revenue sharing program. Revenue sharing represents a new approach to Federal assistance because the act and implementing regulations place only minimal restrictions and requirements on the use of the funds. The Congress concluded that funds made available under the act should give recipient governments broad flexibility in using the funds for what they consider to be their most vital needs. Other Federal aid to State and local governments has been primarily for narrowly defined purposes.

The act appropriated \$30.2 billion for distribution to State and local governments over seven entitlement periods, as follows:

<u>Entitlement period</u>	<u>Funds to be allocated (billions)</u>
1. Jan. 1 to June 30, 1972	\$2.65
2. July 1 to Dec. 31, 1972	2.65
3. Jan. 1 to June 30, 1973	2.99
4. July 1, 1973, to June 30, 1974	6.05
5. July 1, 1974, to June 30, 1975	6.20
6. July 1, 1975, to June 30, 1976	6.35
7. July 1 to Dec. 31, 1976	3.32

The calculation for allocating funds to State and local governments is based on formulas and parameters specified in the act. For local governments the data elements in the formula are population, which is meant to measure a government's size; per capita income, to measure a government's need; and adjusted taxes, to measure a government's effort to meet its need.

A local government's revenue sharing allocation depends on the relationship of its data to that of competing governments and generally increases as its population increases, its per capita income decreases, and its adjusted taxes increase. Two aspects of the data which can impact significantly on the allocations are (1) the completeness of the data as a measure of a government's size, need, and effort to meet its need and (2) the degree of data accuracy.

The Office of Revenue Sharing (ORS), Department of the Treasury, is responsible for administering the act, including distributing funds to State and local governments; establishing overall program regulations; and providing the accounting and auditing procedures, evaluations, and reviews necessary to insure full compliance with the act. The data used in computing allocations, however, is provided primarily by the Bureau of the Census, Department of Commerce.

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## THE ALLOCATION PROCESS

3 Funds are allocated to the 50 States and the District of Columbia by applying two formulas and using the formula which yields the higher amount for each State. The amounts are then proportionally reallocated to equal the funds available for distribution. After the total amount is determined for each State, one-third is allocated to the State government and two-thirds is available for allocation to local governments, including counties, municipalities, townships, Indian tribes, and Alaskan native villages. (NR 80052)

The Congress concluded that no single allocation method could be used without occasionally producing extreme results. To insure that one local government did not receive an inordinately large share of the funds while another government received almost none, minimum and maximum limits were placed on the allocations. As a result, no local government, except county governments, may receive a per capita allocation less than 20 percent or more than 145 percent of the per capita amount available for distribution to all local governments within the State. In addition, no local government, including county governments, may receive more than 50 percent of the sum of its adjusted taxes and intergovernmental transfers. Also the de minimis rule excludes distributions to local governments allocated less than \$200. Such allocations are distributed to the government of the county where the de minimis local government is located.

The intrastate allocation process begins by dividing among county areas two-thirds of the total State allocation, the amount set aside for local governments. The amount for each county area is conformed to the 20- and 145-percent constraints and divided into the following parts:

1. An amount for Indian tribes and Alaskan native villages determined by the ratio of their populations to the total population of the county area.
2. An amount for the county government determined by the ratio of county government adjusted taxes to total county area adjusted taxes.
3. An amount to be distributed to townships determined by the ratio of township adjusted taxes to total county area adjusted taxes.
4. The remaining amount to be distributed to all other local governments.



The amount for townships and the amount remaining for all other local governments are allocated to each township and each municipality, respectively, by means of the three-factor formula recognizing population, relative income, and tax effort.

If the allocation to a township or other local government (excluding Indian tribes and Alaskan native villages) exceeds 50 percent of that government's adjusted taxes and intergovernmental transfers, the excess is allocated to the county government within which the local government is located. For a county government, such excess is given to the State government.

#### THE ADJUSTED TAX DATA ELEMENT

The adjusted tax element included in the intrastate formula was based on the national classification system of the Census Bureau's public sector statistical series. Adjusted taxes are the total taxes of a local government as determined by the Bureau for general statistical purposes, adjusted by excluding taxes for schools and other education purposes. Adjusted taxes include property, sales, and local income taxes; franchise fees; business licenses; and permits; but exclude insurance trust revenues, receipts for service charges, special assessments, interest earnings, and fines.

The public sector statistical series has been published for more than 70 years and represents an application of standard definitions to a large number of governments. However, the series was designed and used for general statistical purposes. Revenue sharing represents the first use of the Bureau's taxation data in an interactive, competitive formula to allocate funds to many recipients. We reviewed three aspects of adjusted taxes to determine how well the data served as an element in the formula to allocate funds.

1. The completeness of the data as a measure of a government's effort to meet its need.
2. The completeness of the data as a measure of taxes paid by local residents.
3. The degree of data accuracy.

In commenting on this report, ORS questioned limiting this review to adjusted taxes. ORS stated:

"There is \* \* \* reason to believe that the general revenue sharing formulas and data elements were actually viewed as a whole by the Congress and were found acceptable in terms of the resulting allocation of funds among governments. \* \* \*

"Since any change \* \* \* will produce changes in allocations \* \* \*, it should be of great value for GAO to include in the final report an analysis of the impact of the proposed changes on different types of jurisdictions throughout the Nation."

We agree with ORS that the general revenue sharing formulas and data elements were probably viewed as a whole by the Congress. However, we believe the data elements were selected to measure certain characteristics about local governments. Our study was limited to the completeness of adjusted tax data as a measure of a government's effort to meet its need and a measure of taxes paid by local residents.

We further agree with ORS that an analysis of the impact of proposed changes on the revenue sharing allocations of different types of jurisdictions throughout the Nation should be made available to the Congress. We analyzed the probable impact of our recommended changes on revenue sharing allocations for selected local governments. However, since many other studies on revenue sharing are recommending data and formula changes, nationwide analysis should not be made until the Congress debates these potential changes. At that time, ORS can include changes considered by the Congress to have merit in a nationwide impact analysis to provide information so that the Congress can determine if they are acceptable in terms of the resulting allocations of funds among governments.

## CHAPTER 2

### ADJUSTED TAXES--AN INCOMPLETE

#### MEASURE OF FISCAL EFFORT

The first aspect of adjusted taxes which we reviewed was the completeness of the data as a measure of a government's effort to meet its need. In our opinion, adjusted taxes are not a complete measure of a local government's effort to meet its need. Adjusted taxes recognize only taxation as a method of financing services, although local governments use various methods to raise revenue. The charts on page 6 show the revenue sources used by local governments and their significance as a part of total local revenues and general revenues from the governments' own sources.

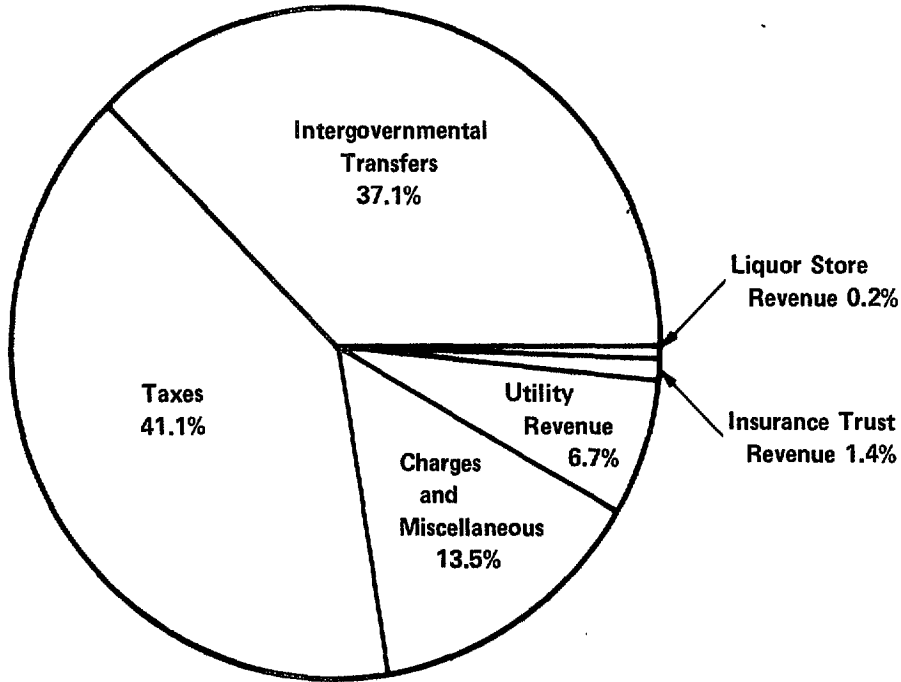
As can be seen from the charts, taxes, which are the primary basis for the adjusted tax element, represent only 41.1 percent of total local revenues and 75.2 percent of general revenues from a local government's own sources. Intergovernmental revenue is the second largest category of a local government's total revenue while charges are the second largest category of general revenues from own sources. Miscellaneous revenues consist of special assessments, interest earnings, sales of property, and other revenues.

#### ADJUSTED TAXES--COMMENTS BY OTHER PARTIES

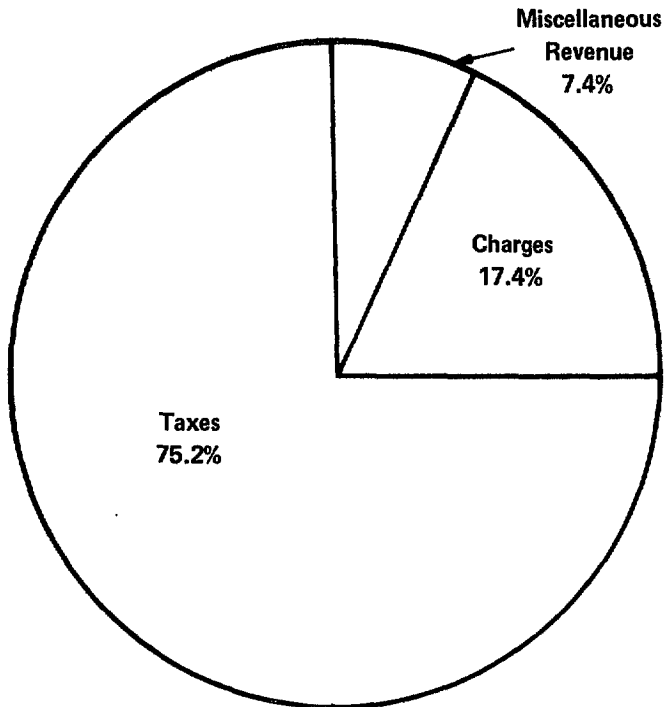
Because adjusted taxes do not include all revenues raised by local governments from their own sources, some local officials claim the act discriminates against many legitimate methods of raising revenues. Some revenue sharing studies comment on excluding these other revenues from adjusted taxes. Several of these comments are summarized below.

1. The Brookings Institution, in a 1975 publication titled "Monitoring Revenue Sharing," stated that local tax revenue can be viewed as an incomplete and discriminatory indicator of fiscal effort because it fails to consider the burdens imposed to varying degrees by other means of public financing. Because tax effort provides additional shared revenue for high effort, it may well give State and local governments an incentive to place more reliance on taxation and less on non-tax financing, which could be undesirable. Furthermore, even disregarding the often-stated view that, for reasons of equity and efficiency, State and local governments should make greater use of service charges to finance some of their activities, it can be argued that the choice between tax and nontax financing should not be biased by considerations of inter-governmental aid.
2. In a November 1974 paper titled, "The Possibility of Amending the Revenue Sharing Act to Encourage Local Government

**TOTAL LOCAL GOVERNMENT REVENUES  
\$129.1 BILLION**



**LOCAL GOVERNMENT GENERAL REVENUES FROM OWN SOURCES  
\$70.5 BILLION**



SOURCE: BUREAU OF THE CENSUS GOVERNMENTAL FINANCES IN 1972-73

Modernization," Mr. Friedrich J. Grasberger, Associate Director, Center for Governmental Research, Inc., said:

"The exclusion of user charges and special assessments deprives those municipalities which by law or by choice rely heavily on the use of such revenue sources from receiving a fair entitlement. The same characteristic also has implications for whether a service should be performed by government or the private sector, for payments in lieu of taxes and for the maintenance of a community's tax effort."

3. Robert P. Strauss and Kenneth L. Wertz of the Department of Economics, University of North Carolina, after studying a sample of cities in North Carolina, stated that municipal electric profits affect the composition of local public finance. The profits from municipally owned utilities lower own-revenue collections, especially property tax collections, but in magnitude they more than compensate for their own revenue forgone. This pattern is observable in cities of all sizes, but appears to be more consistent in larger cities than in smaller ones. Since the total amount of money to be shared annually is fixed, the exclusion of profits in measuring tax effort, in effect, transfers funds from a city with municipally owned utilities to other places. Citizens of North Carolina cities which own electric utilities are actually paying as much or more per capita to their local government than are residents of other North Carolina cities provided that profits of municipal electric utilities are recognized for what they are--transfers of purchasing power to the local public sector. Based on including as adjusted taxes the \$23.2 million received as profits by North Carolina cities with municipally owned electric utilities, their first period allocations would have been increased by an estimated \$1.68 million, or 41 percent.

We have also looked at the problem of measuring a local government's effort to meet its need as it relates to transfers of revenues from publicly owned utilities and service charges. A discussion of our work on each of these revenue sources follows.

#### TRANSFERS OF REVENUES FROM PUBLICLY OWNED UTILITIES

Many local governments own electric, gas, water, or transit utilities. The Census Bureau reported that, during fiscal year 1973, \$8.6 billion, or 6.7 percent of all local revenue, was received from utilities owned and operated by local governments. Most of these receipts were used to offset the cost of providing such service. However,

a portion of these revenues was made available to the general operating funds of local governments.

For example, the Federal Power Commission reports that publicly owned electric utilities made the following contributions to the operation of local governments in 1972.

	(millions)
Transfers of excess funds	\$122
Payments in lieu of taxes	<u>50</u>
Total	<u>\$172</u>

These contributions, in accordance with the Revenue Sharing Act, are not included in adjusted taxes because the Census Bureau treats them as internal transfers.

During the same period the Federal Power Commission also reported that 214 privately owned electric utilities paid about \$3.0 billion in taxes to local governments. Under the act, the local governments were given credit for these taxes.

Potential impact of profit transfers  
and payments in lieu of taxes from  
publicly owned utilities

To test the potential impact of publicly owned utility transfers and payments in lieu of taxes, ORS recalculated the fourth entitlement period allocations for the local governments of Kansas and Missouri using its formula and applicable constraints and data we obtained with the assistance of the Kansas and Missouri municipal leagues. Eighty-three Kansas and 55 Missouri cities reported transfers totaling \$3.5 million and \$4.9 million, respectively. The results of the calculation are shown on the first table on page 9. As shown on the table, 11 cities had decreases even though their adjusted taxes increased. These cities were in county areas where the county area allocations decreased as a result of allocation increases in other county areas throughout the State or where increases in the adjusted taxes of competing governments offset increases in their adjusted taxes.

In addition, 56 cities, not included in the table, would have received higher allocations even though they had no publicly owned utility transfers because other cities in the same county had utility transfers that caused a higher county area allocation in which these cities shared.

Percent of change in revenue sharing allocation	<u>Cities with transfers from utilities</u>		
	<u>Total</u>	<u>Kansas</u>	<u>Missouri</u>
Decreases--			
2.0 or less	11	5	6
No change	1	-	1
Increases:			
10.0 or less	40	27	13
10.1 to 25.0	30	17	13
26.1 to 50.0	26	18	8
50.1 to 75.0	14	9	5
75.1 to 100.0	6	4	2
100.1 to 200.0	<u>10</u>	<u>3</u>	<u>7</u>
Total	<u>138</u>	<u>83</u>	<u>55</u>

Although the increases in the allocations of many cities with publicly owned utilities would have been significant, the impact on most of the other local governments in the two States was minor. The following table shows the impact on local governments whose adjusted taxes were not affected by utility transfers.

<u>Percent of change</u>	<u>Number of governments (note a)</u>			
	<u>Total</u>	<u>Cities</u>	<u>Counties</u>	<u>Townships</u>
Kansas:				
No change	1,236	234	27	975
Increases--				
0.01 to 10.0	10	10	-	-
Decreases:				
0.01 to 1.0	74	37	4	33
1.01 to 2.0	568	163	59	346
2.01 to 5.0	183	91	11	81
5.01 to 10.0	<u>54</u>	<u>12</u>	<u>4</u>	<u>38</u>
Total	<u>2,125</u>	<u>547</u>	<u>105</u>	<u>1,473</u>

<u>Percent of change</u>	<u>Number of governments (note a)</u>			
	<u>Total</u>	<u>Cities</u>	<u>Counties</u>	<u>Townships</u>
Missouri:				
No change	427	331	7	89
Increases--				
0.01 to 10.0	46	46	-	-
Decreases:				
0.01 to 1.0	18	16	2	-
1.01 to 2.0	13	12	-	1
2.01 to 5.0	794	454	104	236
5.01 to 10.0	3	3	-	-
Over 10.0	<u>3</u>	<u>2</u>	<u>1</u>	<u>-</u>
Total	<u>1,304</u>	<u>864</u>	<u>114</u>	<u>326</u>

<sup>a</sup>Excludes governments in preceding table.

Cities with utility transfers would have gained revenue sharing funds of \$541,659 in Kansas and \$936,971 in Missouri. These amounts would have been lost by other recipient governments in the States. The following table distributes the loss among the types of recipient governments. As can be seen, most of the money gained by cities with utility transfers comes from county governments.

	<u>Kansas</u>		<u>Missouri</u>	
	<u>\$541,659</u>	<u>100.0%</u>	<u>\$936,971</u>	<u>100.0%</u>
Gains--cities				
Losses:				
Counties	\$349,294	64.5%	\$561,624	59.9%
Cities	169,784	31.3	340,321	36.3
Townships	22,534	4.2	25,078	2.7
State	-	-	9,948	1.1
Indian tribes	<u>47</u>	<u>(a)</u>	<u>-</u>	<u>-</u>
Total losses	<u>\$541,659</u>	<u>100.0%</u>	<u>\$936,971</u>	<u>100.0%</u>

<sup>a</sup>Insignificant percent.

### Conclusions

Local publicly owned utilities contribute a great deal to certain local governments' financial operations. As was pointed out by Messrs. Strauss and Wertz, of the University of North Carolina, these contributions lower property tax collections but in magnitude more than compensate for these lost revenues.



Investor-owned utilities are taxed, and these revenues are included as part of adjusted taxes. But the Bureau treats amounts received from publicly owned utilities as funds transferred from a government agency and does not include them as part of adjusted taxes. In our opinion, local governments use transfers from publicly owned utilities as a substitute for the taxes lost because the utility is publicly owned and in some instances as a substitute for other means of raising revenue, primarily property taxes. Utility payments in lieu of taxes and profit transfers to municipal general funds are a measure of a local government's effort to meet its need. Because such payments are a measure of effort, they should be included as adjusted taxes in revenue sharing allocation calculations.

#### Recommendation to the Congress

We recommend that the Congress consider including revenue obtained from payments in lieu of taxes and utility profit transfers as a measure of a government's effort to meet its need.

#### Agency comments and our evaluation

The Census Bureau generally agreed with our conclusion that payments in lieu of taxes and profit transfers from publicly owned utilities should be included as adjusted taxes in local revenue sharing allocation calculations. However, the Bureau pointed out several possible problems.

"The \* \* \* governments which operate utilities transfer monies to the general operation funds in a variety of ways. Some governments only transfer a nominal amount to offset the taxes which would have been paid if the utility were privately run. Others make large payments (derived from large utility bills) and use these transfers in lieu of increasing (or for some, levying) a general property tax. In fact, some expenditures for utility operation can be paid out of the general operation funds from the large transfer of utility funds as a bookkeeping expedient. In the latter case, the unit of government would be credited in the adjusted tax element for a utility expenditure.

"Due to the divergence of accounting methods and make-up of the transfers, and also to the sensitivity of utility profits to fuel prices, the cost of living, etc., the Bureau would have a most difficult time in monitoring and verifying the correctness of the responses on the form.

"\* \* \* utilities operated by private corporations, by independent special districts, and by other units of government, also may make payments in lieu of taxes to units of governments. The longstanding system of classifying government finances employed by the Bureau does not classify these as tax revenue for statistical purposes."

We agree that the ways utilities transfer funds to local governments vary. We believe, however, the impact of these variations would be minimized if the Bureau issued specific instructions for determining the amounts of payments in lieu of taxes and profit transfers that should be credited to a government. For example, in areas where expenditures for utility operations are made from local government general operation funds, the adjusted taxes credit should be net of these expenditures.

All new data collection efforts present problems. However, we believe that the Bureau's long history of success with data collection efforts and present knowledge of the area gives them the expertise to prepare instructions and questionnaires which will minimize the apparent problems.

Concerning payments in lieu of taxes by other entities, we did not consider transfers other than from publicly owned utilities in our work. However, where these payments represent tax substitutes, we believe they also should be included as part of adjusted taxes.

ORS pointed out that our analysis did not include the benefit to jurisdictions because publicly owned utilities are exempt from Federal income taxes and can issue tax-exempt bonds. We do not consider the benefits from the Federal tax-exempt bonds pertinent to the issue we are raising concerning these transfers. Similar tax advantages accrue to local governments by allowing taxpayers deductions from Federal income taxes for State and local taxes paid.

#### SERVICE CHARGES

Service charges, or user fees, are an important and increasingly popular source of local government revenue, representing in fiscal year 1973 about 17 percent of general revenue from governments' own sources. Local governments collected about \$12.3 billion in fiscal year 1973 for services, as follows:

<u>Type of service</u>	<u>Amount</u> (billions)	<u>Percent</u>
Hospitals	\$ 3.4	27.6
Education	2.7	22.0
Sanitation	1.9	15.4
Community development and transportation	1.9	15.4
Recreation	0.4	3.3
Other	<u>2.0</u>	<u>16.3</u>
Total	<u>\$12.3</u>	<u>100.0</u>

To gain an insight into the potential effect of service charges on the allocation of revenue sharing funds, we reviewed service charges for sanitation.

## Sanitation service charges

The Census Bureau defines sanitation services as "the provision and operation of sewage facilities, refuse collection and disposal, and street cleaning." Although the method of financing varies, the national trend is to greater use of service charges because of such legislation as the Federal Water Pollution Control Act Amendments of 1972 (Public Law 92-500) and State laws restricting ad valorem and sales taxes.

### Financing characteristics

To determine popular methods of financing for common sanitation services, we surveyed 55 cities with populations of 250,000 or more.

	<u>Number of cities</u>	
	<u>Sewer maintenance</u>	<u>Refuse collections</u>
Provided by cities:		
Financed by service charges	26	8
Financed by taxes	12	33
Financed by a combination of service charges and taxes	9	9
Provided by private enterprise	-	5
Provided by special districts or county governments	<u>8</u>	<u>-</u>
Total	<u>55</u>	<u>55</u>

As can be seen, sanitation for large cities is financed through varied means, of which tax revenues received are included as credits toward determining revenue sharing allocations and other revenues are not.

Smaller governments also use varied means of financing. Two examples follow.

1. In Wyandotte County, Kansas, the city of Kansas City, with a population of 178,000, finances refuse collection and disposal through general taxes which are creditable for revenue sharing allocations. In adjacent Johnson County, Kansas, seven cities in the northeast part of the county, with a combined population of 162,000, do not provide the service. The residents must contract with private companies for the service or otherwise legally dispose of their refuse. The service was provided by other communities in the two counties through service charges.

2. In Lehigh County, Pennsylvania, the residents of about half the communities dispose of their sewage in privately owned septic tanks. Special districts provide sewerage service for about a third of the remaining cities. The balance of the local governments provide sewerage service.

Potential impact of sanitation service charges on local revenue sharing

We tested the effect of allowing credit for sanitation charges on revenue sharing allocations in Kansas and Missouri. In 1972, according to Census Bureau records, 68 Kansas cities and 96 Missouri cities collected sanitation service charges of \$15.1 million and \$21.6 million, respectively. We added the charges to the adjusted taxes of each city, and ORS recalculated fourth period revenue sharing allocations. The allocations to cities with sanitation charges generally increased significantly, largely at the expense of county governments, as shown in the following schedule:

<u>Change by type of government</u>	<u>Kansas</u>		<u>Missouri</u>	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
Cities--gains	66	<u>\$1,392,718</u>	88	<u>\$1,893,092</u>
Counties--losses	77	\$1,179,908	109	\$1,383,093
Cities--losses	332	150,547	511	441,863
Townships--losses	513	<u>62,263</u>	241	<u>68,136</u>
Total		<u>\$1,392,718</u>		<u>\$1,893,092</u>

Six cities in Kansas and 22 in Missouri would have had their allocations increased by more than 30 percent. The largest percentage decreases for county governments by State were 7.79 percent for a Kansas county and 8.84 percent for a Missouri county. The largest percentage decreases for city governments by State were 8.31 percent for a Kansas city and 8.66 percent for a Missouri city. Not all cities with sanitation service charges had increased allocations because some cities were in county areas where the county area allocation decreased as a result of allocation increases in other county areas throughout the State or increases in the adjusted taxes of competing governments offset increases in their adjusted taxes.

Conclusions

The question of including service charges as adjusted taxes is far more complex than the question of including publicly owned utility transfers. The first complication relates to the large variety of services provided through service charges. The second complication relates to the varied means of financing. These include general taxation, service charges, private contracts, citizens actions, or a combination of these.

Despite the complexity, sanitation service charges represent a measure of a government's effort to meet its need. In addition, excluding service charges serves as an incentive to use taxes to provide these services. As a result the Revenue Sharing Act is inconsistent with requirements of the Federal Water Pollution Control Act which encourages using service charges. By including service charges as part of adjusted taxes, the disincentive would be removed and taxes and service charges would be placed on an equal level. In addition, other service charges should be reviewed to determine if they also represent a government's effort to meet its need.

#### Recommendations to the Congress

We recommend that the Congress:

- Consider including sanitation service charges in the adjusted tax data used to allocate revenue sharing funds as an additional measure of a government's effort to meet its need.
- Direct ORS, in cooperation with the Bureau, to review other service charges on a service-by-service basis to determine if such charges should be included as part of the measure of a government's effort to meet its need.

#### Agency comments and our evaluation

The Census Bureau pointed out that services with associated charges are generally those which can be supplied by private enterprise and in many cases are so supplied. Therefore, the Bureau concluded, a county which receives services from a private company would be at a disadvantage compared to a county which operates the service and is credited in the adjusted tax element with the full measure of the charge. We disagree that a county where services are provided by a private company would be at such a disadvantage. A county where services are privately provided incurs no cost for such service and therefore would not be disadvantaged compared to a county which incurs costs to provide such services.

ORS emphasized the need for a more complete analysis of the impact on allocations. It suggested the analysis include the impact on communities where sanitation and other services are provided by private enterprise, and the relative impact on the poor and elderly of services provided through taxation as compared with service charges.

The relative impact on the poor and elderly of services provided through taxation as compared with service charges, in our opinion, is a policy question which transcends a study of a single program, such as revenue sharing. We do not believe that a government's decision to finance sanitation services with either tax revenues or service charges should be affected by the impact this decision would have on the amount of revenue sharing it would receive. Consequently, we believe revenues raised by both methods should be included as adjusted taxes.

The Bureau did not respond to our recommendation that ORS and the Bureau review other service charges for possible inclusion in adjusted taxes. ORS requested GAO to specify criteria to use in this evaluation. We did not develop specific criteria; however, general guidelines leading to the development of specific criteria should include

- the type of service and an evaluation of whether this service is usually performed by a local government,
- the usual method of financing the service,
- an identification of the percentage of local government services financed through service charges,
- the financial impact of a particular service charge, and
- an analysis of whether the service charge specifically covers the service or contributes to financing other local government functions.

## CHAPTER 3

### ADJUSTED TAXES--AN INCOMPLETE MEASURE OF LOCAL TAX BURDENS

Because revenue sharing was designed to help general-purpose governments, school districts and special districts are excluded from directly receiving revenue sharing funds. Special districts are entities, other than counties, municipalities, townships, or school districts authorized by State law with sufficient administrative and fiscal autonomy to qualify as independent governmental units, which usually are authorized to provide only one or a limited number of designated functions. General-purpose governments may provide all or a portion of their revenue sharing funds to special districts and school districts; however, school districts can use such funds only for capital expenditures.

Taxes collected by school districts and special districts are included in calculating the division of revenue sharing funds among States; however, they are not included as adjusted taxes for intra-State allocation calculations. Not only are school district taxes excluded from the local government allocation calculation, amounts for education collected by local general-purpose governments are also excluded. In a general explanation of the Revenue Sharing Act, the staff of the Joint Committee on Internal Taxation noted that:

"\* \* \*This adjustment for education taxes is made principally to place all units of local government on an equal basis without regard to whether they finance their schools through the regular budget of the unit of general purpose local government or whether they provide for schools through independent school districts. \* \* \*In addition, because of the fact that school districts frequently overlap other jurisdictions, crossing city, township, and sometimes county lines, it would be virtually impossible to attribute the taxes raised by a school district to the residents of a particular unit of general purpose local government which would have to be done if school taxes were to be included for all units of general purpose local government."

There is no attempt to include special district taxes in local government allocation calculations, make general-purpose governments deduct taxes collected for services that might otherwise be provided by special districts in order to treat governments equally, or credit residents with taxes they pay to special districts. This lack of credit occurs even though special districts may need funds and can receive revenue sharing funds from general-purpose governments.

Therefore, we looked into the size and importance of taxes collected by special districts, local government reactions to special district tax exclusions, and the feasibility and potential impact of including special district taxes in calculating local government revenue sharing

allocations. Because the Congress had eliminated taxes for education from the local government allocation formulas, thus equalizing the situation among governments, we did not review taxes relating to school districts.

#### SIZE AND IMPORTANCE OF SPECIAL DISTRICTS

The following table shows the public functions performed by special districts and their related revenues according to the 1972 Census of Governments.

<u>Function</u>	<u>Number of districts</u>	<u>Total revenue</u>	<u>Tax revenue</u>	<u>Percent of revenue from taxes</u>
		(millions)		
Cemeteries	1,494	\$ 9.4	\$ 5.6	59.6
Education--school building	1,085	185.7	-	-
Fire protection	3,872	113.4	97.5	86.0
Highways	698	87.0	12.7	14.6
Hospitals	657	1,196.4	125.0	10.4
Housing and urban renewal	2,271	890.7	1.3	.1
Libraries	498	66.8	50.2	75.2
Natural resources	6,639	232.2	75.4	32.5
Parks and recreation	750	215.2	138.8	64.5
Sewage	1,411	543.0	123.9	22.8
Utilities	2,488	1,877.0	199.8	10.6
Other	1,118	292.0	61.0	20.9
Multiple-function districts	<u>904</u>	<u>1,112.6</u>	<u>68.5</u>	<u>6.2</u>
Total	<u>23,885</u>	<u>\$6,821.4</u>	<u>\$959.7</u>	14.1

Between 1962 and 1972 the number of special districts increased 30 percent, from 18,323 to 23,885. Stimulants to creating special districts have been limitations on debt and tax rates applicable to counties and municipalities and a desire for concentrated effort, since most special districts perform only one or a limited number of functions.

In some States special districts are used extensively, other States have few, and Alaska has none. The following table shows an analysis of the varied number of special districts in 1972 within each State:



<u>States</u>	<u>Number of special districts</u>
Illinois	2,407
California	2,223
Pennsylvania	1,777
Texas	1,215
Kansas	1,136
Nebraska	1,081
Washington	1,021
New York	954
Indiana	832
Oregon	826
Missouri	820
Colorado	812
North Dakota	561
Idaho	543
Tennessee	457
Other States (Alaska has no special districts)	<u>7,220</u>
Total	<u>23,885</u>

LOCAL GOVERNMENT REACTIONS  
TO SPECIAL DISTRICT TAX EXCLUSION

In several instances, State and local government officials have recognized the potential impact of special district taxes on revenue sharing allocations and have taken action to obtain credit for these as adjusted taxes.

The auditor for Dallas County, Texas, appealed the Bureau's classification of the Dallas County Hospital District as an independent special district rather than as a district subordinate to Dallas County. His appeal was based on legislation requiring approval of the hospital district's budget by the county commissioners court. The Census Bureau agreed and, in April 1974, directed that the district's 1973 taxes be credited to the county for computing the 5th entitlement period allocation. The Bureau further stated that since the legislation is a general law applying to counties of over 190,000 population, five other hospital districts were eligible. Increases in the 4th period adjusted taxes for these county governments would have ranged from 47 to 106 percent if the taxes of these hospital districts had been included.

In 1973 a California law became effective which allowed cities, in counties having a population of 6 million or more, to impose property taxes to reimburse independent fire and library special districts for their services. If implemented by qualifying cities, the special districts would no longer impose the taxes and the cities would receive credit for the taxes in revenue sharing allocations. Because of the population provision, only cities in Los Angeles County qualify. Tax collections for fire and library services provided by special districts in Los Angeles County totaled \$11.8 million in fiscal year 1974, about

3 percent of all special district tax collections in California for that period. There are, however, fire and library districts in other counties in California, but the cities in these counties will not be able to claim credit for their taxes.

In 1973, Prince Georges County, Maryland, filed a formal appeal pertaining in part, to special district taxes of the Maryland National Capital Park and Planning Commission. The appeal also included Montgomery County, Maryland. The portion of the appeal pertaining to the Commission was based on 1972 legislation which changed budgeting approval procedures and provided for appointment of Commission members by the county governments rather than the Governor. Based on the appeal and the legislation, in January 1974, the Census Bureau ruled that the Commission was a dependent joint agency of Montgomery and Prince Georges Counties and the counties could, therefore, claim credit for taxes collected by the Commission in fiscal year 1974. These taxes are included as adjusted taxes for computing the 6th entitlement period allocation. According to the appeal, if the Commission's taxes for Prince Georges County had been credited as adjusted taxes for the 4th entitlement period, the adjusted tax figure would have increased by \$8 million, or 14 percent.

#### HANDLING SPECIAL DISTRICT TAXES IN THE INTRASTATE ALLOCATION

As with amounts for education collected by general governments, general government tax revenues collected for funded functions, which are at times provided by special districts, could be excluded from adjusted taxes. However, the variety of functions performed by special districts would make this administratively difficult. Taxes raised for most government functions might have to be excluded.

Including special district taxes as part of the adjusted taxes of each general-purpose government would also be difficult, because many of the special districts cross other governments' boundaries. The following example illustrates this:

In the St. Louis, Missouri, metropolitan area, an independent sewer district has been established to provide sewer and storm water service. This includes construction, operation, and maintenance of sewer systems, including treatment plants. In 1972, the metropolitan sewer district levied property taxes of about \$8.4 million. These special district taxes would have increased the total adjusted taxes of governments in the metropolitan area by about 4 percent.

A metropolitan sewer district official said that its activities are financed by watershed districts which overlap municipal boundaries within St. Louis County and to some extent St. Louis City. He also said that it would be impractical to distribute the revenue

to the many governmental entities served by the sewer district.

Special district taxes, however, can be more easily identified with county areas. Only about 2,400, or 10 percent of special districts cross county boundaries.

POTENTIAL IMPACT OF SPECIAL DISTRICT  
TAXES ON COUNTY AREA ALLOCATIONS

We analyzed the effect of special district taxes on the 4th entitlement period revenue sharing allocations of county areas in four States-- California, Illinois, Kansas, and Missouri. Special districts in these States collected about 58 percent of all special district taxes in fiscal year 1972. We limited our calculations to the county area level and did not apply the formula's constraints.

The analyses showed that, in three of the four States, including special district taxes could increase or decrease many county area revenue sharing allocations by more than 5 percent. In these States, special district taxes were 6, 8.5, and 13 percent of total adjusted taxes. The impact was less important in the fourth State, Kansas, where special district taxes were only 1.5 percent of total adjusted taxes.

<u>Percent of increase or decrease</u>	<u>Number of county areas</u>	<u>Number of county areas</u>	
		<u>Increases</u>	<u>Decreases</u>
California:			
0.01 to 2.00		9	9
2.01 to 5.00		6	14
5.01 to 10.00		9	5
Over 10.00		<u>6</u>	<u>-</u>
Total	58	<u>30</u>	<u>28</u>
Illinois:			
0.01 to 2.00		8	5
2.01 to 5.00		4	18
5.01 to 10.00		1	56
Over 10.00		<u>3</u>	<u>7</u>
Total	102	<u>16</u>	<u>86</u>
Kansas:			
0.01 to 2.00		22	70
2.01 to 5.00		9	-
5.01 to 10.00		3	-
Over 10.00		<u>1</u>	<u>-</u>
Total	105	<u>35</u>	<u>70</u>

<u>Percent of increase or decrease</u>	<u>Number of county areas</u>	<u>Number of county areas</u>	
		<u>Increases</u>	<u>Decreases</u>
Missouri:			
0.01 to 2.00		9	13
2.01 to 5.00		12	19
5.01 to 10.00		8	37
Over 10.00		<u>17</u>	<u>-</u>
Total	115	<u>46</u>	<u>69</u>

In a few instances the changes would be particularly meaningful. For example, the allocation of one county area in California could have increased 47.2 percent. This county area's adjusted taxes were increased by about 60 percent by including as tax effort the taxes raised by special districts.

Although including the constraining factors would affect the changes to county area allocations, we believe the potential impact is important, particularly in such States as California, where special districts are used extensively to provide government services.

#### CONCLUSIONS

The primary purpose of revenue sharing is to assist general-purpose governments. The Congress excluded school districts and special-purpose districts from directly receiving revenue sharing funds and also excluded their taxes from being credited in local government allocation calculations. To assure that governments are treated equally, the Congress excluded education taxes, which are collected by general-purpose governments, from being considered part of the adjusted tax element. However, taxes collected by general-purpose governments to provide services similar to those provided by special districts were not excluded. As a result, in our opinion, the goal of equal treatment, in the case of special districts, is not achieved.

If a local government provides education services and collects taxes for this, such taxes are not used in calculating local revenue sharing allocations. However, if a local government provides a service (which may be provided elsewhere by a special district) and collects taxes for it, such taxes are used in calculating local revenue sharing allocations.

Several State and local governments, because of the potential impact of taxes raised by special districts, have modified the methods of collecting taxes or changed the structural autonomy of a special district in order to receive credit from the taxes used to fund it.

In our opinion, adopting the method used for education taxes by excluding revenues raised by general governments to perform services which otherwise may be provided by special districts, would not be feasible because of the variety of such services. Also, crediting the adjusted

taxes of general governments for taxes raised by special districts within the general government's jurisdiction would be administratively difficult.

We believe, however, that a more complete measure of taxes attributable to local residents could be attained by including special district taxes for county area allocation computations. Based on the assumption that county areas with special districts would have increased taxes relative to other county areas, allocations to county areas in which special districts collect taxes would increase. As a result, the revenue sharing allocations to local governments in these county areas would be increased. The citizens who pay taxes to special districts would benefit from increased allocations to their local governments. The above effect would not occur in county areas affected by the maximum and minimum constraints.

#### RECOMMENDATION TO THE CONGRESS

We recommend that the Congress consider including special district taxes as an additional measure of taxes attributable to local residents and that such taxes be credited to the county area for its allocation calculation.

#### AGENCY COMMENTS AND OUR EVALUATION

According to the Bureau, data on special districts is not presently available. Accumulating such data would require a survey about two-thirds the size of the present revenue sharing survey, with a substantially greater potential for problems.

We recognize that providing additional data for revenue sharing will require additional staff and funding for the Bureau's revenue sharing activities and that, without the necessary additional staff and funding, the Bureau's ability to provide accurate and timely revenue sharing data could be impaired. These facts should be considered by the Congress in its deliberations of our recommended change.

ORS states that, because of the constraints in the formula, the results may not be what is expected and that the analysis included in the report does not show the actual impact of this change on allocations.

We agree with ORS that local governments in constrained county areas and constrained local governments in unconstrained county areas will not benefit even if taxes paid to special districts are recognized in local revenue sharing allocations. However, the importance of the adjusted tax data element in a situation where the constraints applied was clearly demonstrated in recalculations made by ORS which included utility transfers and sanitation service charges. These recalculations showed that, in spite of constraints, changes in the adjusted tax data element will have significant impact on revenue sharing allocations.

Although not showing the actual allocation impact of including special district taxes, our analysis clearly demonstrates the potential for change. This impact may be even more significant if present legislative proposals to modify or eliminate the constraints are adopted.

ORS also questioned whether we are recommending including special district service charges as part of adjusted taxes. Our review did not address these service charges, and we are not in a position to recommend their inclusion. However, these service charges can be considered by ORS and the Bureau during the proposed review of service charges.

## CHAPTER 4

### ACCURACY OF ADJUSTED TAXES

To test the accuracy of the adjusted tax data we compiled adjusted taxes from local governments' financial records and compared our figures with those used by ORS to calculate revenue sharing allocations for the fourth and fifth entitlement periods. We found many instances where inaccurate data was used.

Local officials often reported incorrect data to the Census Bureau because they misunderstood which revenue items should be included in compiling adjusted taxes. Other errors occurred because local officials did not submit data from the proper fiscal year.

### COLLECTION OF ADJUSTED TAX DATA

The adjusted tax data for computing revenue sharing allocations is compiled from data the Bureau collects on the revenues of about 39,000 local governments--approximately 3,000 counties, 17,000 townships, and 19,000 cities and other general-purpose local governments. The following table relates the collection of adjusted tax data to the applicable fiscal year and to the entitlement period for which it has been used to allocate revenue sharing funds.

<u>Collected</u>	<u>FY data (note a)</u>	<u>Entitlement period</u>
Summer 1972	1971	1, 2, 3
Fall 1972	1972	4
Fall 1973	1973	5
Fall 1974	1974	6
Fall 1975 (to be collected)	1975	7

<sup>a</sup>Fiscal year data is data for the local government's fiscal year which ends during the Federal fiscal year listed.

Initially, most local government officials reported revenue data by filling out and mailing to the Bureau a Revenue Sharing Survey form. Some governments submitted financial reports and the Bureau officials extracted the adjusted tax data from it. Other governments failed to submit any data and Bureau officials imputed an adjusted tax amount by comparing the government with a similar one. Four States for the 5th entitlement period and nine States for the 6th entitlement period centrally supplied financial data to the Bureau for local governments in the State.

The Census Bureau reviews the adjusted tax data for consistency and accuracy. Adjusted tax data of larger governments is examined more

closely because of the larger amounts involved. In reviewing the data, the Bureau staff uses financial statements and other references. In addition, they may telephone local government officials to clear up questionable items.

After the initial review, the data is prepared for and edited by a computer. The edit checks specific tax items to determine that local governments in a State can legally levy a particular tax and compares the total adjusted taxes to the preceding year's adjusted taxes. Intergovernmental transfers--transfers of funds from other governments--which are used in the formula as part of the 50-percent limit explained in chapter 1, are also compared to the preceding year's data during this edit. In the 1973 survey, data relating to about 48 percent of the governments was identified as needing further review as a result of the edit of adjusted tax and intergovernmental transfer data. A Bureau official said that because of the large volume, not all governments were given this further review. He was not able to tell us how many were reviewed.

After the data has been reviewed and edited, it is released to ORS for use in the ORS Data Improvement Program (see p. 37) and in computing entitlements.

#### ACCURACY OF DATA IN THE STATES REVIEWED

We compiled adjusted taxes for 111 governments in four States and compared our results with the amounts used by ORS to compute revenue sharing allocations for the 4th and 5th entitlement periods. The ORS Audit Guide and Standards for Revenue Sharing Recipients states:

"While the determination of materiality is a judgment which the auditor must make, as a general guide, a difference of 5 percent or less of a line item may be considered not material."

ORS suggests the 5-percent criterion be applied to each line item. Because we applied a 5-percent criterion to the total compiled adjusted tax, some differences which ORS might consider material are not discussed in this report.

The number of governments reviewed and the errors of over 5 percent for each entitlement period are shown in the following table and discussed further in the sections on the results of our review in each State visited:



State	Governments reviewed	4th entitlement period		5th entitlement period	
		Errors of over 5 percent	Percent of governments	Errors of over 5 percent	Percent of governments
California	16	5	31.2	2	12.5
Florida	14	5	35.7	4	28.6
Kansas	56	29	51.8	30	53.6
Pennsylvania	<u>25</u>	<u>6</u>	24.0	<u>8</u>	32.0
Total	<u>111</u>	<u>45</u>	40.5	<u>44</u>	39.6

### California

We reviewed the adjusted taxes of 16 governments (1 county and 15 cities) for the 4th and 5th entitlement periods. Five governments had errors of over 5 percent in the fourth entitlement period, and two had errors of over 5 percent in the fifth period. The errors ranged from an understatement of \$33,642 to an overstatement of \$99,411 in the fourth entitlement period and overstatements of \$75,502 and \$129,665 in the fifth entitlement period.

Government (population)	Entitlement period	Adjusted taxes		Overstatement or understatement (-)	
		Used by ORS	Computed by GAO	Dollars	Percentage
Banning City (12,034)	4	\$649,751	\$584,345	\$ 65,406	11.19
Coachella City (8,353)	4	347,746	248,335	99,411	40.03
	5	397,095	267,430	129,665	48.49
Desert Hot Springs City (2,738)	4	337,268	284,136	53,132	18.70
Indian Wells City (760)	4	125,042	158,684	-33,642	-21.20
Norco City (14,511)	4	609,133	554,921	54,212	9.77
	5	721,640	646,138	75,502	11.69

Overstatements occurred for one or more of the following reasons:

- Including taxes levied by the State.
- Including special district taxes.

--Including service charges, special assessments, or fees.

--Overstating property taxes.

The single understatement occurred because the local official submitted data from an incorrect fiscal year.

Florida

We reviewed the adjusted taxes of 14 governments (1 county and 13 municipalities) for the 4th and 5th entitlement periods. Five governments had errors of over 5 percent in the 4th entitlement period, and four had errors of over 5 percent in the 5th period. The errors ranged from an understatement of \$867,530 to an overstatement of \$61,254 in the 4th entitlement period and from an understatement of \$19,261 to an overstatement of \$905,276 in the 5th period.

Government (population)	Entitle- ment period	Adjusted taxes		Overstatement or understatement (-)	
		Used by ORS	Computed by GAO	Dollars	Percentage
Bell Isle City (2,705)	5	\$ 32,610	\$ 30,282	\$ 2,328	7.69
Eatonville Town (2,024)	4	70,424	82,662	-12,238	-14.80
	5	58,383	77,644	-19,261	-24.81
Lake Buena Vista City (12) (note a)	4	28,273	29,787	-1,514	-5.08
	5	820	1,287	-467	-36.29
Ocoee City (3,937)	4	295,958	234,704	61,254	26.10
Orange County (344,311)	5	17,664,511	16,759,235	905,276	5.40
Orlando City (99,006)	4	9,527,683	10,395,213	-867,530	-8.35
Windemere Town (894)	4	52,716	57,662	-4,946	-8.58

<sup>a</sup>Adjusted taxes decreased in the 5th entitlement period because the city did not assess an ad valorem tax.

Overstatements occurred for one or more of the following reasons:

- Overstating property taxes, cigarette taxes, and tax collection fees.
- Including taxes which were levied by other governments.
- Including special district taxes.

Understatements occurred for one or more of the following reasons:

- Understating or excluding cigarette taxes.
- Excluding franchise fees.
- Excluding building permits and ordinance taxes.

In one case the Census Bureau disallowed the amount of a State cigarette tax during its review even though the tax had not been included in the adjusted tax figures.

Kansas

We reviewed the adjusted taxes of 56 governments (2 counties, 14 cities, and 40 townships) for the 4th and 5th entitlement periods. Twenty-nine governments had errors of over 5 percent in the 4th entitlement period and 30 had errors of over 5 percent in the 5th period. These errors ranged from an understatement of \$9,176 to an overstatement of \$4,840 in the 4th entitlement period and from an understatement of \$3,507 to an overstatement of \$68,403 in the 5th period. Although the amounts of the errors were often small, the percentages of reported taxes that these errors represented were often quite large.

Government (population)	Entitle- ment period	Adjusted taxes		Overstatement or understatement (-)	
		Used by ORS	Computed by GAO	Dollars	Percentage
<u>Anderson County (note a)</u>					
Colony City (382)	4	\$ 7,334	\$ 4,742	\$ 2,592	54.66
Greeley City (368)	4	22,180	24,620	-2,440	-9.91
	5	19,286	22,793	-3,507	-15.39
Harris City (41)	4	480	667	-187	-28.04

Government (population)	Entitle- ment period	Adjusted taxes		Overstatement or understatement (-)	
		Used by ORS	Computed by GAO	Dollars	Percentage
<u>Anderson County</u> (note a)					
Kincaid City (189)	4	\$ 2,211	\$ 1,529	\$ 682	44.60
	5	3,641	2,746	895	32.59
Lone Elm City (66)	4	0	99	-99	-100.00
	5	71	100	-29	-29.00
Westphalia City (185)	4	2,521	1,372	1,149	83.75
	5	1,896	1,097	799	72.84
Lone Elm Township (313)	4	1,150	1,046	104	9.94
	5	680	771	-91	-11.80
North Rich Township (135)	4	667	470	197	41.91
	5	415	668	-253	-37.87
Ozark Township (543)	4	4,623	123	4,500	3658.54
	5	3,695	208	3,487	1676.44
Rich Township (379)	4	600	866	-266	-30.72
	5	638	824	-186	-22.57
Union Township (180)	4	168	62	106	170.97
	5	235	168	67	39.88
Walker Township (606)	4	627	423	204	48.23
	5	605	683	-78	-11.42
Welda Township (334)	4	1,500	1,850	-350	-18.92
	5	0	1,573	-1,573	-100.00
Westphalia Township (518)	4	0	321	-321	-100.00
	5	1,915	368	1,547	420.38
<u>Cowley County</u>					
Arkansas City (13,216)	5	816,297	772,436	43,861	5.68

Government (population)	Entitle- ment period	Adusted taxes		Overstatement or understatement (-)	
		Used by ORS	Computed by GAO	Dollars	Percentage
<u>Cowley County</u>					
Atlanta City (216)	4	\$ 9,319	\$ 7,419	\$ 1,900	25.61
	5	4,169	5,040	-871	-17.28
Burden City (503)	4	4,984	11,135	-6,151	-55.24
	5	12,323	10,331	1,992	19.28
Cambridge City (110)	4	5,090	5,439	-349	-6.42
	5	5,090	5,795	-705	-12.17
Dexter City (286)	4	15,413	10,573	4,840	45.78
	5	16,486	12,128	4,358	35.93
Udall City (668)	4	10,685	19,861	-9,176	-46.20
Winfield City (11,405)	5	528,534	460,131	68,403	14.87
Creswell Township (1,522)	5	18,000	21,328	-3,328	-15.60
Fairview Township (233)	4	10,758	8,867	1,891	21.33
	5	10,756	9,648	1,108	11.48
Pleasant Valley Township (792)	5	10,199	10,920	-721	-6.60
Rock Creek Township (248)	4	9,540	8,050	1,490	18.51
	5	9,540	8,277	1,263	15.26
Spring Creek Township (122)	4	5,783	4,978	805	16.17
	5	6,298	5,010	1,288	25.71

<sup>a</sup>Excluded from this chart are 7 townships in Anderson County which did not report adjusted taxes for either period, although they levied taxes which should have been reported.

Overstatements occurred for one or more of the following reasons:

- Including intergovernmental revenues.
- Including special assessments.
- Using data from an incorrect fiscal year.
- Using budget figures rather than actual amounts.
- Overstating property taxes.

Understatements occurred for one or more of the following reasons:

- Understating property taxes or not reporting property taxes in the case of several townships.
- Excluding franchise fees.
- Excluding licenses and permits.

### Pennsylvania

We reviewed the adjusted taxes for 25 governments (1 county, 8 boroughs, 1 city, and 15 townships) for the 4th and 5th entitlement periods. Six governments had errors of over 5 percent in the 4th entitlement period, and eight governments had errors of over 5 percent for the 5th entitlement period. These errors ranged from an understatement of \$92,839 to an overstatement of \$27,449 in the 4th entitlement period and from an understatement of \$43,053 to an overstatement of \$59,976 in the 5th period.

Government (population)	Entitle- ment period	Adjusted taxes		Overstatement or understatement (-)	
		Used by ORS	Computed by GAO	Dollars	Percentage
Alburtis Borough (1,142)	4	\$ 51,533	\$ 42,189	\$ 9,344	22.15
	5	56,732	51,421	5,311	10.33
Borough of Fountain Hill (5,384)	5	212,274	232,018	-19,744	-8.51
Macungie Borough (1,414)	4	96,866	69,417	27,449	39.54

Government (population)	Entitle- ment period	Adjusted taxes		Overstatement or understatement (-)	
		Used by ORS	Computed by GAO	Dollars	Percentage
Hanover Township (1,217)	4	\$ 53,182	\$ 56,612	\$-3,430	-6.06
Heidelberg Township (1,532)	5	59,003	54,941	4,062	7.39
Lower Macungie Township (8,814)	5	250,757	293,810	-43,053	-14.65
Lower Milford Township (2,189)	4	51,411	60,801	-9,390	-15.44
Salisbury Township (11,285)	5	532,178	562,238	-30,060	-5.35
South Whitehall Township (13,971)	4	520,429	613,268	-92,839	-15.14
	5	754,682	694,706	59,976	8.63
Washington Township (3,732)	4	86,860	92,391	-5,531	-5.99
	5	92,612	114,979	-22,367	-19.45
Weisenburg Township (1,737)	5	45,572	52,005	-6,433	-12.37

Overstatements occurred for one or more of the following reasons:

--Using data from the calendar year rather than the fiscal year.

--Including service charges for water and refuse collection.

--Including intergovernmental revenues.

Understatements occurred for one or more of the following reasons.

--Excluding occupation taxes, real estate transfer taxes, and real estate taxes.

- Excluding licenses and permits.
- Understating income and per capita taxes.
- Understating licenses and permits.

Analysis of overall accuracy

We found that smaller governments in our sample (governments with populations of 2,500 or less) accounted for most errors greater than 5 percent and the majority of large percentage errors.

Of the 111 governments we reviewed, 67 (60 percent) have populations of less than 2,500 based on the 1970 census. These governments accounted for 37 (82 percent) of the 45 errors in the 4th entitlement period and 33 (75 percent) of the 44 errors in the 5th period. The following table compares errors for small and large governments in our selection.

	<u>Less than 2,500 population</u>		<u>Over 2,500 population</u>		<u>Total</u>	
	<u>Number</u>	<u>Percent</u>	<u>Number</u>	<u>Percent</u>	<u>Number</u>	<u>Percent</u>
<u>Entitlement period 4</u>						
Errors:						
None	16	23.9	5	11.4	21	18.9
0.01 to 5.00%	14	20.9	31	70.5	45	40.6
5.01 to 25.00%	12	17.9	6	13.6	18	16.2
25.01% or more	<u>25</u>	<u>37.3</u>	<u>2</u>	<u>4.5</u>	<u>27</u>	<u>24.3</u>
Total	<u>67</u>	<u>100.0</u>	<u>44</u>	<u>100.0</u>	<u>111</u>	<u>100.0</u>
<u>Entitlement period 5</u>						
Errors:						
None	11	16.4	6	13.6	17	15.3
0.01 to 5.00%	23	34.3	27	61.4	50	45.1
5.01 to 25.00%	15	22.4	10	22.7	25	22.5
25.01% or more	<u>18</u>	<u>26.9</u>	<u>1</u>	<u>2.3</u>	<u>19</u>	<u>17.1</u>
Total	<u>67</u>	<u>100.0</u>	<u>44</u>	<u>100.0</u>	<u>111</u>	<u>100.0</u>

Although governments with populations of 2,500 or less receive only a small portion of the funds, they represent a large part of the data collection effort. About 27,000 of the 39,000 governments for which



adjusted tax data is collected have populations of 2,500 or less. However, the effect of errors in small governments on the allocations of revenue sharing is lessened because they are the group most affected by the 20-percent limitation explained in chapter 1. For example, allocations of about 9,000 units of local government were affected by the 20-percent limitation for the 4th entitlement period. Most affected units are jurisdictions with small populations. Fewer than half of these have as many as 1,000 inhabitants. Over two-thirds have populations of 2,500 or less.

In Kansas, the adjusted taxes for townships was more accurate when county records were used to compile the data. We compared townships in two counties in Kansas. In all instances, township populations were less than 2,500. In one county, with 15 townships, local township officials either submitted the data to the Bureau compiled from township records or failed to file any data. In this same county, all 15 townships had errors of over 5 percent for both the 4th and 5th entitlement periods. In the other county with 25 townships, the county clerk assisted in compiling data for 21 townships using county records. The remaining 4 submitted data compiled from township records. Of the 50 survey forms submitted to the Bureau--25 for each entitlement period--1 of the 42 prepared from county records was in error by more than 5 percent, while 7 of the 8 prepared exclusively from township records had errors of over 5 percent.

Most errors for both small and large governments occurred because local officials did not include the proper revenue items when reporting adjusted taxes.

#### ATTEMPTS TO IMPROVE DATA ACCURACY

The Census Bureau and ORS have taken steps to improve the accuracy of data being used for revenue sharing. These include:

- Special assistance to local government officials.
- Centralized data collection by State governments.
- The Data Improvement Program.
- Provision for audit verification of adjusted tax data.

#### Special assistance to local government officials

The Bureau has tried several methods to help local officials report correct adjusted tax data. First, Bureau officials answer questions concerning which revenues should be reported. However, many local government officials in our sample did not know this type of assistance was available.

Second, using data collected for the 4th entitlement period, the Bureau identified common problems and prepared special instructions for each State for use in the fiscal year 1973 survey. These special instructions listed taxes which were incorrectly claimed. An example of the special instructions is shown as appendix I.

Finally, Bureau officials told us they included prior years data on the survey form to enable local officials to make comparisons and know before submitting the data whether changes have occurred which may require explanations.

#### Centralized data collection by State governments

To further improve accuracy, the Census Bureau has changed the method of collecting some of the data. Originally, the Bureau used a mail-out/mail-back system, which required local government officials to report to the Bureau the financial data needed for revenue sharing. Several States, however, were already collecting this type of data for other purposes. In these States, the financial data being requested by the Bureau was available for all or most local governments from a central source.

In the 1973 survey for the 5th entitlement period, the Census Bureau used data collected by four States to compile adjusted taxes for local governments. During the 1974 survey, nine States supplied the data on local governments to the Bureau. The Census Bureau plans to centrally collect local financial data from between 21 and 25 States for the 7th entitlement period. These States account for about 22,000 of the 39,000 local governments.

Bureau officials told us there are two major advantages in using centrally collected data:

1. The reporting burden on local officials is reduced.
2. The data is more consistent for all local governments in the State.

Three of the four States included in our review have State systems which collect the same financial data for State purposes as the Bureau collects for revenue sharing. Florida revised its reporting requirements in 1972 to provide local finance data to the Bureau for the 1973 survey. Pennsylvania's system already collected data in the Census Bureau format and, during the 1974 survey, provided the Bureau with data for most local governments. California has a system which collects local government financial data, but the Bureau had not made use of this system, because the State's data was not compiled in time to meet the Bureau's information receipt deadline. Bureau officials are working with California officials to solve the timing problem for the 1975 survey.

Kansas did not have a State system for collecting local finance data at the time of our review. However, Census Bureau officials are working with the State to develop one.

The Data Improvement Program

To provide a check on data accuracy, ORS instituted the Data Improvement Program. Under this program, the data elements used in computing revenue sharing entitlements are sent to local government officials and they can challenge the data they believe incorrect.

ORS refers documented challenges to the Census Bureau where they are reviewed and a validity determination is made. The Bureau then recommends appropriate disposition to ORS. ORS accepts the Bureau's recommendations in nearly all instances and notifies local officials that their challenges have been accepted or rejected. The number of challenges received by ORS and forwarded to the Bureau by entitlement period are shown in the following chart. An ORS official said, however, that these do not include challenges received after the official deadline for receipt of challenges. The actual number would, therefore, be greater than is shown in the table.

<u>Entitlement period</u>	<u>Challenges received by ORS</u>	<u>Challenges forwarded to the Census Bureau</u>
4	2,095	1,133
5	1,632	920
6	2,445	1,625

Challenges not forwarded to the Bureau are usually returned to the local government because of insufficient documentation.

During our review we noted ORS provides recipient governments with only a total amount for adjusted taxes. Components of this total are not provided to local officials.

Audit verification of adjusted tax data

In fulfilling its audit responsibility, ORS relies on audits by State and local government auditors and independent public accountants. In October 1973, ORS issued an audit guide which calls for verification of the adjusted tax data used in computing the entitlements. During our visits to local governments, we found adjusted tax data was verified for only 9 of the 111 governments reviewed during either of the entitlement periods.

In Kansas, none of the governments we reviewed had an audit of the adjusted tax data. Kansas State statute requires that only cities with a population over 2,000 and counties be audited by independent auditors. As a result, there was no State audit requirement for the majority of the local governments reviewed.

In California, 10 of the 16 governments did not have adjusted tax data verified for either period and another 3 had the data verified for only 1 of the 2 periods.

In Florida, we found only one instance where auditors had verified the data furnished to the Census Bureau. Most local officials indicated they would have the data verified in future audits. However, one official said he considers verification unnecessary.

In Pennsylvania, all but 1 of the 25 governments reviewed had audits of the financial statements for both periods under review. The audits were performed by elected auditors or certified public accountants. Only two of the governments, however, had the data submitted to the Bureau verified as part of the audit. The county government did not have the adjusted taxes verified, and the county controller said that he did not consider this verification necessary.

Few of the governments reviewed had their adjusted taxes verified in past audits. Fiscal year 1972 data was collected before issuance of the audit guide and, in several cases, audits of the governments' finances were performed before local officials were aware of the ORS suggestion for verification.

Officials of 36 governments said verification would be included in future audits. Reasons given by other local officials for not having the data verified were:

- Audits are not timely.
- Verification is costly.
- Audits are not required by ORS.

Errors reported as a result of audits are referred to the Census Bureau. A Bureau official said that many of the errors reported were without merit. According to this official, the Bureau will ignore a reported error if the entitlement period has been closed unless the error would make a substantial difference in the revenue sharing allocation.

## CONCLUSIONS

ORS, in some instances, used inaccurate adjusted tax data to compute entitlements for local governments in the 4th and 5th entitlement periods. Governments in our sample with populations of 2,500 or less were in error, by over 5 percent, more often than larger governments and also accounted for the majority of large percentage errors. The data for both small and large governments was inaccurate because local officials misunderstood which revenue items should have been included.

Steps have been taken by both the Bureau and ORS to improve the accuracy of the data and, in our opinion, these steps will help. We believe, however, that the effectiveness of these actions by the Bureau and ORS can be increased.

Assistance from the Bureau, which is available to local government officials, should be given more emphasis. This could be accomplished by providing local officials, as part of the survey form, a telephone number to call for answers to special problems. This assistance may not be necessary for all local governments in States where data is centrally collected; however, we believe it should be provided to local officials who are primary respondents in the revenue sharing survey.

The use of centrally collected data will accomplish the objectives mentioned by Bureau officials. The reporting burden on local officials will be lessened because they will no longer have to file a revenue sharing survey form. The data will be more consistent because it will be taken from records which are comparable for all local governments. If the problems we noted with Kansas township officials submitting data are typical of many small governments, use of data from centralized records will result in more accurate data. We believe the Census Bureau should continue its efforts to use centralized records and should continue assisting States to establish a central data collection system where one does not already exist.

The Data Improvement Program could be made more effective as a check on the accuracy of adjusted taxes by including the detail underlying the compiled adjusted tax amount as part of the information sent to local officials. One local government official said he did not challenge the adjusted tax data, although he could not reconcile to the total, because he assumed the Bureau and ORS knew the proper amount to be used.

If local officials were provided the underlying detail to the adjusted tax total, they would be able to identify the specific revenue components which they believe incorrect. In addition, they would improve their knowledge of the adjusted tax components which could improve the accuracy of the data in the future.

The lack of audits for many smaller governments we reviewed and the fact that only 36 officials said the data would be verified in future audits, indicate verifications will not be done for a large number of local governments. As a result, verification will not be an effective method of assuring accuracy of data.

#### RECOMMENDATIONS

To increase the effectiveness of programs designed to improve data accuracy, we recommend that:

- The Census Bureau include with the revenue sharing questionnaires sent to local officials, in States where data is not collected centrally, a telephone number which can be called to obtain assistance in completing survey forms.
- ORS include the supporting detail to the adjusted tax amounts as part of the data sent to local officials in the Data Improvement Program.

#### AGENCY COMMENTS AND OUR EVALUATION

In response to our recommendations to improve the accuracy of the data the Bureau agreed that the inclusion on the survey questionnaire of the name and phone number of a Bureau staff member should prove valuable. The Bureau plans to implement this recommendation for the seventh entitlement period.

The Bureau also stated that providing underlying detail in the notification sent to local government officials as part of the Data Improvement Program should be possible provided some ORS forms are revised.

Although expressing reservations as to the potential benefits of providing underlying detail to local government officials, ORS is exploring with the Bureau of the Census the possibility of initiating a pilot program for a selected sample of local governments not located in States with central data collection. This would allow ORS to assess the benefits of the program before incurring costs necessary to supply this detailed data to all local governments.

## CHAPTER 5

### SCOPE OF REVIEW

We interviewed various local government officials to identify problems currently being encountered with adjusted taxes as a measure of a local government's effort to meet its need. In addition, we interviewed officials of ORS; the Census Bureau; the Environmental Protection Agency; universities; States; State municipal leagues; and Federal, State, private and intergovernmental boards, commissions, and associations.

To determine the potential impact on allocations of revenues presently excluded from adjusted taxes, we recalculated, with assistance from ORS, the allocations of shared revenues to local governments in Kansas and Missouri. We included, as part of adjusted taxes, transfers of funds to local governments from publicly owned utilities and service charges from sewers and refuse collections. Also, we allocated special district taxes to county areas in Kansas, Missouri, Illinois, and California to determine how these additions would affect the revenue sharing distribution in these States.

We analyzed accounting records in the following counties to verify the accuracy of the adjusted tax data used by ORS in the 4th and 5th entitlement periods:

Riverside County, California;  
Orange County, Florida;  
Anderson County, Kansas;  
Cowley County, Kansas; and  
Lehigh County, Pennsylvania.

I-RS-9 (6/73)  
USCOMM-DC

SUPPLEMENTARY INSTRUCTIONS FOR CALIFORNIA CITIES

Here are some further clarifications of the enclosed Form RS-9, which together with the instructions on the form itself, will be of assistance in your reporting.

---

PROPERTY TAXES Part I, Item 1

Include: Receipts from the solvents credits tax.

SPECIAL ASSESSMENTS

Exclude: Do not include in this report any special assessments collected from property owners to finance local improvements.

SALES TAXES Part I, Item 2

Include: City Retail Sales Tax  
Utility Franchises Tax  
Room Occupancy Tax

LICENSES, PERMITS AND OTHER TAXES Part I, Item 3

Include: Property Transfer Tax

INTERGOVERNMENTAL REVENUE Part II

Include: Your city's share of any State property tax relief payments.  
Your city's share of the following State taxes:

Gasoline Tax  
Liquor Tax  
Cigarette Tax  
Vehicle in Lieu Tax  
Open Space Property Tax Relief



MUNICIPAL DISTRICTS AND AGENCIES

Include: Tax and intergovernmental revenues of any special agencies of your municipality, such as:

Improvement District  
Lighting District  
Parking District  
Sewer District  
Water District  
Community Redevelopment Agency

I-RS-9 (6/73)  
USCOMM-DC

SUPPLEMENTARY INSTRUCTIONS FOR CALIFORNIA COUNTIES

Here are some further clarifications of the enclosed Form RS-9, which together with the instructions on the form itself, will be of assistance in your reporting.

---

SALES TAXES Part I, Item 2

Include: Revenue from utility franchises tax.  
Receipts from the county retail sales tax even though the tax is collected for the county by the State Board of Equalization.  
Room occupancy tax.

Amounts collected on the county junior college tuition levy and equalization aid offset tax fund levy. Report these amounts also at Part I, item 4.

Property taxes levied for the county school service fund. Report these amounts also at Part I, item 4.

SPECIAL ASSESSMENTS

Exclude: Do not include in this report the proceeds of any special assessments used to finance public improvements within your county.

LICENSES, PERMITS AND OTHER TAXES Part I, Item 3

Include: Property transfer tax.

INTERGOVERNMENTAL REVENUE Part II

Include: Your county's share of the following State payments:

Alcoholic Beverage License Fees  
Highway Users Tax  
Motor Vehicle in Lieu Tax  
Business Inventory Property Tax Relief  
Homeowners Tax Apportionment

Cigarette Tax Apportionment  
Open Space Property Tax Relief

SPECIAL DISTRICTS

Include: Taxes and intergovernmental revenue of only those special districts governed by the county board of supervisors.

Exclude: Special districts governed by local boards.  
School districts.



## OFFICE OF THE SECRETARY OF THE TREASURY



OFFICE OF REVENUE SHARING  
2401 E STREET, N.W.  
COLUMBIA PLAZA HIGHRISE  
WASHINGTON, D.C. 20226

AUG 15 1975

Dear Mr. Lowe:

Thank you for the opportunity to review the draft report of the General Accounting Office entitled "Impact of Adjusted Tax Data on Revenue Sharing Allocations."

The draft report examines the adjusted taxes data element prescribed by the Congress as one element to be used in the intrastate allocation formula for the determination of allocation of funds among local governments (including Indian tribes and Alaskan native villages) in the General Revenue Sharing Program. The draft report specifically discusses the completeness of adjusted taxes as a measure of fiscal effort, and separately addresses the accuracy of adjusted taxes data.

The draft report concludes that adjusted taxes do not recognize all the methods used by communities and their local governments to finance services. The draft report, therefore, suggests that Congress consider adding certain types of income other than taxes to the adjusted taxes amount for each local government. The rationale stated is that per capita income was intended to be a measure of need of a community, and that adjusted taxes was intended to be a measure of a local government's effort to meet its need.

There is, however, reason to believe that the general revenue sharing formulas and data elements were actually viewed as a whole by the Congress and were found acceptable in terms of the resulting allocation of funds among governments. The formulas and the data prescribed by Congress, taken together since they are highly interactive, have been shown generally to provide significantly more shared revenues to those jurisdictions characterized by a low income population or a high tax effort or both.

Since any change in general revenue sharing formulas or the data required will produce changes in allocations of shared revenues to the vast majority of local governments, it should be of great value for GAO to include in the final report an analysis of the impact of the proposed changes on different types of jurisdictions throughout the Nation.

It would be especially helpful if the analyses of the impact of the proposed changes on allocations made clear the degree to which the changes altered the present pattern of allocations with special attention to the impact on low income rural and urban jurisdictions and those in areas of high population density.

The draft report specifically recommends that Congress consider including in the total of adjusted taxes those amounts paid to a municipality by a publicly-owned utility. The draft report presents an analysis that shows that jurisdictions with publicly-owned utilities would receive larger general revenue sharing allocations if transfers of funds from publicly owned utilities were included in the adjusted taxes totals. The draft report, however, does not show the degree to which jurisdictions with publicly-owned utilities already benefit as a result of their exemption from federal income taxes and their ability to issue tax-exempt bonds.

The draft report recommends that Congress consider including sanitation service charges in the adjusted tax data and also direct the Office of Revenue Sharing in cooperation with the Bureau of the Census to review other service charges to determine if such charges should be included as part of the measure of a government's effort to meet its need. As GAO notes in the draft report, the question of including service charges is indeed a complex matter. Consequently, it would seem essential for the GAO report to include a more complete analysis of the effects of including sanitation service charges and/or other service charges as an element in adjusted taxes.

An expanded analysis of the GAO proposals should include the relative impact on the poor and elderly of services provided through taxation as compared with service charges. Also, further discussion of the impact on communities where sanitation and other services are provided by private enterprise through direct contract with individuals should be included.

With regard to the recommendation that Congress direct the Office of Revenue Sharing and the Bureau of the Census to review other service charges for possible inclusion in adjusted taxes, it would be helpful if GAO would specify the criteria which it proposes be used in such an evaluation.

Chapter 3 discusses special districts and recommends that Congress consider including special district taxes in the adjusted taxes figure for each county area, recognizing the impracticality of apportioning taxes of the nearly 24,000 special districts among the approximately 39,000 local governments.

The draft report notes in passing that the limiting factors contained in the general revenue sharing formula which determine the maximum and minimum amounts that a local government may receive would affect the allocations that were actually received if the recommendation went into effect. The draft report does not, however, analyze the actual impact of the recommendation in terms of resulting revenue sharing allocations. GAO is urged to make such an analysis and include the results in the final report since there are several factors that could bring about a result different from the belief expressed in the report that "the citizens who pay taxes to the special districts would benefit from increased allocations to their local governments."

Inclusion of special district taxes at the county area level would not provide increased allocations to either the county government or the municipal governments if the county area was affected by the 145% constraint. Increased allocations would not result if the added special district taxes failed to raise the allocation of the county above the 20% minimum constraint. Further, should the county government

and other local governments total adjusted taxes fail to increase in relation to the total adjusted taxes of all other county areas in the state, then the allocation could remain the same or decrease apart from the effects of the constraints.

In a county area where none of the foregoing circumstances apply, and where a county area received an increased revenue sharing allocation related to the addition of special district taxes to its adjusted tax figure, the benefit of the added revenue sharing payment might not in fact accrue to the local government serving the citizens who had paid the special district taxes. This possibility arises because of the formula provisions of the statute.

Section 108(b) provides that the county area allocations are distributed first to Indian governments on the basis of population, then to the county government and townships in proportion to their adjusted taxes, and finally, the remaining funds are distributed to municipalities. Subsequently, a three factor formula is prescribed for dividing among individual municipalities and townships their appropriate share of the total amount for municipalities and the total amount for townships. At this latter stage, individual governmental units are again subject to the 20%, the 50%, and the 145% constraints. Therefore, a township or municipality might well have citizens paying taxes to a special district yet receive no additional shared revenues under the proposed recommendation due to the operation of the constraints. In fact, a township or municipality whose citizens do not pay taxes to a special district might be the recipient of increased shared revenues if it were not subject to the constraints.

In view of the foregoing considerations, it is urged that GAO include in the final report an analysis of the actual impacts of the proposed recommendations. Also, it would be helpful if the final report clarified whether it is intended that service charges be included with the current tax effort factor or a new "revenue effort factor." It should also make clear whether service charges of special districts are part of tax effort to county areas and most significantly whether GAO intends that such changes in the definition of

tax effort be made at the state level for purposes of interstate allocations. If such changes are intended, then it is urged that they be included in the suggested analyses of the impact of the proposed changes.

Chapter 4 of the draft report assesses the accuracy of adjusted tax data currently in use. The Office of Revenue Sharing strongly agrees that the development of the most accurate data possible is of key importance in the general revenue sharing program. We especially welcome the GAO support for the Bureau of the Census' efforts towards central collection by states of adjusted tax and inter-governmental revenue data for local governments. At the same time, we are concerned that GAO found a number of errors in the adjusted tax data collected by the Bureau of the Census for use in revenue sharing allocations as required by law. In cooperation with the Bureau of the Census, we initiated the Office of Revenue Sharing data improvement program as one of several efforts to increase the accuracy of the data.

We are giving careful attention to the recommendation in the draft report that the Office of Revenue Sharing send local officials the supporting detail along with the total adjusted tax amounts as part of the data sent by us to local officials in the data improvement program.

At present, the 23,000 local governments in states with central data collection already receive the Census Bureau form RS-8 to verify the data in detail. The other local governments have prepared the detailed supporting data themselves and are individually informed of any significant changes made by the Bureau of the Census to that data. Therefore, since the local governments have the detailed data, the Office of Revenue Sharing provides them only the total figure so that if there is a difference they may notify the Office of Revenue Sharing and cause a review by the Bureau of the Census of the data which will result in notice to the individual government as to whether the data will be changed and why.

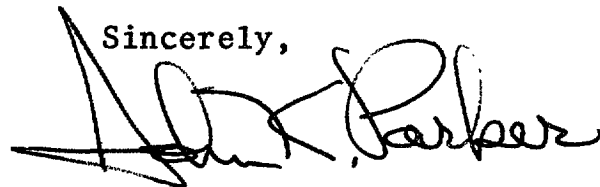
Provision of another set of detailed adjusted taxes supporting data to all 39,000 governments



would involve appreciable expense and it is uncertain that improvements in data would be achieved. Therefore, the Office of Revenue Sharing is exploring with the Bureau of the Census the possibility for a pilot project which would return detailed adjusted tax and intergovernmental revenue data to a selected sample of local governments not located in states with central data collection. Such a pilot project would enable an assessment to be made of whether data errors are significantly reduced for the pilot group as compared to other jurisdictions before incurring the cost of distribution of detailed supporting data to all 39,000 local governments.

I trust that these comments are helpful to GAO in preparing the final version of the report, and do wish again to express appreciation for the opportunity to review the draft.

Sincerely,

A handwritten signature in black ink, appearing to read "John K. Parker". The signature is written in a cursive style with a large, sweeping initial "J".

John K. Parker  
Acting Director  
Office of Revenue Sharing

Mr. Victor Lowe  
Director of the General  
Government Division  
U. S. General Accounting Office  
Washington, D. C. 20548



August 19, 1975

Mr. Victor L. Lowe  
Director, General Government Division  
U. S. General Accounting Office  
Washington, D. C. 20548

Dear Mr. Lowe:

This is in reply to your letter of July 18, 1975,  
requesting comments on the draft report entitled  
"Impact of Adjusted Tax Data on Revenue Sharing."

We have reviewed the enclosed comments of the  
Bureau of Census and believe they are responsive  
to the matters discussed in the report.

Sincerely,

Guy W. Chamberlin, Jr.  
Acting Assistant Secretary  
for Administration

Enclosure





APPENDIX III  
**UNITED STATES DEPARTMENT OF COMMERCE**  
**Social and Economic Statistics Administration**  
 BUREAU OF THE CENSUS  
 Washington, D.C. 20233

OFFICE OF THE DIRECTOR

Mr. Victor L. Lowe  
 Director  
 General Government Division  
 U. S. General Accounting Office  
 Washington, D.C. 20548

Dear Mr. Lowe:

Secretary Morton and Assistant Secretary Pate have requested that I respond to your letters of July 18 and thank you for the opportunity to review the draft copy of your report entitled "Impact of Adjusted Tax Data on Revenue Sharing Allocations." We have examined the report and respectfully offer the following comments.

We would agree that governments which operate utilities do generate revenues from the utility operation, which takes the place of tax revenues which would have to be paid by a privately operated utility or from other sources (including general property taxes). The recommendation to include these revenues in the adjusted tax element made in Chapter 2 is well stated.

The Bureau could collect these data using the normal operating procedures. It would involve an adjustment to the survey forms and one more set of data items to edit and verify. There is also the possibility that this may impact on those States which supply the Bureau with the data centrally.

The units of governments which operate utilities transfer monies to the general operation funds in a variety of ways. Some governments only transfer a nominal amount to offset the taxes which would have been paid if the utility were privately run. Others make large payments (derived from large utility bills) and use these transfers in lieu of increasing (or for some, levying) a general property tax. In fact, some expenditures for utility operation can be paid out of the general operation funds from the large transfer of utility funds as a bookkeeping expedient. In the latter case, the unit of government would be credited in the adjusted tax element for a utility expenditure. Due to the divergence of accounting methods and make-up of the transfers, and also to the sensitivity of utility



profits to fuel prices, the cost of living, etc., the Bureau would have a most difficult time in monitoring and verifying the correctness of the responses on the form.

Also, it should be noted that utilities operated by private corporations, by independent special districts, and by other units of government, also may make payments in lieu of taxes to units of governments. The longstanding system of classifying government finances employed by the Bureau does not classify these as tax revenue for statistical purposes.

The other recommendation in Chapter 2, to include service charges, is, in our opinion, not as well founded. These particular services, for which charges are associated, are generally those which can be supplied by private enterprise. In many cases, in fact, they are so supplied. Therefore, a county which receives sewerage and water or refuse collection services from a private company would be at a disadvantage, vis-a-vis a county which operates the services and is credited in the adjusted tax element with the full measure of the charge.

Again, the inclusion of these data in the revenue survey could be handled, however, it would require a longer form, more work, and, of course, would be more expensive. Our experience indicates that the longer and more complicated the survey form is, the lower is the general level of quality of the response.

The suggestion in Chapter 3 that the taxes levied by special districts be credited to the county area's tax effort would require a complete annual survey of all special district finances in the Nation. The present survey is based on a sample of districts and is designed to yield State-by-State estimates only. The Bureau would have to survey the nearly 24,000 special districts concerned, of which many are very small governments served only by part-time officials. The difficulties involved in gathering accurate data on the tax revenues of these units would be even greater than those encountered in obtaining information from small municipalities and townships, since these special districts do not receive any general revenue sharing funds. We should point out that in most States there is little possibility of gathering these figures centrally, since special districts are seldom included in statewide local government reporting systems. The need to distribute the taxes collected by

multi-county districts could also cause problems. Both the special district data requirement and the problems inherent in adequately measuring public utility transfers would necessitate a considerable increase in the level of funds presently appropriated for the Bureau's revenue sharing surveys. It is our considered opinion that the inclusion of these recommendations (especially the special district taxes) would seriously impact our ability to provide accurate and timely data.

Perhaps our main concern with the report involves the sections evaluating the accuracy of the data. We regret that the sample of local governments chosen for analysis included such a large number of Kansas townships. The Census Bureau, in all its efforts to provide adjusted tax data, has devoted most of its resources to those governments which fall in larger population groupings. Conclusions based on the review of small units may tend to overstate the impact of data inaccuracies in the revenue sharing program as a whole. We might point out that the findings of the 1972 Census of Governments indicate that the 27,000 municipalities and townships with populations (1970) of under 2,500 received only about 4 percent of the total revenues of all municipalities and townships.

We are in complete agreement, however, that the quality of the data from large jurisdictions, as well as small, can be improved through the expansion of the State central data collection program, and are continuing our efforts in this direction. For the seventh entitlement period, data will be centrally collected for over 23,000 governmental units.

We also find merit in the other recommendations included in the report. It should be possible, given the revision of certain Office of Revenue Sharing forms, to present the underlying detail of the adjusted tax total in the notification sent to local government officials as part of the data improvement program. We should point out that most of our inquiries to local governments do show the prior year data in detail as a guide to filling out the current questionnaire.

The inclusion on the questionnaire of the name and telephone number of a Bureau staff member who can help answer questions should prove valuable. Our present plans are to have a telephone number printed on the survey forms for the seventh entitlement period.

Please be assured that we are eager to do whatever we can to improve the quality and timeliness of the data utilized and to contribute to the successful implementation of the general revenue sharing problems.

Sincerely,



VINCENT P. BARABBA  
Director  
Bureau of the Census

PRINCIPAL OFFICIALSRESPONSIBLE FOR ADMINISTERING ACTIVITIESDISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF THE TREASURY:		
William E. Simon	Apr. 1974	Present
George P. Shultz	June 1972	Apr. 1974
John B. Connally	Feb. 1971	June 1972
DIRECTOR, OFFICE OF REVENUE SHARING:		
Vacant	Aug. 1975	Present
Graham W. Watt	Feb. 1973	Aug. 1975
SECRETARY OF COMMERCE:		
Rogers C. B. Morton	Mar. 1975	Present
Frederick B. Dent	Feb. 1973	Mar. 1975
Peter G. Peterson	Feb. 1972	Feb. 1973
ADMINISTRATOR, SOCIAL AND ECONOMIC STATISTICS ADMINISTRATION (note a):		
Edward D. Failor	Apr. 1973	Jul. 1975
Vacant	Mar. 1973	Apr. 1973
Joseph R. Wright, Jr. (acting)	Jan. 1973	Mar. 1973
Harold C. Passer	Jan. 1972	Jan. 1973
DIRECTOR, BUREAU OF THE CENSUS:		
Vincent P. Barabba	Aug. 1973	Present
Vincent P. Barabba (acting)	May 1973	Aug. 1973
Robert L. Hagan (acting)	Mar. 1973	Apr. 1973
Joseph R. Wright, Jr. (acting)	Jan. 1973	Mar. 1973
George Hay Brown	Sept. 1969	Jan. 1973

<sup>a</sup>The Social and Economic Statistics Administration was disestablished by the Secretary of Commerce effective July 16, 1975.





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