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ARIZONA TAX RESEARCH ASSOCIATION

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Weaknesses Revealed in Maricopa County Treasurer's Financial Operations

According to a recent audit of Maricopa County, several material weaknesses were uncovered in Maricopa County Treasurer Royce Flora's office that resulted in nearly \$100 million in audit adjustments to county financial statements and tens of millions in misstated amounts to its local governments.

The County Treasurer is the custodian of billions in taxpayer dollars it receives from state and local taxpayers. The Treasurer is statutorily required to safeguard all monies deposited in county coffers, to maintain electronic records for each entity, and reconcile accounting records to bank records.

See WEAKNESSES REVEALED, Page 5

Local Government Proposed Tax Increases

As Arizona local governments prepare to enter another fiscal year, much of the discussion in adopting their budgets includes whether or not to raise property taxes. Elected officials have the ability to reduce tax rates to avoid tax increases when values rise. However, many reflexively opt to keep the rate the same, advancing a narrative that the establishment of the tax rate is perfunctory or outside their control. To be clear, when property values grow and tax rates remain unchanged, that translates to a tax increase. The Truth-in-Taxation (TNT) laws that have been on the books for twenty years force taxing entities to be more transparent when communicating that message to taxpayers.

See TAX INCREASES, Page 3

Auditor General Deems Maricopa County's Unfunded Pension Cost Exclusions Improper

Skyrocketing pension costs under the Public Safety Personnel Retirement System (PSPRS) have placed a massive financial strain on local governments over the past several years. Not only do local governments lack the funding to address the mountain of unfunded liability that has accrued, but the increased spending has put new pressure on the constitutional expenditure limit. To circumvent its expenditure limit, Maricopa County began excluding its unfunded pension liability costs from the limit. However, the Office of the Auditor General (OAG) determined those exclusions to be improper in its latest audit of the County's expenditure limit. By disallowing the county's

See EXPENDITURE LIMIT, Page 2

EXPENDITURE LIMIT, *Continued from Page 1*

pension liability exclusions, the OAG determined that the expenditures the county was permitted to exclude was actually \$3.3 million rather than the \$60.9 million it reported.

Approved by the voters in 1980, the constitutional expenditure limits are intended to restrict dramatic growth in local government expenditures, and those limits are increased each year by population and inflation. Certain costs may be excluded from the expenditure limits, such as long-term debt obligations that exceed one-year. However, if jurisdictions find it difficult to operate within those parameters, the constitution provides the opportunity for local governments to ask voters for an increase to those limits. Jurisdictions that would rather avoid the unpleasantness of admitting to voters their intent to spend more have resorted to issuing long-term debt to dodge the expenditure limit. This is not an ideal path to dealing with the expenditure limit by any means, but it is legal.

Maricopa County has been issuing long-term debt for years to manage its expenditure limit problem rather than appeal its case for increased spending to voters. However, since FY 2016, the county has become more aggressive in its view of what long-term debt entails by excluding unfunded liability pension costs for all of its plans. This was about the same time that Maricopa County was leading the charge in ushering through a legislative remedy that provided statutory authority for local governments to exclude the unfunded pension liability costs from their expenditure limits. Knowing they lacked the legal authority, Maricopa County advanced legislation in 2017 to exclude all payments for unfunded pension liabilities from the expenditure limits. ATRA opposed the legislation because it would undermine the legitimacy of the expenditure limits. Although the bill ultimately failed, the county brazenly continues to exclude these expenditures.

According to the FY 2016 and FY 2017 Maricopa County Expenditure Limit Reports, the OAG determined that the county’s exclusions for unfunded pension liabilities are not excludable expenditures in accordance with the Constitution. In explaining the difference between long-term debt and unfunded pension liability costs, the distinction is that long-term debt is the result of amounts or property received by the entity that in turn incurs a debt obligation. Unfunded pension liability, on the other hand, results when the required pension contributions and investment earnings of the fund are inadequate to cover employee benefits. The OAG warned that if all political subdivisions developed the same viewpoint as Maricopa County, then contracts could be structured to exceed one-year and be considered a long-term obligation, and thus would “render the constitutional expenditure limitation meaningless.”

According to county officials, the county attorney submitted a written request earlier this year to the Attorney General to opine on the issue. While a response awaits, the county will continue to exclude its pension costs as if they have the legal authority to do so. If the Attorney General sides with the OAG, it’s likely the county will continue to issue debt to deal with its expenditure limit problem, at least in the short-term.

-Jennifer Stielow

TAX INCREASES, *Continued from Page 1*

Primary property taxes, which fund the maintenance and operations of local government budgets, are subject to TNT. TNT requires taxing entities to notify taxpayers of the intent to increase property taxes over the previous year, exclusive of new construction, by publishing notice in a newspaper of general circulation and holding a public hearing. The TNT law also applies to secondary taxes levied by several county special taxing districts.

Counties

The Maricopa County Board of Supervisor's (BOS) plans to increase primary property taxes and the taxes levied for its special taxing districts by \$29 million in FY 2020. Although they could have avoided the tax increase by reducing the tax rates, the BOS made the unanimous decision during their TNT hearing to raise taxes by keeping rates the same.

Yavapai County is proposing an 18% increase in its primary levy by raising its tax rate nearly 24 cents. If approved by the BOS, the primary levy will generate \$8.5 million more than last year.

Pima County claims to be taking a conservative approach this year by reducing its primary tax rate by 7 cents; however, that reduction is not enough to prevent a \$6.5 million increase in primary taxes as a result of increased property values. Collectively among the primary tax and its special taxing districts, Pima County is proposing to increase property taxes approximately \$11 million.

County	2018	2019	TNT Rate	TNT Req?	% Chg.	MAX TR
Apache						
Primary	0.5922	0.6176	0.6055	YES	2.00%	0.6176
Library (ops)	0.3067	0.3136	0.3136	NO	0.00%	
PHSD	0.2478	0.2500	0.2500	NO	-1.32%	0.2500
Jail	0.1978	0.2000	0.2000	NO	-1.10%	0.2000
Juvenile Jail	0.0889	0.1000	0.0909	YES	10.02%	0.1000
Junior College Tuition	0.3750	0.3750	N/A	N/A	-	
Post Sec. Education	0.1400	0.1400	N/A	N/A	-	
FCD	0.0861	0.0893	0.0893	NO	0.00%	
Library (bond)	0.1089	0.1113	N/A	NO	-	
Cochise						
Primary	2.6747	2.6747	2.6760	NO	-1.76%	4.0301
Library	0.1451	0.1451	0.1452	NO	-4.05%	
FCD	0.2597	0.2597	0.2577	YES	0.78%	
Coconino						
Primary	0.5589	0.5413	0.5307	YES	1.99%	0.5413
Library	0.2556	0.2556	0.2427	YES	5.31%	
FCD	0.1808	0.2280	0.1716	YES	32.88%	
PHSD	0.2500	0.2500	0.2374	YES	5.31%	0.2500
Gila						
Primary	4.1900	4.1900	4.1095	YES	1.96%	6.7163
Library	0.2425	0.2425	0.2378	YES	1.96%	
Maricopa						
Primary	1.4009	1.4009	1.3444	YES	4.20%	1.7262
Library	0.0556	0.0556	0.0534	YES	4.20%	
FCD	0.1792	0.1792	0.1705	YES	5.10%	

County	2018	2019	TNT Rate	TNT Req?	% Chg.	MAX TR
Mohave						
Primary	1.9696	1.9496	1.9084	YES	2.16%	2.4666
Library	0.2716	0.2716	0.2632	YES	3.20%	
FCD	0.5000	0.5000	0.4832	YES	3.48%	
TV	0.0200	0.0400	N/A	N/A	-	
Navajo						
Primary	0.8921	0.8820	0.8820	NO	0.00%	0.9177
Library	0.0995	0.0980	0.0980	NO	0.00%	
PHSD	0.2489	0.2453	0.2453	NO	0.00%	0.2500
FCD	0.2788	0.2724	0.2724	NO	0.00%	
Pima						
Primary	4.0696	3.9996	3.9257	YES	1.88%	5.1263
Debt	0.6900	0.6900	N/A	N/A	-	
FCD	0.3335	0.3335	0.3208	YES	3.95%	
Library	0.5153	0.5353	0.4971	YES	7.69%	
Pinal						
Primary	3.8300	3.7900	3.6658	YES	3.39%	5.9549
Library	0.0965	0.0965	0.0924	YES	4.48%	
FCD	0.1693	0.1693	0.1626	YES	4.11%	
Yavapai						
Primary	1.7788	2.0152	1.7079	YES	17.99%	2.1765
Library	0.1720	0.1651	0.1651	NO	0.00%	
FCD	0.2188	0.2120	0.2103	YES	0.81%	
Yuma						
Primary	2.5288	2.5288	2.4675	YES	2.49%	2.6930
Library (ops)	0.6608	0.6708	0.6448	YES	0.44%	
Library (debt)	0.2426	0.2429	N/A	N/A	-	
FCD	0.2522	0.2419	0.2463	NO	-0.71%	

Other counties proposing significant tax increases this year include Coconino, with a \$1.5 million increase, and Pinal County, with a proposed tax increase of \$3.4 million. Graham, Greenlee, La Paz, and Santa Cruz counties have yet to post their tentative budgets.

Cities

Over 50 cities and towns levy primary property taxes, and so far, at least 21 cities are proposing tax increases. The Town of Hayden and Casa Grande have proposed the largest primary tax rate increases of 51% and 22%, respectively. The Town of Hayden, which is located in Gila County, is proposing to increase its primary tax rate \$2.5365 to \$8.50, and Casa Grande is proposing a \$0.1339 rate increase to \$1.1244. Homeowner values account for approximately 40% of the tax base in Hayden; therefore, all of the tax applicable to homeowner's will be picked up by the state general fund since they are at the 1% cap. Because of legislation that passed in 2016, the council members of Hayden and Casa Grande must have unanimous agreement to adopt their proposed tax increases since they exceed 15%.

Other cities that are proposing significant tax increases include Queen Creek (6.8%), Buckeye (6.5%), Yuma (6.1%), Wickenburg (5.4%), and Peoria (5%).

City/Town	FY 2019 Primary Rate	FY 2020 Proposed Rate	TNT Rate	% Increase
Hayden	5.9635	8.5000	5.6183	51.3%
Casa Grande	0.9905	1.1244	0.9225	21.9%
Queen Creek	1.9500	1.9500	1.8257	6.8%
Buckeye	1.8000	1.8000	1.6905	6.5%
City of Yuma	2.2747	2.3185	2.1847	6.1%
Wickenburg	0.5270	0.5270	0.5001	5.4%
Peoria	0.2900	0.2900	0.2762	5.0%
Lake Havasu	0.6718	0.6718	0.6404	4.9%
Surprise	0.7591	0.7591	0.7252	4.7%
City of Maricopa	4.7845	4.7845	4.5805	4.5%
Benson	0.8288	0.8704	0.8367	4.0%
Phoenix	1.3163	1.3055	1.2649	3.2%

WEAKNESSES REVEALED, *Continued from Page 1*

Furthermore, the Treasurer is required to specifically safeguard and account for school district monies and allocate interest earned on a quarterly basis.

A material weakness is a deficiency in internal controls in which there is a reasonable possibility that the deficiencies will translate into incorrect information being reported in the government's financial statements. Based on the FY 2018 Internal Control and Compliance Report issued for Maricopa County, the Auditor General reported the Treasurer's office did not reconcile its accounting records against bank records between March and June, until November that year. As a result of not timely reconciling its accounts, those errors carried through to the county's financial statements. Therefore, the county finance department had to make \$99.1 million in audit adjustments to its FY 2018 financial statements.

The Treasurer's office also failed to correctly allocate interest earnings to local governments in the spring of that year. Although those errors were corrected in July, the Treasurer did not communicate the errors to its local governments until several months later. As a result, there were \$27.6 million in potential misstatements that occurred due to "unaccounted-for reconciling differences." The report also noted that it is likely there are other unresolved errors and unreconciled accounts that carried over into the local government systems.

The reason for these deficiencies? The Treasurer did not properly "plan and implement" its new accounting system. More concerning, the Treasurer failed to ensure staff adequately monitored the system's output through reconciliation of accounting records and investigating unposted transactions.

The Treasurer blamed inadequate staffing for failure to sufficiently perform its statutory responsibilities. Since FY 2015, the full-time equivalents in the county treasurer's office has grown by five to nearly 60 and the budget has grown 15%.

-Jennifer Stielow