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ARIZONA TAX RESEARCH ASSOCIATION

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Ducey Signs Adjacent Ways Reform Bill

On March 18, Governor Ducey signed SB1117 (Dial) which shines a spotlight on a unique property tax fund which has been the source of past abuses. Adjacent Ways is a special property tax authority school districts have for "public way" projects adjacent to schools such as sewers, gutters and sidewalks. The Adjacent Ways tax is levied by local school districts and is in addition to K-12 tax rates for operating budgets. Prior to this legislation, there was no audit of the fund and no state oversight of expenditures from the fund which provided opportunities for misspending.

While ATRA has uncovered several past examples of questionable uses of the Adjacent Ways fund, the most glaring was the recent expenditure of $6.4 million over two years by Higley Unified for lease payments on two middle schools (see ATRA July 2015 newsletter).

SB1117 ensures a legal project exists before an expenditure occurs by requiring school districts submit projects costing over $50,000 to the School Facilities Board (SFB) for validation. It also adds the Adjacent Ways fund to school district's annual audit. Oversight from SFB will curtail future abuses of the Adjacent Ways levy and bring transparency to taxpayers. School districts maintain the ability to levy for this fund as necessary.

ATRA worked with several K-12 school groups to negotiate this compromise legislation. Regrettably, the Arizona Association of School Business Officials (AASBO) remained opposed to the bill despite amendments addressing their most significant concerns. Due to this opposition, the bill narrowly passed both the Senate and the House. SB1117 was also supported by the Greater Phoenix Chamber of Commerce, the National Federation of Independent Businesses (NFIB), the Commercial Real Estate Development Association (NAIOP), The Goldwater Institute, CenturyLink and the Homebuilders Association of Central Arizona.

Legislature Dilutes Constitutional Expenditure Limits

In the same week the Maricopa Community College District made the front page of *The Arizona Republic* for profligate spending on lavish benefits for executives, the Legislature passed SB1322 which immediately allows an estimated 25% increase in statewide community college district expenditure authority.

For the past two years, ATRA has urged the Legislature to bring accountability to community college student counts which were exaggerated to artificially inflate constitutional expenditure limits. The expenditure limits were approved by voters in 1980 and adjust for population (students) and inflation.

See Comm College Spending Limits, Page 6

INSIDE:

New Laws Local Governments Need to Know for FY 2017 Budget Year

During the 2015 session, legislators passed two important taxpayer measures: SB1066 (financial audits) & HB2538 (TNT; countywide special taxing districts).

SB1066 political subdivisions; financial audit reports (Pierce)

State statute requires all counties, community colleges, and cities to file their financial audits with the Auditor General (AG) on an annual basis, except for Arizona's towns that must file every two years. Prior to the passage of SB1066, the deadline to file financial audits was four months after the close of the fiscal year (six months for cities and towns), which could be granted an additional four months by the AG with extenuating circumstances. Even with the extension, many local jurisdictions failed to file their audits within the statutory deadline, and in some cases, had fallen several years behind. The lack of a penalty allowed jurisdictions to ignore their statutory responsibility without consequence.

In recognition that unusual circumstances can occur that prevent local governments from timely filing their financial audits, ATRA agreed to extend the filing deadline to nine months (cities and towns remain at six months). However, local jurisdictions that fail to file their financial audits in time must submit a form with their published budget stating that the financial statements have not been filed with the AG, the reasons for the delay, and the estimated date of completion. Additionally, the jurisdiction is required to submit a copy of the form to the AG, Speaker of the House, and the Senate President. Similar to local government budgets, SB1066 requires all jurisdictions post their financial audits in a prominent location on their websites within seven days of filing for at least 60 months. In the instance where the financial audit has not been completed, the abovementioned form must be posted on the website in place of the financial audit until it is completed.

Requirements of SB1066 if behind on financial audit:

1. Submit form in budget & post on website in place of audit. Form contents:
   - Written disclosure that financial statements have not been filed
   - Reasons for the delay
   - Estimated date of completion

2. Submit copy to Auditor General, Speaker of the House, and Senate President

3. All financial audits or form (in lieu of audit until filed) must be posted in a prominent location on official website within seven days of filing for a minimum 60 months.

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At the time of this article, there are at least two counties that will likely be impacted by the new law for FY 2017. Gila County is three years behind; their last filed audit is for FY 2012. Apache County is two years behind. Of Arizona's twelve community college districts, Gila Provisional is disturbingly behind by six years. Based on a review of city websites, there may be up to eight behind on their financial audits.

HB2538 TNT; countywide special taxing districts (Mitchell)

The Truth in Taxation (TNT) law was originally enacted in 1996 and requires counties, community colleges, cities, towns, and school districts to hold a public hearing and provide public notice of the intent to increase primary property taxes over the previous year, exclusive of new construction.

In addition to the levy of primary property taxes to fund the operations of local government budgets, counties have the authority to levy secondary property taxes for countywide special taxing districts to fund library, flood control, public health services, and adult and juvenile jail facilities. Although these special taxing districts are created as their own legal separate taxing entity, the county board of supervisors (BOS) serves as the board of directors for each district. As such, the BOS sets the tax rates and levies for these districts, which have minimal limits, if any, on annual growth.

COUNTYWIDE SPECIAL TAXING DISTRICTS TNT REQUIREMENTS:

- Publish notice twice in newspaper of general circulation (outlined under 48-254) – First notice, 14-20 days before hearing; Second notice, 7-14 days before hearing or mail TNT notice to all registered voters at least 10-20 days before hearing
- Issue a press release containing the TNT notice
- Roll call vote to levy increased property taxes
- Failure to comply: governing body may not levy above TNT limit

ATRA argued during the 2015 legislative session that since the BOS must adhere to the TNT requirements when increasing county primary property taxes, it only made sense that the other tax levies in their control should also be subject to TNT. Additionally, the lack of TNT requirements against countywide special taxing districts incentivizes counties to syphon revenues from the districts to their general fund.

Beginning in FY 2017, counties proposing to increase the taxes of their special taxing districts for library, flood control, public health services, and jails must adhere to the TNT requirements. This important disclosure will make taxpayers aware of tax increases in a timely manner so that they may choose to engage in the public process.

-Jennifer Stielow

Prospects for K-12 Finance Overhaul Dim as Deseg/OCR Fix Stalls

After 30 years of paying for Desegregation taxes in both Phoenix Union and Isaac Elementary school districts, local businessman Meyer Turken is finally off the hook. But it's not because policymakers had the courage to end this abusive tax. At 74 years young, Turken recently sold his business to retire out of state. It wasn't easy; it took him more than a year to find buyers for his commercial properties which are unlucky enough to offer some of the highest property taxes in the state as a result of Deseg/Office of Civil Rights (OCR) tax levies.

The combined property tax rates for K-12 schools for Turken (Isaac Elementary/Phoenix Union) for FY2016 was $15.44 per $100 of assessed value, more than double the statewide average. Consider his competition just down the street in Fowler Elementary/Tolleson Union which had a combined rate nearly half of Turken's at $8.05. Neither of those school districts have Deseg/OCR levies.

It shouldn't surprise policymakers to witness new businesses locating in areas outside the Phoenix core despite the increased popularity of urban living and revitalization in Phoenix. The combined property tax rates in areas such as Scottsdale, Gilbert and Peoria are typically half that of central Phoenix and Tucson. Barring a property tax abatement deal, it is rare to see a substantial business which could locate anywhere choose one of these areas.

In the last decade alone, Turken's business paid $711,260 in Deseg/OCR taxes. This is on top of the several million dollars he paid for general fund expenditures and bonds and overrides.

Policymakers aware of Arizona's K-12 finance equity struggles are quick to concur that Deseg/OCR is a problem in need of reform. But sympathy for the taxpayer is lost in the discussion. It is not lost on the taxpayers in those communities.

Tired excuses were exhausted during the 2016 legislative session as benefitting school districts suggested Deseg/OCR monies could not be phased out without causing financial devastation and legal battles. SB1125 and HB2401 would have phased out Deseg levies over 10 years and OCR levies over five years. The bills passed House Ways & Means and Senate Finance respectively but lacked the votes to pass the floor. Recipient school districts and K-12 advocates quietly suggested districts are hoping to reduce their reliance on this "black eye" levy which suggests a district continues to remediate their federal civil rights violations. However, their budgets continue to demonstrate they will not levy one dollar fewer than statutorily allowed.

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The message is clear: benefitting school districts will not willingly complete their remediation of their alleged civil rights abuses, most of which occurred decades ago. The loophole is viewed as a permanent budget bonus that cannot be retracted. Oddly, the 200 other Arizona school districts remain disappointingly silent on the issue.

The debate on SB1125 and HB2401 certainly underscores the difficulty of reforming Arizona's school finance system. For years, K-12 district and charter advocates and taxpayers have all expressed concerns about aspects of the current funding structure. No one argues that the current system- designed in 1980 to fund school districts, makes any sense for today's robust school choice model where parents and students can access the public school of their choice. Not surprisingly, Governor Ducey took the step of creating the Classrooms First Initiative Council to develop recommendations to reform the school finance system.

However, the debate on phasing out Deseg/OCR has cast a pall over the prospects of achieving financial equity for schools and taxpayers via a system overhaul. Despite the lack of any serious policy justification for this major budget loophole benefiting only 18 districts, the opposition to its elimination actually extends beyond those 18 districts. The Arizona School Boards Association (ASBA) for example, that also represents the other 200 districts that don't receive this benefit, actually opposed the phase out.

Regrettably, the K-12 lobby joined some unserious lawmakers in suggesting that equity in school finance could only be achieved by bringing all districts up to the highest level of the Deseg/OCR districts so there would be no phase out. This $2 billion idea highlights the K12 lobby's position that school finance reform should be accomplished solely on the backs of taxpayers.

-Sean McCarthy

Maricopa Community Colleges Pay Hourly Employees on an Honor System

The Arizona Auditor General FY 2015 audit on Maricopa Community College District's (MCCD) internal control and compliance revealed several material weaknesses which have the effect of creating a reasonable possibility that district financial statements contain inaccuracies.

The most stunning finding relates to financial controls for the payment of hourly employees. Unbelievably, the district pays hourly employees based on an honor system. From the audit: "To help ensure that employees are paid in a timely manner, the District's payroll system automatically approves time sheets not approved by a supervisor in order for payroll to be processed. The District did not have other controls in place to require supervisors to review and approve time sheets after they had been automatically approved." The district paid over $36 million to hourly employees last year.

> "…the District's payroll system automatically approves time sheets not approved by a supervisor…"

The district agreed with the finding but justified it by saying they are "…reluctant to penalize hourly employees for lack of supervisory compliance," meaning they don't trust supervisors to efficiently approve time sheets in time to make payroll. The district partially rationalized this lack of control by insisting "there are many budget checks of expenses throughout the fiscal year and any material deviations from budgeted wages or large variances from prior year's actual expenses would be noted and investigated."

The audit revealed several deficiencies in IT security controls which were previously identified to the district. The district has responded with several changes to its IT departmental structure including several new hires directed to oversee IT security as well as increased training for all employees related to cyber and data security.

It was a rough couple of weeks for MCCD. The district made the front page of *The Arizona Republic* when Craig Harris uncovered expensive perks for high-level administrators http://azc.cc/1Rfko8u. District executives receive handsome compensation packages that include vehicle allowances, spending allowances, and wellness packages ranging from the hundreds to tens of thousands per year. In most instances, receipts were not required to show how the money was spent but there were receipts to show executives were compensated for expensive massages at local resorts.

While staff justified the packages as necessary for the district to compete for quality executives, several Board Members inferred staff kept them in the dark about the design of compensation packages and expressed shock at the profligate spending. Harris' reporting indicated many of the benefit packages had substantially increased in just the last several years, meaning they were not a historical norm.

In the June 2014 ATRA newsletter, an analysis of the *National Education Association* faculty pay statistics shows Arizona's Two-Year College Full-Time Faculty average salary ranks second in the nation when adjusted for per-capita income. ATRA analysis over the years has shown Arizona's community college staff to generally be very well compensated. The extent to which the public maintains its trust for publicly supported colleges depends on those jurisdictions keeping compensation packages within reasonable terms. The taxpayers of Arizona certainly expect complete transparency in compensation packages as well as tight controls on expenditures to avoid fraud.

-Sean McCarthy

COMM COLLEGE SPENDING LIMITS, *Continued from Page 1*

Unfortunately, the community colleges would only agree to use more accurate student counts if they could also change the way they are calculated to statutorily justify and maintain past exaggerations. SB1322 arbitrarily weights any career and technical education (CTE) program by 30%. Increased spending will certainly be used to justify future local tax increases.

ATRA was successful in convincing many House Republicans to oppose the bill but it ultimately passed 39-18 with several Republicans and all House Democrats voting aye. ATRA and other opposed groups such as The Goldwater Institute requested Governor Ducey veto the bill.

The crux of the debate centered on whether the constitutional expenditure limits can be significantly increased with formulaic changes without voter approval. ATRA believes the law calls for voter approval on such actions, similar to municipal "Home Rule" elections. College lobbyists relied on a curious legal interpretation whereby the State Legislature can alter these voter approved constitutional measures at will to the effect of creating substantial expenditure capacity.

During the interim, ATRA suggested allowing community colleges the ability to ask their district voters for a permanent change to the 1980 base spending limit, similar to what counties and municipalities may do. This was included in the bill but colleges made it clear they are uninterested in going to the voters to ask for relief, which is why they needed the 30% CTE weights. One lawmaker testified: "We were careful to avoid any provision where we'd have to go back to the voters… The intent was to provide relief to the colleges so they could spend more of their own money."

The precedent created is any jurisdiction seeking relief can simply change their population factor formula and avoid the unpleasantness of a public debate with taxpayers on spending. One cosponsor of the bill publicly suggested it would be too difficult to secure a voter-approved expenditure limit increase and that their being an elected official sufficed to determine the will of the voters. College presidents agreed; they testified that elections are expensive and unlikely to be successful.

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One lawmaker justified their support by undermining the relevancy of a constitutional provision as old as 35 years: "I was eight years old when [these] passed." They argued further: "I'm struggling to find a philosophical reason why the taxpayer needs to be protected from how much the community college spends." One college lobbyist testified: "The spending limits are an archaic measure that has [sic] no practical role but they are in the Constitution so we encourage you… to provide some relief" and that the limits "were a political afterthought… and are outdated."

The bill also provides a special bailout at the request of Pima College to allow a ten-year average for student count estimations for the next three years (in session law). The message was the worst offenders of the law will be provided a generous parachute.

If the original intent of the expenditure limits was to create a strain between taxing and spending, that effort has been significantly neutralized for community colleges. One college president testified that with this legislation: "We are all lifted out of our expenditure limit problem." The question remains: was it the voter's intent for the Legislature to be able to cure all expenditure limit "problems" with a statutory change to a constitutional provision.

-Sean McCarthy