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Pennsylvania Local Government Units – Revenues

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Presented before the Pennsylvania Institute of Certified Public Accountants' First Statewide Conference on Auditing and Accounting for Governmental Units in Pennsylvania, Harrisburg — May 1969

MY TOPIC for today covers an area that overlaps some of the topics that have already been discussed, and some of the topics which will be discussed later in this conference. I have attempted to avoid encroaching upon the subjects being presented by other speakers. Thus, the important revenue areas of earned income taxes, the second largest tax revenue source to Pennsylvania municipalities, and of authority income receive only slight attention from me. They will be covered, later in the conference, in substantial detail. Similarly, in my comments as to audit procedures, I have not dwelled upon Code requirements, details of internal control evaluations, federal programs and statistical sampling. These topics, too, have been covered, or will be covered, by other speakers.

While reference is made to county government revenues in the over-all context, my talk is not particularly concerned with them, since counties are complex enough to require a conference unto themselves. For this reason they were not included in the program of this conference. My remarks do not cover the city of Philadelphia. Its unique position would require far more time than I have been allotted.

Each participant at this conference has received a copy of the volume "Governmental Accounting, Auditing, and Financial Reporting." Chapter 14, "Auditing of Governmental Units," presents an excellent analysis of municipal revenue, general audit procedures, and a comprehensive audit check list. My remarks on revenues attempt to supplement this general program with specifics as they relate to Pennsylvania municipalities.

Distribution has also been made of the audit programs prepared by the PICPA Committee on Local Government Auditing and Accounting for:

Second, Third and Fourth Class School Districts
Pennsylvania Municipal Authorities
and
Earned Income Tax Collectors

These programs are excellent for use by practitioners with limited exposure to governmental audits. Here, again, with respect to revenues, my talk is intended to supplement the information you have already received.

REVENUE SOURCES

Pennsylvania local government units derive revenue of many kinds from a variety of sources. These sources include tax levies on inhabitants and on property within the unit's jurisdiction, aid from higher governmental entities, special assessments, business and professional licenses, fees, permits, fines, forfeitures, interest, rents, departmental earnings, utility revenues, tuition, cafeteria operations and student activities. In addition, they derive receipts from many "non-revenue" sources, which require much the same auditing attention as do revenues. These sources include temporary and long-term loans, sales of assets, refunds, receipts related to joint operations with similar entities, and interfund transfers.

INTERNAL CONTROL

Wide differences frequently exist in the degree of control exercised over these various types and sources of revenues and receipts. In some instances, legal requirements provide highly effective safeguards through established procedures having built-in controls. In other instances, legal requirements are vague and their administration lax.

Because of the wide variety of revenue sources and the differences in control procedures exercised, it is normally not practical to utilize a composite evaluation of internal control to establish necessary testing procedures.

The degree of internal control existing for each type of revenue should be evaluated separately and audit tests should be formulated for each individual revenue source on the basis of such evaluation.

**THE PUBLIC EMPHASIS ON
SAFEGUARDING OF PUBLIC FUNDS**

It should be noted that, generally, a significant portion of the reve-

nues of a governmental unit is recorded only as received. In this respect, it is expected that the auditor, through inquiry, investigation, and familiarity with the functions of the governmental unit will determine the various sources of revenue that the unit is accountable for, and then apply appropriate auditing procedures to satisfy himself concerning the proper recording of such revenues.

The public emphasis on propriety of transactions suggests that the auditor should include each collection point in his revenue verification program—justices of the peace, inspectors, police, recreation personnel, school activity fund officials, cafeterias, etc. He should not limit himself to the over-all records of the secretary, treasurer and tax collector.

TAXES

Real estate taxes are the largest source of revenue to most local government units, but other taxes are not unimportant. Act 511, the most recent version of the Pennsylvania "tax anything" law, enables local government entities, other than counties, to raise revenue from taxes on such diverse items as earned income, mercantile transactions, real estate transfers, trailers, amusements, mechanical devices, and persons. Under other acts, taxes can also be levied on occupations, on a per capita basis, and on personal property.

TAX LEVY RESTRICTIONS

Although the levying of taxes is the province of the local governing body, such taxes can only be levied within the limits set by the Constitution and State law. The auditor should always determine that the tax levy is within the limits established by law.

Each type and class of local government entity is subject to different maximum rates on the real estate and occupational taxes it may levy. There are sometimes vagaries connected with the basis of levy. As an example, second and third class cities may levy separate and different rates of tax on land and buildings, with higher rates allowed on land. Cities, boroughs, and townships are restricted to a maximum tax rate for general purposes but, within their groupings and within other restrictions, they can institute special levies for such diverse purposes as employee benefits, recreation, shade trees, libraries, permanent street improvements, street lighting, utility service installations, fire houses

and apparatus, jails, and municipal buildings. School districts, while subject to a maximum levy restriction on real estate taxes for general purposes, may levy additional taxes to pay the full amount of State mandated minimum salaries and increments of their teaching and supervisory staffs and to pay school-building rentals.

All local taxing entities can either levy an unlimited millage for debt service or have recourse to the courts for authorization of a levy sufficient to liquidate such indebtedness.

ACT 511 TAX LEVY RESTRICTIONS

The taxes allowed under the Local Tax Enabling Act of 1965 are also subject to limitations. These limits range from maximum rates for particular levies to sharing provisions covering taxes levied by overlapping local units, and also include specific exemptions from taxation and an over-all limitation. The individual levy limitations are too diverse to mention here. The over-all limitation provides that the aggregate amounts of all Act 511 taxes imposed by any local unit may not exceed an amount equal to the product obtained by multiplying the latest total market valuation on real estate in the local unit by twelve mills.

THE TAX COLLECTOR

The tax collector in most instances functions much as an independent contractor in relation to the local taxing entity. His office staff and expenses are paid from his personal funds. His hours, except for third-class cities, need only conform to a state-mandated minimum of at least three days of each week during the last two weeks during the periods in which discounts are allowed. He designates the location of his office and establishes his own accounting system within minimal state requirements. Although every tax collector must be bonded, the provisions concerning the type and amount of bond vary with each taxing district.

In most instances, the tax collector concurrently collects taxes for at least three taxing entities—the municipality, school district, and county. Since legal requirements for the accounting for collections, other than with respect to turnovers and final settlements, are minimal, he sometimes commingles all collections with his personal finances.

The tax collector's internal control procedures are often poor. He collects different types of taxes for different entities, frequently including

self-assessed and delinquent taxes, and the possibility of error or fraud is great. Because the tax collector serves several entities, seldom does one auditor cover all his accounts.

In performing audit tests the auditor should always work with the tax collector and the latter's records. Too frequently, particularly in reorganized school districts served by several collectors, there is a tendency to check only the reports and settlements on file with the taxing entity as to levy, turnovers, and liens filed or taxes remaining outstanding. These procedures will not disclose tax office operational weaknesses, lapping of collections between taxing entities, or between old and new tax duplicates, posting errors, etc. The Codes, in every instance, require an audit of the accounts of the tax collector, and further require that the collector appear before the auditors when directed to do so, to assist them in their work of auditing his accounts.

CURRENT PROPERTY AND OCCUPATIONAL TAXES

In Pennsylvania, the assessment of real estate and occupations for local tax purposes is generally the function of the county. An exception to this custom may be found in cities, which have the option to use either county valuations or those arrived at by their appointed assessors.

The auditor should confirm with the appropriate assessment body, normally the county board of assessment and revision of taxes, the total of original taxable assessments, the details of corrections and adjustments to original assessed valuations taxable, and the details of interim assessments.

After the total charge to the tax collector for the current tax levy has been established by multiplication of adjusted assessed valuations taxable by the tax rate, the auditor should then apply the necessary tests to satisfy himself of the propriety of the tax collector's settlements.

These tests should include procedures relative to substantiation of:

- Exonerations claimed to have been granted by the governing body on occupational taxes for mistakes, indigent persons, deaths, etc.
- Turnovers to the taxing entity within the time period specified by law; state law requires turnovers once monthly, by the tenth day of the month following collection, but the local unit may enact legislation to require more frequent turnovers.

- Treatment of discounts by the tax collector—Taxpayers who pay the full amount of their tax within two months of the date of the tax notice receive a 2% discount.

- Treatment of penalties by the Tax Collector—Taxpayers who fail to pay the full amount of their tax within four months of the date of the tax notice are subject a 5% penalty.

Unpaid taxes receivable should be confirmed on a test basis. The auditor should generally confirm paid taxes on a test basis to substantiate the propriety of recorded payments and turnover dates.

DELINQUENT PROPERTY TAXES

The tax collector normally returns unpaid real estate taxes to the county commissioners, or the taxing district returns them to the county tax claim bureau in the year following the year of levy. The county then assumes responsibility for collection, with interest from the date it assumes such responsibility. The county has the right ultimately to sell the property for unpaid taxes or to confiscate any rents to satisfy such taxes.

The auditor should, when possible, confirm the detail of amounts returned to the county by the tax collector; the amounts remitted to the local unit by the county, being face value plus penalty and interest, minus the county's collection commission; and the amounts of delinquent taxes still held by the county for collection.

It should be noted that there is an alternate method of handling delinquent real estate taxes available to townships and boroughs. The delinquent taxes, instead of being returned to the county, may be individually filed as tax liens with the county prothonotary by the local solicitor. If this procedure is followed, the local solicitor must collect on the liens or force the sale of the property. This procedure is not too frequently encountered because of the costs incurred in the filings, collections, and forced sales.

Unfortunately, many local units in Pennsylvania seem to feel that once their local collector has been relieved of the responsibility for collecting real estate taxes, they need no longer be concerned. They rely completely upon the county and maintain no records of returned taxes. The auditor should always call attention to this situation when it is encountered.

CURRENT PER CAPITA TAXES

Per capita tax rolls are normally made up under the supervision of the taxing body. The charge to the tax collector—number of taxables multiplied by the rate of tax—is thus usually readily available to the auditor. The same types of audit tests utilized for current occupational taxes can be applied to current per capita taxes.

DELINQUENT OCCUPATIONAL AND PER CAPITA TAXES

Delinquent occupational and per capita taxes are sometimes turned over to professional collection agencies, who use wage attachments and distress sales to enforce collection. In those municipalities that do not utilize professional collectors, sizable uncollectible amounts frequently appear on the books. Because of the tendency to concentrate on current taxes, control procedures over delinquent taxes are frequently lax. It behooves the auditor to look closely at the procedures being followed in the entity with which he is concerned and to extend his tests on prior-year delinquencies if such action seems warranted by the practices in use, particularly if the amount is material in comparison with total revenues or receivables.

SELF-ASSESSED TAXES

Controls over self-assessed taxes, other than the earned-income tax, are frequently poor. The local entity too often takes the avenue of accepting that which is received and ignoring possible additional revenues because of legal costs, poor public relations, or for other reasons. The taxes under discussion include levies on real estate transfers, amusements, mercantile transactions, and mechanical devices.

The auditor should tailor his audit program to the existing situation. When he encounters inherent weaknesses or inequities in the revenue collection system, he is provided with an excellent opportunity to render a constructive service to the client by calling attention to such deficiencies either in his report or in a separate letter. It should be noted that in self-assessed tax situations, where mere acceptance is the rule, the possibility of irregularities on the part of the collector is as great as the possibility of nonfiling by those subject to taxation.

LICENSES AND PERMITS

In the licensing area, controls are sometimes good but often poor. The same person is often responsible for issuing licenses and permits, determining the appropriate fee, and collecting such fees. Internal control frequently does not exist.

The auditor should, on a test basis, research each class of licenses or permits, starting with the appropriate ordinance and continuing through the data on which the license or permit is based to the actual issuance and fee collection. Prenumbered accountable forms should always be recommended if they are not already in use. It should be noted that outside influences, such as building starts, new businesses, etc., often fluctuate from year to year. Thus the normal verification procedure of comparing collections from year to year and investigating significant variations must be supplemented by appropriate inquiries. Otherwise, in a busy year, the official concerned may be tempted to "become a partner."

In the auditing of licenses and permits, an over-all tie-in concept should be used. Items selected for test should be tied into all facets of the governmental operation. Thus, plumbing permits should be compared with sewer rent records if a per-fixtute sewer rent charge is being made; building permits should be compared with interim tax duplicate changes; occupancy permits with real estate transfer tax receipts; vendors' licenses with mercantile tax returns, etc.

SPECIAL ASSESSMENTS

A special assessment is a charge made against a property to pay all or part of the cost of improvements made by the municipality. The improvement is a benefit to the property, and its cost is therefore borne by the property owner rather than by the general citizenry.

Three types of special assessments are normally levied in Pennsylvania:

- Front footage assessments levied for improvements such as curbing and paving of streets or construction of sewers and the like.
- Assessments by court-appointed viewers who determine how much a property has been benefited by a particular action or project. This procedure is used in eminent domain cases in which land has been condemned for public purposes, but the property owner has derived a net benefit.

- Actual cost assessments for work done by the local unit, as in sidewalk construction or in planting of shade trees.

Special assessments, if unpaid within a specified time limit, frequently thirty days, from the date of billing are usually liened with the county prothonotary. After a lien has been filed, interest is charged from the date of completion of the project. Municipal liens remain in force for five years, after which they must be revived. The lien must ultimately be satisfied or the property may be put up for sheriff's sale.

The auditor, in addition to normal audit procedures with respect to assessment transactions, should satisfy himself that all assessable projects completed have been billed. This would normally be done by reviewing assessment intent ordinances enacted in the year under audit and in prior years. Further, in addition to his normal confirmation of unpaid items, he should confirm, with the solicitor, that proper liens are in force for such unpaid items.

FINES AND FORFEITURES

Most authoritative literature relative to auditing court transactions refers to examining the dockets of the court. All too frequently in the Pennsylvania minor judiciary system, formal dockets are not maintained. Also, local police tickets are not uniform and leave much to be desired in the form of audit trails. Here again, because of the lack of uniformity of records and procedures between municipalities, the auditor is best guided by his training and experience. Weaknesses should be formally revealed in an official report to the governing body.

The auditor should devote careful attention to minimum and maximum fines prescribed by the Motor Vehicle Code or by local ordinance, to allocations of fines to recipient entities, and to the basic violations data. Data changes, numerous dismissals, or levies of "costs" only, and sizable unresolved case backlogs should be suspect until satisfactory conclusions are reached.

OTHER REVENUES

The other revenues received by local government units are somewhat similar to those with which most auditors are familiar or are such that regular audit programs, with minor adjustments based on the particular circumstances, can be readily utilized. Items such as grants and gifts

are readily subject to outside confirmation and supported by applications, transmittal letters, and computation formulas. Audit procedures required for interest, rents, utility operations, etc., are much the same as they would be in the audit of a business concern.

The auditor should, however, keep in mind the fact that governmental entities, lacking a profit motive, do not always devote their best talents to revenue procurement. Many sources of readily available revenue are frequently untapped because they have not been researched. Here, too, the auditor can render a constructive service by qualifying himself to advise his governmental client on available federal and state-aid programs and on practices and procedures that will enhance revenues from such run-of-the-mill items as investment income. He is frequently in a position to point out available revenues that will far exceed the fee for his auditing services.

SCHOOL DISTRICTS

The bulk of school district revenues comes from real estate taxes and from federal and state aid. These prime revenue sources should, of course, be fully audited in the manner previously discussed. As noted earlier, the auditor can be helpful if he is familiar with his client's operations and able to point out possible "aid" programs that are not being utilized. His recommendations with respect to "aid" applications, reimbursement requests, etc., should be designed to determine both whether funds applied for were received and whether grants that could properly have been applied for were, in fact, requested. By the same token, he must ascertain whether the reimbursement requests and formulas utilized are, in fact, appropriate in the circumstances.

In school audits, all too frequently, the activities and cafeteria-fund operations are given short shrift. These segments of the audit are time-consuming and difficult to a degree far in excess of their materiality in relation to the financial statements of the entity as a whole. Nonetheless, they are important. The school board has the responsibility of control over activities funds and the parents of school children, who are constantly being "nickel and dimed" for activities purposes, tend to become properly enraged with "coffee can" accounting procedures. Central control, businesslike procedures, proper reconciliations, etc., are a "must" recommendation where they do not exist.

School cafeterias, even with the various aid programs of lunch and milk subsidies, free government food, etc., tend to be losing operations. When the direct and indirect district subsidies are taken into account, their losses, in relation to volume, are frequently staggering.

Because of this "loss orientation," expenditures to improve control over revenues are not often considered feasible. Yet control over (1) portions prepared as compared to sales, (2) moneys received and physical security of such receipts, and (3) proper costing for charges to school activities functions, etc., could often do much to reduce operational losses.

In the activities, cafeteria, and special-fund revenue areas of school districts, the auditor again has an opportunity for special service in connection with accounting for recorded receipts; namely, to study the operation and formally to advise his client of the control areas that could readily be improved.

CONCLUSION

In conclusion, I wish to emphasize the frequent need in the revenue area for formal constructive service comments by the auditor to his governmental client. Legal stipulations in Pennsylvania are such that controls over expenditures are normally good to excellent. The public, too, is oriented to question government expenditures. The taxpayer equates his tax bill to governmental expenditures only. Proper controls over revenues are fully as important to net operational results. The budget must be balanced. It is not enough to ascertain that recorded receipts were fully accounted for. The audit programs should be designed to permit the auditor to satisfy himself generally that all money that should have been received was actually received and accounted for. If basic weaknesses in the system of internal control make this determination impracticable, then the auditor is presented with one more opportunity to render constructive service recommendations to his client to remedy such weaknesses.

In the field of governmental audits and other services to governmental units by CPAs in Pennsylvania, the surface is just being scratched. If we meet the challenge competently, enthusiastically, and with a full-service outlook, the effect will be beneficial both to our profession and to our fellow citizenry.