The Illinois Government Finance LEADER

The Newsletter of the Illinois Government Finance Officers Association • Spring 2004

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Illinois Government Finance Leader is the membership publication of the Illinois Government Finance Officers Association, suite 202 One S. Cass Avenue, Westmont, IL 60559

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GASB Statement Number 40, *Deposits and Investment Risk Disclosures*

By James R. Savio, CPA, Sikich Gardner & Co, LLP

The Governmental Accounting Standards Board (GASB) issued Statement Number 40, *Deposits and Investment Risk Disclosures* in March of 2003, which amends Statement Number 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*. This statement modifies disclosures for credit risk, including custodial credit risk, and also adds disclosure requirements for concentrations of credit risk, interest rate risk and foreign currency risk, which were not addressed in Statement No. 3. These expanded disclosure requirements thus offer a more complete picture of the various risks that investments of state and local governments are exposed to. This statement is effective for financial statements for periods beginning after June 15, 2004 (i.e., fiscal years ending June 30, 2005 and thereafter) and is applicable for all state and local governments. Early application is encouraged.

General disclosures

Statement No. 40 first addresses general disclosure principles, including the level of detail of disclosures and deposit and investment policies. As a general rule, disclosures should be organized by investment type (i.e. U.S. Treasury securities, U.S. Agency securities, corporate bonds, etc.) Although the statement specifically states that dissimilar assets, such as U.S. Treasury bills and U.S. Treasury strips, should not be combined into one investment type, it does not define investment type, so professional judgment should be used when categorizing investments.

Disclosures should generally be made for the primary government, including its blended component units. This is usually sufficient if the government uses an internal investment pool. If an internal investment pool is not used and one or more funds hold investments of one issuer that represents five percent or more of total investments of that fund it may be necessary to make disclosures at the governmental and business-type activities, individual major funds, nonmajor funds in the aggregate, or fiduciary fund types level. This requirement would be most applicable for police and fire pension plans or other single employer pension plans that are reported as part of the primary government as fiduciary funds.

Governments should also disclose their deposit and investment policies related to the various risks required to be disclosed by Statement No. 40. If no policy is adopted related to these risks, then that fact should be disclosed. Since Illinois Compiled Statutes (ILCS) require investment policies for almost all units of government in Illinois and their component units, failure to have an investment policy in place could require disclosure of a violation of finance related legal provisions.

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GASB issues statement on asset impairment and insurance recoveries

The Governmental Accounting Standards Board (GASB) has published STATEMENT NO. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. It requires governments to report the effects of capital asset impairment in their financial statements when it occurs. The guidance also enhances comparability of financial statements by requiring all governments to account for insurance recoveries in the same manner.

In reflecting on the impact of STATEMENT 42, GASB Project Manager Roberta E. Reese stated, "Because capital assets are long-lived, they are exposed to various risks, including the risk of diminished service utility that is caused by unexpected events or circumstances. This statement will ensure that government financial statements report this loss of service utility when it occurs, rather than over the remaining useful life of the capital asset."

The statement requires governments to evaluate major events affecting capital assets to determine whether they are impaired. Those events include physical damage, changes in legal or environmental factors, technological changes or obsolescence, changes in manner or duration of use and construction stoppage.

Impairment will be measured using methods that are designed to isolate the cost of the capital asset's service capacity that has been rendered unusable by impairment.

The guidance includes several disclosure requirements that will assist users of financial statements in understanding the nature and impact of impairment of capital assets. Disclosures are required for impairment losses that are not evident from the face of the financial statements, for impaired capital assets that are idle and for insurance recoveries that are not evident from the face of the financial statements.

During the research and development of this statement, the GASB benefited from collaboration with the Public Sector Committee of the International Federation of Accountants as they also pursued development of standards for impairment of assets.

STATEMENT 42 is effective for fiscal years beginning after December 15, 2004. The statement may be ordered by telephoning the GASB Order Department at 800-748-0659.

Released by the Governmental Accounting Standards Board

IML explains ethics statute

The General Assembly and Governor Blagojevich agreed on several bills pertaining to ethics legislation during the fall veto session. The first bill, HB 3412 (as approved by the Legislature before adjourning last summer), was substantially rewritten by the Governor in his amendatory veto. That veto was considered in November during veto session and was overridden in both chambers and is now PUBLIC ACT 93-615 effective November 19, 2003. In addition to this action, during the veto session, the Legislature approved a new ethics package in SENATE BILL 702. The Governor has signed this legislation into law: PUBLIC ACT 93-617, effective December 9, 2003. Both bills contain language that is applicable to local governments.

HOUSE BILL 3412 contains many provisions concerning state officials and employees of the state. In HB 3412, local governments are covered by Section 70-5, which requires the adoption of an ordinance no less restrictive than Section 5-15 pertaining to prohibited political activities of employees during compensated time. The Attorney General's office is to draft model ordinances pursuant to SB 702 and HB 3412 three months after the effective date of SB 702. It then requires local governments to adopt ordinances six months after the effective date or three months after the Attorney General's office has completed its work. SENATE BILL 702 also rewrites the STATE GIFT BAN ACT in Article 10 and original Section 70-5 of HB 3412 is amended in SB 702 applying those requirements to local governments with the same Attorney General's provisions and same dates for ordinance passage.

The third provision in effect now pertaining to ethics is P.A. 92-853, which became effective on August 28, 2002. That bill changed the STATE GIFT BAN ACT to define $100 as the nominal value of gifts in a calendar year from a prohibited source (which is the same dollar amount as SB 702). In addition, P.A. 92-853 contains an amendment to the CRIMINAL CODE on solicitation misconduct by local government employees from a person engaged in a business or activity over which the person has regulatory authority.

The provisions in these new ethics bills must be reviewed carefully and certain actions must be taken by local governments to be in compliance.

From the Illinois Municipal League, http://www.iml.org

The Chicago Metro Chapter raised over $850—*plus oodles of toys*— for the Marine Corps' Toys for Tots at the December 2003 Holiday luncheon.

Shown with representatives of the DuPage County Marine Corps League are at left, Jeff Martynowicz, Chicago Metro's Second Vice President, and Jon Batek, Chicago Metro's President, third from left.

For information on Chapter meetings and events, visit www.igfoa.org.

Customer service is all about responding

Customer service is all about how one responds to malfunctions in the system. Take, for example, the following notice Village of Northbrook Payroll Clerk Barb Solvig included with paychecks in December 2003 when direct deposit went awry:

> **IMPORTANT**
>
> Due to system inaccuracies, we have not deposited your paycheck. Please note that this check must be taken to your bank and deposited.
>
> If this creates a hardship for you, please call me at centrex 5319. I will do everything possible to help.
>
> We examined every possible option to ensure a timely and accurate paycheck. We have made every effort to make sure funds are available and opted to issue checks instead of direct deposit so that funds are not delayed. if you encounter any problems, let me know.
>
> I apologize for any inconvenience and hope that you have a happy holiday season.
>
> Barb Solvig
> Payroll Clerk
> Finance Department

Making the case for a CAFR

Eric Dubrowski, Finance Director for the City of Galena, reports that the following one-minute synopsis was effective in convincing the City of Galena Council to authorize an audit contract including preparation of a CAFR:

"A comprehensive annual financial report (CAFR) is a form of fiscal reporting that is performed in the spirit of full disclosure of information. This information is a combination of financial statements, demographics and statistics. It is a way in which pre-existing data that is currently scattered across departments in City Hall can be centralized into a useful format. This information is not only a reference for the past fiscal year, but a historical guide over the last 10 years. This allows for elected officials and city staff to make more informed decisions by being aware of data from past years. It allows for a macro view of the city's finances and overall development as opposed to a micro level snapshot of the same data. This form of financial reporting is completed in a standardized format that follows the rules and recommendations set forth by the Government Finances Officer's Association.
A CAFR is a progressive approach to governmental financial reporting that allows a government unit to obtain a more in depth level of data collection and analysis when compared to a standard reconciliation of financial statements."

Save the date for the 2004 IGFOA Annual Conference!

Be sure to be in Moline September 27–29 for the latest in Illinois government finance!

Find the agenda, programs, registration & more at www.igfoa.org beginning May 1.

Beware of Treasury Circular 230—Muni bonds as tax shelters

To "regulate the practice of representatives of persons before the Department of the Treasury," the U.S. Treasury long ago issued rules of professional conduct governing the practice of attorneys, CPAs, actuaries and others before the Internal Revenue Service in TREASURY CIRCULAR 230. Those rules provide standards for giving "tax shelter opinions." CIRCULAR 230 specifically excluded municipal bonds from its provisions. On December 30, 2003, proposed amendments to CIRCULAR 230 were issued in the FEDERAL REGISTER containing a definition of "tax shelter" that did not exclude municipal bonds. In its current form, the proposed changes to CIRCULAR 230 will take effect "on the date that final regulations are published in the Federal Register." No one can accurately predict that date.

This memorandum will briefly discuss how the changes in CIRCULAR 230 will likely affect opinions of bond counsel from the perspective of issuers and underwriters if adopted in its current form as well as some short-term and long-term consequences of its application to municipal bonds.

It should be no surprise that the municipal bond industry has objected to the new rules. In any case, the Treasury has been asked to change the effective date from date of publication of the new rules to some reasonable time after that so that the market can react in a rational way to its adoption.

Changes in bond opinions as a result of Circular 230

1. The opinion of bond counsel (and the portions of the official statement describing it) will be longer and more detailed. A tax shelter opinion must (a) identify and consider all relevant facts, (b) relate the applicable law to the relevant facts, and (c) provide an overall conclusion.
2. The opinion of bond counsel must contain certain disclosures. A tax shelter opinion must disclose that (a) it may not be sufficient for a taxpayer to use for the purpose of avoiding penalties under section 6662(d) of the INTERNAL REVENUE CODE and (b) taxpayers should seek advice from their own tax advisors.
3. The opinion of bond counsel must consider and discuss all "material federal tax issues." A "material federal tax issue" is defined as a "federal tax issue for which the Internal Revenue Service has a reasonable basis for a successful challenge and the resolution of which could have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstance, on the Federal tax treatment of a taxpayer's tax shelter item or items." An important issue is whether, in a particular fact situation in which bond counsel would previously have rendered the traditional unqualified opinion as to the tax-exempt status of the interest on the bonds, bond counsel will be able to conclude that the IRS has no "reasonable basis for a successful challenge."
4. If there are material federal tax issues discussed, bond counsel must state its conclusion as to the likelihood that "the taxpayer will prevail on the merits with respect to each material federal tax issue." The opinion must describe the reasons for its conclusion, including the facts and analysis supporting the conclusion. How the market will view an opinion that discusses material federal tax issues, even if an unqualified opinion is rendered (i.e. "interest on the bonds is exempt"), is anybody's guess.

Short-term issues

The immediate problem occurs when the new rules become effective after the pricing of a deal but before the closing. In the usual underwritten transaction, the form of bond counsel opinion (a typical unqualified opinion) is attached to or described in the official statement, and the bond purchase agreement provides that the delivery of that opinion is a condition to the underwriter's obligation to purchase the bonds. If the new rules become effective prior to closing, depending on the actual content of the new rules and how bond counsel answers some of the questions raised in this memorandum, bond counsel may have to revise its opinion. This could delay the closing. The underwriter would then need to determine whether the opinion has been changed in a material way so as to require the recirculation of the official statement (a "sticker") and potentially, a repricing of the bonds.

There have been some attempts to draft bond purchase agreements in such a way that the underwriter would be obligated to purchase the bonds even with a new form of opinion required by CIRCULAR 230 so long as bond counsel ultimately concludes that the bonds are tax exempt. This requires specific disclosure in the official statement. We believe that the better approach is the one described in the preceding paragraph which essentially permits the market to deal with the situation in the normal course.

Long-term issues

Issuers, underwriters, credit enhancers and other participants in the municipal market should inform themselves about CIRCULAR 230 in preparation for what may be significant changes. Increased complexity in transactions caused by the opinion and disclosure issues discussed above as well as certain other provisions of proposed CIRCULAR 230 is likely to result in higher transaction costs. Bond closings may be delayed if they occur on or near the effective date of final regulations. Practitioners are attempting to understand the difference in the standards and necessary procedures for giving the new style opinion, as compared with what was applicable in the past. No one expects that the new standards will be any less rigorous than the old standards.

Reprinted from Chapman and Cutler's *Public Finance Tax Update*, March 2004

Non-referendum bonds can be used to pay alternate bonds

by Heidi A. Katz, J.D. and Lynda K. Given, J.D.

Districts that use non-referendum general obligation bonds as a revenue source for servicing the debt on alternate bonds now have an appeals court decision they may use as a precedent to defend themselves against corporate taxpayers that file tax rate objections in such instances.

The Illinois Second District Appellate Court's ruling stems from the case of Commonwealth Edison Co. v. People ex rel. John H. Coffman, County Treasurer and ex officio County Collector of Ogle County.

In that case, Commonwealth Edison argued that the Byron Forest Preserve District improperly used general obligation bonds to pay the debt service on alternate bonds used to build an 18 hole golf course for Ogle County residents and other members of the public.

But the Ogle County Court and, just this spring, the Illinois Appellate Court, rejected ComEd's argument, saying that the Byron Forest Preserve acted within its authority as described in the Local Government Debt Reform Act (30 ILCS 350/1 et seq) and the Downstate Forest Preserve District Act (70 ILCS 805/13).

Visit http://www.lib.niu.edu/ipo/ip030914.html for the full text of the article, in which the authors review the facts of the case and theories advanced by Commonwealth Edison in objecting to the district's tax levies, set forth the appellate court's rationale for rejecting ComEd's argument, and discuss the decision's implications.

Author Heidi A. Katz of Robbins, Schwartz, Nicholas, Lifton & To/for, Ltd., and co-author Lynda K. Given's colleague David T.B. Audley of Chapman and Cutler, LLP, represented the Collector as Special Assistant State's Attorneys for Ogle County in the Coffman appeal.

Reprinted from *Illinois Parks and Recreation* magazine

Introducing SAS 99 New standard addresses fraud risk

by Don Rahn, CPA

A new auditing standard has been designed to increase the likelihood of finding unidentified material fraud. The new standard, SAS 99 (Statement on Auditing Standards) requires the auditor to identify and assess risks due to fraud which could result in materially misstated financial statements. This new standard is now in effect.

Auditors are guided by professional judgment and follow a national set of auditing rules known as "generally accepted auditing standards" (GAAS). No two governmental organizations are alike, and neither is the effort necessary to render an audit opinion on their financial statements. GAAS help provide consistency in the audit effort, which leads to more value for financial statement users. GAAS are contained in documents known as "Statements on Auditing Standards" (SAS), developed by the American Institute of Certified Public Accountants (AICPA).

The auditing standards state that the auditor is to obtain reasonable assurance that the financial statements are free of material misstatement. In the past, the standards did not distinguish between **errors** and **fraud** when considering this important goal. Now the auditor must specifically identify and assess risks due to fraud that may result in materially misstated financial statements. (The auditor does not have the same responsibility for errors or fraud which are not material to the financial statements.) Management is still responsible for establishing the appropriate controls to prevent, deter, and detect fraud.

SAS 99 outlines the following process to accomplish its objective:

1. Discuss, among the audit team, the client's risk of fraud in relation to the financial statements.
2. Obtain information needed to identify risks of material misstatement due to fraud.
3. Identify risks that may result in a material misstatement due to fraud.
4. Assess the identified risks after taking into account an evaluation of the organization's antifraud programs and controls.
5. Respond to the results of the assessment.
6. Evaluate audit evidence.
7. Communicate to management about possible fraud.

How does this impact your organization? As auditors, we still have the same responsibility for detection of material financial misstatement due to fraud. Now we will be more focused on how to do that, and are required to document the seven steps listed above. You will see this in the questions we ask. The audit team will bring a new level of professional skepticism to the audit. The new standard will benefit you and the public with financial statements that are more useful and accurate, with less risk of unidentified fraud occurring. But even a properly planned and completed audit may not detect a material fraud because deception and concealment are a natural part of any fraud. Auditing standards clearly state that it is management's responsibility to design and implement procedures and controls to prevent, deter, and detect fraud. The new standard should result in an improved audit, including an assessment of your antifraud controls, and reduce the risk of fraud within your organization.

Don Rahn is a partner with Virchow Krause. He can be reached at drahn@virchowkrause.com.

Seminar: SAS 99 Consideration of Fraud in Financial Reports

Thursday, April 29 9:30 – 11:30 am
Algonquin Village Hall

SAS 99 requires auditors to follow a more rigorous process to assess the risk of fraud. Beginning this year, auditors will conduct more in-depth inquiries and analysis of the entity's potential for fraud. Linda Abernethy, McGladrey & Pullen, LLP will review the types of fraud, auditors' responsibility to detect fraud, & implications for your upcoming audit. Presented by IGFOA and IMTA.

To register, visit www.igfoa.org/seminars.html or email info@igfoa.org.

Impact fees: A vote of confidence for economic growth?

by Joel R. Theis and Richard D. Giardina

An unpopular reaction is often the result any time a local government attempts to increase its funding of infrastructure by raising fees, taxes, etc. The implementation or increasing of impact fees is no different. However, while generally opposed by developers and homebuilders, impact fees are typically supported by current citizens. That is because impact fees shift the cost burden associated with new facilities to new residents. For this and other reasons, impact fees are a widely used infrastructure-funding source that has been opposed by developers as a deterrent to economic growth.

Growth brings to the community increased property and sales tax revenues, and jobs that further contribute to the demand for government-provided services. Although there are many who oppose impact fees under the premise that they limit or restrict growth and economic development, there is little empirical or quantitative evidence to support this conclusion. In fact, there is some evidence that impact fees can act as a precursor or impetus to growth, especially if implemented appropriately and with careful consideration of their application.

This article provides a summary of two relatively current research documents on the question of whether impact fees deter growth.

Impact fees and economic growth

A report by The Milken Institute[1] ranked the largest 200 cities and metropolitan areas based on economic growth. The report does not measure specific business costs or cost-of-living components. Instead, it focuses on outcomes such as job creation, wage and salary levels, and technology growth.

Each year, Milken's report lists factors that were associated with cities that had strong growth. These factors include: government employment, service-based industries, healthcare related services, and population-driven growth. One can deduce from this report the following: if an area has the resources and cultural amenities to meet the demands of new citizens, then businesses will locate in such areas provided their employment needs are met and key resources are available at a reasonable price.

One of the requisites for growth, therefore, is to understand what types of entities can best be supported by a location, and making the location attractive by providing the appropriate services.

In order to assess whether there may be a correlation between impact fees and growth, a comparison was made of impact fees in the top three highest and lowest ranked cities. The results of these comparisons are summarized in Table 1. Comparisons shown in Table 1 include fees for parks and recreation, water, sewer, roads, and schools.

In addition, a comparison was made of impact fees for the three cities that moved up in ranking the most, to the cities that moved down in ranking the most. Based on these results, there appears to be no clear correlation between high impact fees and low growth, or low impact fees and high growth. Furthermore, discerning which characteristics led to growth is not simple, as one might expect. The reader is referred to the Milken report for the detailed explanations that contribute to a community's growth.

The topic of whether impact fees impede growth has also recently been researched by the Brookings Institute[2] which found that rather than impede growth, impact fees may serve as a catalyst for growth, or at least do not deter growth. In their study, 67 counties in Florida were analyzed using a quantitative approach designed to assess the association of impact fees with job growth. The results indicate that there was no direct correlation there or implied cause-and-effect relationship.

Thus, there is little evidence that impact fees significantly influence an entity deciding on where to locate. The recent evidence uncovered for this article seems to support this conclusion, and is consistent with the Brookings Institute findings. Specifically, impact fees can send a message that a community is planning for and securing the financing of infrastructure to meet the demands of new development.

continued next page

Table 1: Residential Impact Fees

Category of Growth (1)	*Fees (2)*
Top Three in Growth	
Fayetteville, AK	$0
Las Vegas, NV	$9,043
Fort Meyers-Cape Coral, FL	$6,805-$10,523
Bottom Three in Growth	
Flint, MI	$0
Youngstown-Warren, OH	$0-$2,496
Gary, IN	$0
Three Most Improved	
Savannah, GA	$1,000
Des Moines, IA	$1,668
Newburgh, PA-NY	$0
Three Greatest Decline	
Santa Cruz-Watsonville, CA	$4,556-$31,099
Boston, MA	0
Portland-Vancouver, OR-WA	$5,748-$8,888

(1) As ranked in "Best Performing Cities: Where America's Jobs Are Created," The Milken Institute, July 2003.

(2) Fees for parks and recreation, water, sewer, roads, and schools as tabulated by RGA.

Table 2: Influential factors for choosing a locality

Business Environment	***Resources***	***Public Services***	***Governmental Policies and Regulation***
State and local taxes	Educational institutions	Parks and recreation	Business activity related regulations
Cost-of-living	Natural resources	Water and wastewater services	Growth and development policies
Competition/business Location	Financial resources	Public transportation	Environmental regulations
Geographic location	Police and fire protection	Zoning restrictions	
Workforce characteristics	Information technology services	Air, water, and land transportation access	Health services
Social, recreational, and cultural amenities		Electric power	

Where to locate

What factors do businesses consider when deciding where to locate? A review of the literature and various news media suggests that any number of factors could influence an entity's decision to choose a given area or city. Yet, no definitive surveys have been uncovered.

High priority characteristics of a relocation or expansion decision might focus on proximity to competitors and transportation, both of which may be a higher priority than the cost-of-living or one-time relocation costs. Some of the factors entities consider in choosing a location involve infrastructure and associated services such as those listed in Table 2. The factors influencing a relocation or expansion decision are often business specific. However, it is likely that any number of the factors listing in Table 2 would take higher priority than the impact fees that might be paid, but it is difficult to determine which ones, if any, consistently rank higher than the others.

In short, financial timing considerations and how businesses balance many objectives influence their decisions on where to locate. These considerations include the current economic environment and business activity.

Advantages of impact fees

One of the advantages of impact fees is the credibility and fairness aspect that can coincide with the process associated with developing impact fees. Fairness can be ascribed to impact fees by carefully identifying the facilities that growth will require, and calculating the fees from reasonable cost estimates so that those paying the fee receive "value" for the promised service (e.g., parks, roadways and utilities). In contrast, implementing sales taxes or property taxes to finance "growth-related" facilities, often shifts cost responsibility based on factors other than who the facilities were constructed for (i.e., property value or sale volume).

Credibility is gained with impact fees through a public approval process that relies on demonstrating how the costs of growth are determined. City councils and county boards can be shown through a properly conducted impact fee calculation who pays how much and why. Whereas, in the case of implementing a sales tax to pay for new facilities needed to meet growth, only general correlations can be made between who pays and who benefits from the facilities. As such, with impact fees there is a link between cost causation and revenue; links typically not found in sales and property taxes.

While it can be difficult as a public finance director to win favorability by marshaling an effort to obtain more revenue from those viewed as bringing "growth and prosperity" to the community (i.e., developers and homebuilders), there are clear advantages associated with impact fees. These include:

- Impact fees are a one-time payment, not a recurring payment like most taxes.
- Impact fees are often not noticeable to the end-user (in many instances the fee, in part or in whole, is paid by the land owner, developer or home builder), but when they are, they can have clear purposes and can be supported by a comprehensive impact fee study.
- Impact fees are targeted for specific projects, and are restricted to funding those projects from a separately managed fund.
- Considering the alternative sources of funding, there is less chance of biases and inequities if impact fees are used.

Conclusion

In summary, with careful planning, impact fees can provide the funding source to maintain service levels in a growing community. They represent an affordable one-time entrance fee into a highly desirable place in which to live and conduct business.

They can also be encouraging for certain types of entities in terms of providing a funding source for infrastructure. In this way, instead of being viewed as a deterrent to growth, impact fees may actually support growth.

Notes

1 "Best Performing Cities: Where America's Jobs Are Created," The Milken Institute, July 2003.

2 "Paying for Prosperity: Impact Fees and Job Growth," The Brookings Institute, Center On Urban and Metropolitan Policy, June 2003.

Joel R. Theis and Richard D. Giardina are with Rick Giardina & Associates, Inc.

Reprinted from Colorado GFOA *Footnotes*, December 2003

GASB 40

continued from front

Credit risk

Custodial

As noted previously, Statement No. 40 amends Statement No. 3 and was influenced by the federal bank reforms adopted since the release of Statement No. 3, including the Government Securities Act of 1986 and the repeal of the Glass-Steagall Act by the Financial Modernization Act of 1999. The following amendments are made to Statement No. 3.

Statement No.3 required deposits (and investments with modifications) to be categorized in the following categories of credit risk:

1. Insured or collateralized with securities held by the government or the government's agent in the government's name.
2. Uninsured, with collateral held by the pledging financial institution's trust department or agent in the government's name.
3. Uninsured, with collateral held by the pledging financial institution, but not in its trust department or by its agent, in the government's name.

   OR

   Uninsured, with collateral held by any of the above, but not in the government's name.

   OR

   Uninsured and uncollateralized.

Statement No. 40 essentially eliminates any distinction between Category 1 and Category 2 deposits and investments. During GASB's research, they noted no recent losses in investments and deposits in either of these two categories. As a result, exception based reporting is now used and only deposits and investments that fall under Category 3 are required to be disclosed, along with the reason why they are considered Category 3. If all of a government's deposits and investments fall under Category 1 or 2, then no disclosure of credit risk is necessary.

Statement No. 40 also eliminates the activity disclosure requirements of Statement No. 3. Under Statement No. 3, disclosures were required when custodial credit risk was greater during the year than at year end. These disclosures are no longer required, with the focus being put more on potential future losses, not on what has occurred in the past.

Finally, Statement No. 40 eliminates fair value disclosures, since book value in most instances equals fair value as a result of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.*

Credit quality ratings

Statement No. 40 now requires governments to disclose the credit quality ratings of investments in debt securities as described by a nationally recognized statistical rating organization (rating agencies) as of the date of the financial statements. Examples of acceptable rating agencies include Standard and Poor's, Moody's Investors Service and Fitch Ratings. Obligations of the U.S. Government and obligations **explicitly** guaranteed by the U.S. Government are excluded from this disclosure requirement. Obligations **implicitly** guaranteed by the U.S. Government must have their credit ratings disclosed. Credit ratings of external investment pools, money market funds, bond mutual funds and other pooled investments of fixed-income securities should be disclosed as well. If a credit quality rating for an investment is required but that investment has no rating, that fact should be disclosed.

Concentration of credit risk

Statement No. 40 now requires governments to disclose, by amount and issuer, investments in any one issuer that represents five percent or more of total investments based on the level of detail previously discussed in the "General Disclosures" section. As with Credit Quality Ratings, U.S. Government securities and securities explicitly guaranteed by the U.S. Government are exempt from this disclosure. Also exempt are mutual funds, external investment pools and other pooled investments which are, by nature, diversified.

Interest rate risk

Statement No. 40 now requires all governments to disclose the interest rate risk of debt securities by using one of the following methods.

Segmented time distribution

Under this method, investments are disclosed by type and fair value. Each investment type's fair value is then categorized by maturity date, with separate categories for less than 1 year, 1-5 years, 6-10 years, etc. This method will probably be the most used in practice.

Specific identification

Specific identification discloses each individual investment, its maturity date and fair value.

Weighted average maturity

Weighted average maturity discloses each investment type and fair value. A weighted average maturity in years or months is then calculated for each investment type. The calculation is based on dollar weighting the maturity of each investment within the investment type, thus giving more weight to larger investments. The dollar weighted maturities for each investment are then summed to arrive at a weighted average maturity for the investment type. The portfolio's overall weighted average maturity is then derived by dollar weighting the weighted average maturity for each investment type.

Duration

Duration is the measure of a debt securities' cash flows using present values, weighted for cash flows as a percentage of the investment's full price. Duration models are often included as part of an investment software package and are fairly complex. There are several duration models used in practice and Statement No. 40 does not recommend one model over another.

Simulation model

Simulation models analyze the changes in an investment's fair value

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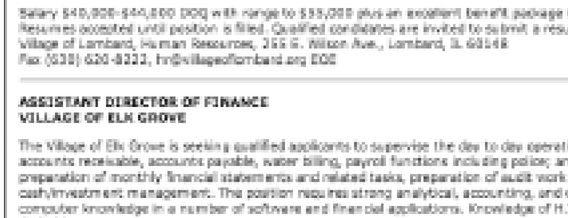

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Here are just two examples of the hundreds of pages of information available to you at www.igfoa.org.

Shown above is the Jobline page, where current and archived detailed job listings are available.

Shown at right is the Legislative Committee's page, complete with alerts, descriptions of current legislation and links to the full text of the bills.

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GASB 40

continued

based on hypothetical fluctuations in interest rates. Statement No. 40 does not recommend one model or technique over another. Normally, a portfolio's fair value would be disclosed at year end and the fair value would be adjusted for each change in basis points (100 points, 200 points, etc.).

Statement No. 40 recommends that governments use whichever of the five methods above they use in practice. Once a method is selected, all assumptions made regarding that method should be disclosed (e.g., call dates, interest rate changes, etc.). Also, if any investment terms are not addressed in the method selected, they should be disclosed (e.g., benchmark indexes, reset dates, embedded options).

Foreign currency risk

Statement No. 40 requires the disclosure of U.S. dollar balances of deposits and investments that are exposed to foreign currency risk. These disclosures should be organized by currency denomination and investment type, if necessary. Disclosures should also include maturity dates and fair value.

Sample disclosures

Appendix C of Statement No. 40 contains numerous sample note disclosures for both deposits with financial institutions and investments. Furthermore, the appendix provides illustrative disclosures using each of the five methods for disclosing interest rate risk.

Potential issues

Governments that manage, track and account for their own investment portfolios will find that the disclosures that are required by Statement No. 40 can be readily prepared and perhaps even incorporated into the regular reporting of investment balances to the governing board. Governments that rely on entities outside the government for these services, or with single employer pension plans, may find that additional information will be required that may not be readily available or that additional fees may be required to prepare the additional information for disclosure. Accordingly, the disclosure requirements of Statement No. 40 should be communicated to the outside entities and pension funds as soon as possible to ensure that the requirements will be met on a timely basis.

James R. Savio, CPA is a manager with Sikich Gardner & Co, LLP based in Aurora, Illinois. Over the last ten years, Jim has devoted most of his professional career to working with state and local governments on a variety of accounting, auditing and financial reporting issues.

Demystifying the taxing world of tax objections, assessment complaints and tax appeals

by Keri-Lyn Krafthefer

With all the limitations public entities have on increasing their revenues, they are often distressed to find that the amounts they receive from the county for their levies have been further reduced by settlements for tax objection claims or from tax assessment reductions. For many governmental bodies, property taxes represent the largest single source of revenue. Understanding how assessment complaints, objections and appeals differ and how each should be handled is key to avoid reductions in tax revenues.

Challenging the tax levy

Generally, property owners fight property taxes in two ways: by challenging the validity of the tax levy or by challenging their property's valuation. When a taxpayer challenges the legal or procedural aspect of a tax levy, he or she objects to the manner in which the taxing district exercised its tax levy power. Such objections may include allegations that the levy was not authorized by statute, that the entity did not properly follow the procedure for levying the tax or exceeded the statutory levy limits, that the purpose for the levy was not specifically stated in the levying ordinance, or that the entity failed to comply with Illinois Truth in Taxation Law. This type of taxpayer complaint is referred to as a tax objection or a rate objection.

A taxpayer initiates a tax objection by filing a formal complaint in the circuit court. The complaint names the county collector as a defendant, specifies the tax year at issue, and lists all of the objections against each taxing district that has levied on the objector's property. While the state's attorney will appear on behalf of the county collector, each affected taxing district is also notified so that it may intervene to counter the objector's allegations. Depending on the county, the initial notice may or may not include a copy of the complaint. If not included, the taxing district should obtain a list of the specific objections against the district and the grounds upon which they are based as soon as possible.

Tax objection proceedings can be lengthy and will generally involve a lead objector and several other taxpayers/ objectors who will often conform their arguments to that of the lead objector. Large enterprises that own expansive tracts of land and industrial and commercial buildings will scrutinize the tax levies of all of the districts taxing their property every year, and may file objections as to the entire tax rate extended by a taxing district or against any one or more of the district's funds.

To minimize any possible liability, you should have legal counsel review the objections. As soon as a taxing district receives notice of a tax objection complaint, it should immediately forward the notice to its attorneys so that they may investigate the allegations, file an appearance on behalf of the taxing district, and prepare the appropriate responses. It is not uncommon for a tax objector to either withdraw his complaint based upon the arguments of counsel or agree to a settlement of the tax dollars at issue. Most tax rate objections settle before trial, often with a small reduction in taxes which will be deducted by the county from the entity's next levy amounts. If a taxing district does not appear, it may lose valuable tax dollars. If the taxing district has committed a serious error in the tax levy process, it can, on rare occasions, lose its full tax levy for the year, but only as to those properties which have filed and successfully pursued a rate objection.

Challenging property valuation

Every year, the county board of review receives hundreds of complaints from residential, commercial and industrial property owners reacting to an increase in the annual assessment placed on their property. Under 35 ILCS 200/16-55, if property owners believes their property has been incorrectly assessed, they can file a written complaint challenging the assessment with the county board of review. When a complaint is filed, the board must review the assessment and correct it if justified.

In all counties except Cook, the initial complaint is filed directly with the county board of review. In Cook County, the assessor has the authority to unilaterally revise the property's assessment based on documentation submitted by the property owner. If the owner still disagrees with the assessor's findings, a formal complaint is then filed with the board of review.

Whenever a property owner seeks to reduce his or her property's assessment by $100,000 or more, all taxing districts shown on the last available tax bill are notified that a complaint has been filed. This gives taxing districts an opportunity to intervene. Unfortunately, the statute only requires that the notice be sent at least 14 days prior to the hearing. Therefore, it is very important to immediately review and take action on these notices. If the taxing district misses the hearing, it may not have another chance to voice its objections to an assessment reduction unless the taxpayer files an appeal before the Property Tax Appeals Board.

While legal counsel should always be consulted, a quick calculation can help expedite the decision whether to intervene: Multiply the difference between the assessor's valuation and the petitioner's valuation by the state

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multiplier and then by your individual taxing district's tax rate. The result will yield the potential tax dollars that may be lost if a full assessment reduction is allowed. If the district's tax rate has not been determined or the state multiplier is not available, use the prior year's rates to arrive at an estimate.

Let's consider two examples—one a large industrial complex and the other, a "mom and pop" retail business. Suppose a public entity's tax rate is 4% and the state multiplier is 2.3. The assessor has placed an assessment of $3,750,000 on the large industrial complex, but the owner believes $2,375,000 is more accurate based upon a recent appraisal. Here, the potential loss revenue to the entity could be as high as $126,500 calculated as follows: $3,750,000 -2,375,000 = 1,375,000 x 2.3 = 3,162,500 x.04=$126,500. For a second example, let's suppose the assessor has valued the retail property at $1,400,000. Mom and Pop petition for a reduction to $1,250,000 based upon the price they just paid: $1,400,000-1,250,000=150,000 x 2.3=345,000 x .04=$13,800.

In the first example, the potential loss of over $100,000 in revenue is significant and a public entity may decide that avoiding such an outcome outweighs the legal costs necessary to intervene (e.g., attorneys' fees and the costs for an independent appraisal of the property). The public entity could also contact the other affected tax bodies (e.g., municipality, township, park district;, school districts) and see if they would like to join efforts, sharing costs, in order to protect their individual revenues.

In the second example, while the loss to some taxing districts may still be sizeable, one must balance it against not only the costs to intervene, but also the likelihood of prevailing. The property owner has just acquired the property and has the best indicia of value—the actual price paid for it. In this instance, the taxpayer has a good chance of obtaining the reduction he seeks, so the taxing district may choose to not intervene.

2004 IGFOA Directory online

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Appealing the board of review's action

When things don't go well for the property owner at the county board of review level, he can appeal the board's decision to the Illinois Property Tax Appeals Board (PTAB) within 30 days. As in assessment complaints, all taxing districts affected by an appeal involving a reduction in valuation of $100,000 will receive notice.

The taxing district should evaluate the potential loss in tax dollars based upon any lowered assessment that may have been made by the board of review. Again, taxing districts may want to form a consortium to collectively oppose any reduction and share costs. This joint effort is particularly attractive when the property involves a large industrial or business complex and a successful defense will involve significant legal and independent appraisal fees.

If a taxing district decides to intervene, it must do so within 30 days from the date of the notice of appeal. The request to intervene must be accompanied by a resolution authorizing the intervention. Thus, again it is important to act quickly to allow time to place the resolution on the agenda for the next board meeting, act on it and prepare and file the request to intervene within the 30-day time period.

PTAB's decisions are based upon the equity and weight of the evidence presented and are binding. While an appeal is pending, the extension of taxes on the disputed assessment is not delayed. If the appeal results in an assessment reduction, any overpaid taxes are abated and the amounts disbursed to the taxing district are reduced accordingly. Decisions of the PTAB can be appealed to the court system but such appeals are rare.

Remember, a taxing district's most important act upon the initial receipt of a tax objection, an assessment complaint, or a PTAB appeal is to contact its legal counsel immediately so that the taxpayers' challenges may be evaluated and acted upon within the strict timeframes imposed by statute.

Reprinted from Ancel, Glink, Diamond, Bush, DiCianni & Rolek, P.C. *Local Government News* Fall 2003

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Inside:

GASB 40...

New ethics statute explanation...

New auditing standard on fraud risk...

Tax appeals... and more!

2004 IGFOA calendar

April 15	Downstate Chapter Spring Conference
April 16	Illinois Public Pension Institute
April 21-22	Public Investors' Financial Symposium
April 29	SAS 99 Consideration of Fraud in Financial Reports
May 5-6	Illinois & Wisconsin GFOA: Intermediate Investing Conference
May 13	TARC meeting
May 21	Chicago Metro Chapter Luncheon Meeting
June 13	GFOA Conference Reception with Wisconsin, and Minnesota GFOA, 4 to 6 pm, Milwaukee Ale House, Milwaukee
June 25	South Metro Chapter Golf Outing, Bolingbrook Golf Club *Contact Kenneth R. McConnaughay 630-245-6088, kenneth.mcconnaughay@morganstanley.com*
July 15-16	Downstate Chapter Summer Conference
July 29	Chicago Metro Chapter Networking Day
Aug. 8	South Metro Chapter Meeting, House of Hughes, Crestwood

Visit www.igfoa.org/calendar for details, or contact IGFOA at info@igfoa.org or 630-663-0019.

Statewide salary and benefits database on the way

The Illinois Municipal League, in partnership with The Waters Consulting Group, Inc. (WCG) is undertaking the development of an online, statewide database of employee salary and benefits information.The annual subscription rate for participants is $350. Subscribe at www.watersconsulting.com/iml/subscribe.asp

Did you know?

There are 864 TIFs in 353 municipalities in Illinois.