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BY G. CHARLES HURDMAN

Much has been written of late indicating the awakening interest of public accountants in the possibilities offered by the municipal field. Whether this has been stimulated by the scarcity of fees from the usual remunerative commercial practice or whether it springs from a real desire to be of public service is not known. Whatever the motivating force, both accountants and governmental agencies should benefit if the interests of the profession are sufficiently engaged.

Several recent public addresses on various phases of the subject of independent accountants and municipal accounting have indicated a growing appreciation of the possibilities of this type of practice.

Lloyd Morey delivered an excellent paper on the subject of "Municipal and governmental accounting" at the annual convention of the American Institute of Accountants at New Orleans. I have read it, as subsequently published in THE JOURNAL OF ACCOUNTANCY, with intense interest. Except for passing references, however, Mr. Morey may be said to have restricted himself to the limitations implied by the term "accounting" or perhaps to the even narrower concept implied in the word "auditing."

This article is intended to direct further attention of public accountants to some of the specific financial problems of municipalities. It is hoped that the interest which may be aroused will be of sufficient intensity to bring about a serious study of public affairs and result in more members of the profession, in public practice, fitting themselves to be of service in this direction.

Accountants have not hitherto been attracted to the municipal field, probably because of lack of understanding of its possibilities and possibly because of a consciousness of lack of equipment on the part of many of them who consider that it is a field most properly left to specialists.

It is unfortunate and yet true that many accountants whose practices have included municipal work have failed to perceive the possibilities of service which were opened to them and in consequence have not grasped the opportunity at hand for public usefulness as well as professional advancement.

In view of these circumstances, it is not surprising that neither municipal officers nor the public generally has turned to the independent accountant as one peculiarly fitted to assist governmental units in their financial problems and policies.

The truth of the statement that accountants themselves have not recognized their opportunity is evidenced by the fact that, when municipal practice is discussed in a gathering of accountants, the discussion invariably turns to such topics as competitive bidding, routine audit procedure, certified public accountants versus state department auditors, and similar vexing subjects.

Municipal budgets are usually prepared either by the fiscal officer or by the legal advisor, neither of whom in many cases possesses any peculiar training or ability to fit him for this responsibility. Likewise, the operation of the budget for the ensuing fiscal period may be left in the hands of persons only dimly conscious of its nature and possibilities.

Public accountants accept budgetary control as a necessary part of efficient commercial management. Much that is good in commercial budgetary practice seems to be forgotten in governmental work, however, where the advice of public accountants is seldom available or sought. Municipal budgets, for example, are considered as being available for expenditure up to the limits stated, as soon as confirmed by the legislative body. The budget becomes the end rather than the means. It is not emphasized that appropriations are permissive but not mandatory. In fact, it is forgotten that, even if an entire appropriation were intended to be expended, this could only be done to the extent that the collection of revenues would permit.

Budget-making requires trained municipal fiscal experts. The municipality should plan as part of the budget-making process the control which is to be exercised through the budget. To accomplish this it may be necessary, for example, to allocate certain large appropriations on a monthly basis rather than as lump sum appropriations for the entire year. For several years past, welfare appropriations might well have been so apportioned. A department head operating on prearranged allotments must take account each month. This method prevents the uncontrolled squandering of a year's appropriation in four or five months, thereby leaving the fiscal officer at his wit's end to provide funds for the balance of the year.

The value of comparisons with prior years may easily be overrated, as conditions are frequently unlike. It is essential, therefore, that the budget maker base his estimate on a real insight into the coming year's operations, rather than on past totals. Cost records, wage and commodity-price trends, work programs and other supplemental information should be of material assistance to the budget-making officer.

The futility of using past years' totals as the sole guide may be exemplified by a departmental equipment appropriation for one year which included a substantial sum for a large piece of equipment and for several smaller items. In three successive years the municipality allowed approximately the same gross appropriation under this code; and, strange as it may seem, the department head contrived to spend it. When the weakness of this type of budget making was pointed out, the following year's appropriation was cut to one tenth of the amount previously allowed.

Members of the accounting profession, who, figuratively speaking, have their hands on the business pulse of the state and nation, are in an advantageous position to obtain data of assistance in forecasting distributive shares returnable to municipalities of franchise, bank, mortgage, income and other state and federal revenues.

Willful over-estimates or under-estimates of expenditures and revenues are favored means for manipulating tax rates. These are apparent to trained men. Municipal officers are generally credited with having done a good job if they live within their budgets. The public could be more certain that the credit for efficiency was justified if they had as additional evidence the testimony of independent experts that in the first instance the budget had been fairly and properly prepared.

The fiscal advisor of the city should constantly note the progress of tax and other revenue collections; and when serious variations from estimates are observed, he should be prepared to direct economies or arrange for necessary financing.

The commercial outlook of the accountant is not usually shared by officers. This should make the independent practitioner, therefore, particularly valuable in appraising the operating results of traction, light and power, water and other similar ventures which are now frequently operated by municipalities.

In capital, even as in current budgetary procedure, the public accountant who is qualified to serve as a trained fiscal advisor may render a unique service. Every municipality should follow a broad basic capital plan or budget in authorizing and financing its permanent improvements. The long-term nature of this work and the frequent changes of administration, due to the turns of political fortunes, make the independent accountant, who should survive these comings and goings, particularly valuable. Only by such a plan, administered without preference, may the effects of politics, vested interests and noisy minorities be steadfastly counteracted.

A capital budget plan providing for possibly fifty or more years should only be adopted upon the assurance that the necessary studies have been carefully, intelligently and comprehensively made. Regional plans, population trends and other factors should all be coördinated. The public should be widely and completely informed as to its provisions and implications, and the plan should have public approval, by referendum or otherwise, before adoption.

An essential feature of a capital budget should be its flexibility, permitting increases or decreases in the volume of capital work as conditions warrant. Such a budget should, of course, be constantly checked and adjusted on the basis of actual results against estimates.

The plan would include a forecast of long-term financing and sinking-fund provisions. I shall deal with these two subjects more fully under their respective captions.

The capital accounts generally may be described as recording the cost of properties acquired from the proceeds of bond sales and the liabilities relating to these bonds or the funded debt. The idea that municipal bonds are secured by a lien or, if you will, mortgage, on the physical properties owned by the city is a misconception. With the exception of tax-anticipation certificates and other special issues, general city bonds are secured by the taxing power of the city and not by city-owned properties. This fact makes apparent the fallacy of showing city properties on the capital balance-sheet as resources from which bonds may be matured. Actually, current or sinking funds will provide for the payment of these bonds when due.

Many municipalities do a large part of their own construction work without recourse to outside contracts awarded on the basis of competitive bids. If a municipality does its own work, a trained accountant is especially well qualified to determine if the costs are fair, and if they are comparable with the cost of open market work of the same standard.

Too frequently the proceeds of bond sales are considered as being entirely available for expenditure. A careful hand at the financial helm would see that unused balances (provided long-term bonds are sold in advance of actual construction) are as great as conditions permit and that they are returned to the sinking fund to meet maturities of the respective issues.

The terms of bonds or sinking-fund provisions contained in the ordinances should provide for serial maturity or orderly retirement within a period estimated to represent the useful life of the improvement. Land acquisition costs, where the useful life is considered as perpetual, should be spread over somewhat longer terms but in no case exceeding fifty years.

Bond ordinances should be drawn with regard to expert financial and accounting advice on the trends of the capital markets. Construction in some instances may be financed by small issues of temporary certificates, later to be funded by long-term bonds; or it may be advisable to sell long-term bonds in advance, notwithstanding the attendant necessity of leaving large amounts of funds on deposit at bank interest rates, which are usually lower than the bond rates.

Having covered some of the problems relating to capital expenditures, it may be well to discuss those connected with the financing of a separate group of permanent improvements which are not chargeable in their entirety against the capital budget. There is much room for constructive thought in relation to the financing and apportioning of the cost of local improvements. If widely circulated opinions are justified, frequently the proportion of special assessments borne by abutting property owners and the proportion borne by the municipality are determined by other than equitable considerations.

A capital budget, as I have said, would ordinarily designate certain highways, plazas and other improvements as city wide projects. In ordinary circumstances these would be financed 100% from the proceeds of bond sales. Improvements of a purely local character, on the other hand, are apportioned between abutting property owners and/or the district of assessment and/or the city at large. The basis of these apportionments should be uniform and scientific.

Standard specifications may be adopted for certain types of streets, side-walks, curbs, sanitary sewers and other assessable improvements. If for any reason it becomes necessary to depart from these standard specifications in making local improvements, there might be well defined requirements as to whether or not the increased cost resulting from the change should be borne by the abutting property owners and/or the district of assessment and/or the city at large.

Instalment assessment plans and other schemes for the general purpose of giving preferential treatment to large speculative real-estate developers should be considered with particular care. In many instances municipalities which have been overindulgent in this respect have found themselves holding liens of many thousands of dollars on vacant lands which, even if fully developed and sold in the most active speculative markets, would not bring returns sufficient to satisfy the liens.

The public accountant, with his training in actuarial and financing matters generally, can, by advocating the use of sinking funds, do much to stabilize municipal finances. Future generations of taxpayers, particularly, and present and future bondholders should hail such a plan as one calculated to curb reckless extravagance and to eliminate the difficulties resulting from unwisely planned bond maturities.

Exceptionally heavy lump-sum maturities of bonds may be anticipated many years in advance by the creation of sinking funds. On new issues the accountant, with due regard for the life of the improvement, should be prepared to recommend the sinking-fund provisions to be specified in the ordinance.

Sinking-fund provisions should be coördinated with the related current tax budgets as forecast in the capital budget plan under which the municipality operates.

The temptation to use sinking funds for unwise investments should be guarded against by provision that only bonds of the issue for which the fund is provided or state or government bonds enjoying a wide and ready market be eligible as investments.

Even though it be the voice of one crying in the wilderness, the accountant should not fail to point out to the administration, and to the taxpayers if necessary, the serious implications of failure to make a careful study of and proper annual provision for pension-fund purposes.

It seems generally preferable, from the viewpoint of both employees and taxpayers, to have employees join the pension fund of some larger jurisdiction, such as the state. If, for good and sufficient reasons a local fund is desired, it should be based on a comprehensive study by a qualified actuary. Moreover, the fund should be checked periodically for the purpose of verifying its actuarial soundness. In a surprisingly large number of municipalities, failure to place these funds on a sound basis is creating serious contingent liabilities which beyond doubt will some time have to be paid by the taxpayer.

A competent committee should be charged with the responsibility for investing these funds. Reports should be required periodically, showing the detail of the investment portfolio.

Tax delinquency constitutes a serious problem for municipalities today. In the metropolitan district, title companies, savings banks and other mortgagees compelled property owners to pay their taxes promptly. Recent legislation designed to alleviate the financial burdens of mortgagors, internal troubles of the title companies, some semblance of a taxpayers' strike and perhaps a moral let-down on the part of debtors have combined to create a tax-delinquency condition of unprecedented proportions.

Public accountants expert in municipal affairs should be prepared to advise on the subject of reserves for financing arrears of taxes. The amount and the method of providing these reserves require some consideration, particularly in times like the present, when delinquencies, instead of being normal at from 3% to 5% of the levy, are actually approaching 20% or 30%.

An expert municipal accountant should keep himself informed sufficiently to advise municipal officers concerning the probable effects of discontinuing penalties and the result of experiments which have been made in this direction. He should also know the details of the operation of tax-foreclosure and the tax-lien provisions found in municipal charters, in order that their respective advantages or disadvantages may be brought to the attention of the many municipal corporations which allow taxes to accrue for years without taking action against the property.

The feasibility of a municipality using commercial collection methods, the advertising of tax delinquencies and the payment by the city to delinquent taxpayer-vendors, in a form of scrip redeemable in taxes, are subjects with which the municipal expert should be familiar.

The possibility of developing new sources of taxation not related to real estate or improvements is a question on which the accountant's advice might well be sought. In this respect the legal or constitutional phases of the question would, of course, be considered by counsel, but the expected yield, method of assessment and collection, are all matters with which the accountant may be presumed to be informed.

A solution for the present inability of local municipalities to tax county, state or federal jurisdictions for large properties within their boundaries, even though such properties frequently produce substantial revenues, would be a worth-while contribution looking to the elimination of a serious problem. A parallel opportunity exists with respect to church, private school, hospital, cemetery, social welfare and other institutions now commonly exempt from taxation.

Many municipalities operate on fiscal years which begin before necessary taxes may be levied. This obviously requires anticipatory financing to bridge the gap between the beginning of the spending period and the receipt of taxes. In some states this condition prevails generally, because of state laws which render the individual communities powerless to correct this situation with its attendant cumbersome processes and financing expenses.

In a neighboring state the accountants have had a prominent part in bringing about the enactment of legislation to permit the synchronization of the fiscal and the tax years. This exemplifies the type of constructive service which, in my judgment, accountants should strive to render.

Tax assessment systems are the basis of approximately 75% of the revenues raised for local governments. There is more opportunity for inequalities and studied advantages to a favored few in this obscure field than in any other; and yet the municipal auditor, in the course of his work, usually does not even look inside the assessor's office.

Accountants have the right mental equipment but are generally lacking in training on the subject of assessments. The fact is that there is no trained group to question the arbitrary verdicts of assessors or boards of review. No matter of law is involved, but lawyers seem to be the only ones even remotely interested. Their interest, it should be added, is usually on behalf of a client and not on behalf of the taxpayers generally.

Has it ever occurred to the members of the accounting profession that there may be room for drastic improvement in our real-estate taxation methods? Consider two equally valuable and favorably situated plots. One is improved with shoddy buildings by a speculator. On the other is erected a splendid structure, a credit to the community and tending to enhance adjacent values. Both, we shall assume, make equal demands on the public services, although in all probability the fire risk and attendant contingencies are greater in the lightly constructed building. There is considerable doubt as to whether it is right that one building should be assessed and taxed on the basis of $50,000 and the other at $250,000. One may lead to the conclusion that our taxes are based too much on capacity to pay and too little on benefits received.

As local assessments are important to one person as against another, so also is equalization important to one municipality as against another. Too frequently the equalization rate of a community is indicative of the relative strength of its representatives in the county legislative body. This, of course, should not be the case. Often local municipal officers are only dimly conscious of the real effect of variations in these equalization tables. The trained municipal accountant might perform valuable services in this regard.

The statutes of New York state place the debt limit for municipalities at 10% of the taxable assessed values. There is much room for doubt as to the soundness of this basis. One may be led to ask why it was set at 10% rather than 5%, or 25%, or any other percentage for that matter. Also when the 10% limit was set, was it contemplated that taxable assessed values would be increased at a rate commensurate with the increase in speculative values resulting possibly from abnormal activity in the real-estate market, or in other instances from nothing more tangible than the enactment of a local zoning ordinance which makes certain property available for commercial purposes and thereby artificially raises its value?

There is grave question as to the wisdom of exempting from the provisions of the recently enacted federal securities act of 1933 local municipalities and investment bankers and others interested in selling municipal bonds to the public.

Those interested in government have not even begun to consider the true implications of overlapping administrative costs and of overlapping debt. Are public accountants prepared to take their rightful, responsible places in the disentanglement of this maze, which must ultimately be achieved, or shall we yield to the legal profession or others less qualified, as we have in the past?

The New York State Society of Certified Public Accountants has placed itself on record in a resolution specifying the generally desirable characteristics of municipal reports. The resolution contained a sound expression of opinion. It is, however, only a beginning. There is a corollary which has not yet been supplied, but must be eventually. If the present accepted forms of reports are lacking, wherein are they deficient? Space prevents a full discussion of the subject, but a few examples may raise some important points.

Let it be assumed that stated reports to superior governmental jurisdictions must, for the present at least, be continued in the required form. This requirement need not prevent the preparation of audited, intelligible reports for the edification and use of investment and commercial bankers and taxpayers generally. If the required report does not call for balance-sheets for each fund, they should nevertheless be prepared and published. If the report to the county or state comptroller allows or requires a confused intermingling of current, capital, assessment, agency, trust, sinking fund or other cash, the public reports should not countenance similar conditions. If the periodic reports call for comparisons of actual expenditures or receipts with budget estimates, thereby producing a cumbersome form which obscures important facts, the published reports need not be so prepared. The old concept of legal personal accountability attaching to any public office of a financial nature has, by creating an effect of accounting for every last cent, made municipal reports generally far too detailed. There is no necessity for continuing this practice. A sensible condensation, designed to eliminate useless detail but not to obscure important facts, should be allowed.

On the other hand, overenthusiastic public accountants have been known to prepare consolidated operating statements and balance-sheets for municipalities. This is overcondensation and, moreover, an act clearly showing a lack of comprehension by the accountant of the true nature of the elements involved in the consolidation. The practice is as indefensible as it would be for a trust company to consolidate with its own resources the assets held in trust for customers.

Municipalities could render reports more promptly and frequently if they would use machine-accounting methods with multiple-posting and daily-proof features.

Published reports might well be accompanied by an intelligent summarization and review by the chief fiscal or administrative officer, in a manner following the custom of commercial enterprises. Such an accompanying letter would point out the important elements in the statements submitted, would note contingent liabilities, proposed financing, changes in local conditions or policy or other matters and might indicate the important financial steps contemplated for the subsequent year. It might also include comparative statistics on construction and maintenance costs, personnel, purchasing and general management information. School, water, sewer, park, drainage, light, highway, or other district accounts not included should be clearly noted as exceptions.

Each subject which I have mentioned in this article might in itself be given consideration requiring much more space than is available. It was not my purpose, however, to do more than suggest certain problems and, in some instances, to outline an approach to their solution.

It must be plain from what has been said that there is much room for study and research in matters relating to municipal finance. Active participation in this work by accountants and coöperation with recognized existing groups in the municipal field will serve to develop accepted authorities among the members of the accounting profession.

Only when this end has been achieved will accountants generally be called upon to take a responsible place in the conduct of municipalities. Such a place would require from them consultation and advice in planning and administering municipal finances and would not limit their usefulness, as now, to the field of auditing.

Accountants themselves, and in fact they only, can take steps to qualify for rendering these more extensive and more valuable services.