

## Section 4: Finance

# Chapter 17: Authority and Internal Controls

Oversight and governance of financial affairs is among the most important of the responsibilities of village officials. Inadequate oversight can lead to abuses such as embezzlement, misuse of and/or misappropriation of funds, and general loss of esteem for the municipality and its officials. Excessive control or oversight can render your village ineffective and incapable of delivering important services.

Local elected officials are given the responsibility and authority to establish financial policies for their municipality. For example, only the elected governing body of a municipality can levy property taxes, establish fees and charges for utility services, levy special assessments, incur debt, establish spending levels, and determine independent audit requirements. Appointed officials may recommend policies in these matters, but the final authority to enact financial policy is reserved for the governing body of elected officials. They fulfill these responsibilities through budgets, ordinances, and resolutions. Most of these must be enacted by majority vote of the elected body. Two exceptions are tax increases and special assessments—these require a 2/3 vote (MCL 65.5).

This chapter provides a brief overview of the very complex and pervasive subject of municipal finance in Michigan, with emphasis on general law villages.

### Limitations on Local Authority

Authority and responsibility for municipal financial policies for villages are established by the Michigan Constitution, state statutes, federal statutes, state and federal administrative codes, and specifically, the General Law Village Act. These instruments, along with case law, grant certain authority on one hand and limit it on the other.

### State Limitations

Elected officials have become acutely aware of the limits imposed by the Michigan electorate through constitutional provisions which limit the authority of local officials to levy property taxes.

Constitutional revisions adopted in the late 1970s (known as the Headlee Amendments) limited local authority by:

- requiring local voter approval for increasing tax rates above the rates then authorized by law or charter, and
- rolling back, or decreasing millage rates, so the total amount of taxes paid on existing property increases by no more than the rate of inflation during periods when property values increase by more than the rate of inflation.

If one class of property has declining or stagnant market values and another class has spiraling increases, the total roll for the taxing unit may not increase more than the rate of inflation. And, the taxing authorities are not required to reduce the millage rate. In many local units, residential property values have spiraled upward while other classes stagnated. As a result, residential taxpayers found little or no relief from the Headlee roll back requirements.

Again in 1994, the Michigan electorate amended the Constitution with Proposal A. This amendment defined a special class of property, *Homestead*, which is treated differently than the other classes of property (e.g., commercial, industrial, non-homestead residential, agricultural, etc.). Homesteads are exempt from the local school tax of 18 mills. No other class has this exemption. Schools were provided with state funds, generated by the state sales tax, to offset this loss of revenue.

In addition, Proposal A requires each parcel to be taxed on the basis of its taxable value which is to be limited to an annual increase of "...the rate of inflation or five

percent, whichever is less.” This limitation is imposed for each parcel.

Prior to Proposal A, properties were taxed on the basis of their state equalized value which was set at 50 percent of market value and adjusted upward or downward as the market value changed.

The local assessor now maintains two columns on the tax roll: the state equalized value and the taxable value. Taxes are levied on the taxable value. As long as the property continues under the same ownership, the taxable value of the parcel may only increase at the rate of inflation or five percent, whichever is less. However, upon sale or transfer of the property to another owner, the state equalized value (SEV) becomes the new taxable value.

By shifting school financing from the property tax to the sales tax, the reduced potential captured revenue through tax increment financing has had a negative side effect on certain financing authorities for future programs. The full effect of Proposal A is still unknown. Some believe it has had an inflationary effect on home values. Others believe that the reverse will be true in the future when new owners find the accumulated state equalized value (SEV) entered into the roll of taxable value for their payment of taxes. It also remains to be seen what its full impact will be on local units of government.

### **State Statutes**

State statutes also limit the authority of local officials in administering their financial affairs in matters ranging from procedures to be followed by local governing bodies in advertising the annual budget hearing, to the use of motor fuel taxes on local street systems; from debt limits to fidelity bonding requirements for local treasurers; from the audit to creation of special financing authorities.

State statutes control almost every aspect of municipal finance. (See Appendix 1 for a comprehensive listing of controlling state statutes). Local officials should seek

advice and counsel from their own local resources when embarking upon changes of policy and practices in the conduct of the financial affairs of their local government.

Officials should not overlook resources at their disposal (which may include a village manager, finance officer, treasurer, accountant, city attorney, and independent auditor) in fulfilling their duties and responsibilities.

Additional municipal finance materials are available from the League at [mml.org](http://mml.org) or requests can be emailed to [info@mml.org](mailto:info@mml.org).

### **Case Law**

Case law issuing from the judicial system also imposes controls and limitations on local officials. For example, a state court adjudicated a disputed special assessment which was levied upon owners of homes in a platted subdivision with streets emptying out into a major thoroughfare which was to be improved with special assessment financing. The court set aside the special assessment on the subdivision homeowners because in the opinion of the court:

- a. The benefit derived from the improvement was a general benefit to the community and not a special benefit to homes in the subdivision, and
- b. Special assessments may only be levied for direct benefit (i.e., the street upon which the homes fronted) and such may not be levied for indirect benefits (for the major thoroughfare to which their frontage street connected).

A second example has had perhaps an even greater impact on municipal finance. In 1998, the Michigan Supreme Court ruled that the city of Lansing’s stormwater service “fee” was unconstitutional, declaring that the fee was actually a “tax” under the Headlee Amendment to the Michigan

Constitution that required a vote of the city’s electorate.

The Act assigns duties and responsibilities for financial management of the village.

Type of Taxation	Authority	Limitations
<b>Millage:</b> General Operating	GLV Act, 1895 PA 3, MCL 69.1(2)	12.5 mills upon taxable real property
Highway and Street	GLV Act, 1895 PA 3, MCL 69.2	5.0 mills for general street and highway purposes
Cemetery Maintenance	GLV Act, 1895 PA 3, MCL 69.4	1.0 mill for general maintenance of cemeteries
Garbage Collection, Disposal	1917 PA 298, as amended, MCL 123.261	3.0 mills for operating garbage system
Special Assessment	GLV Act, 1895 PA 3, MCL 68.31-68.35; MCL 69.5-.6	varies with project
Principal, etc. on bonds or indebtedness	1951 PA 33, MCL 41.801 - 41.810	10.0 mills for purchase of fire extinguishing apparatus, equipment and housing.

The ruling in *Bolt v City of Lansing* has significant implications for municipalities statewide. Municipal bond attorneys have expressed concern that the ruling could impact the security of revenue bonds backed by user fees. See the January/February 2014 issue of *The Review* magazine for a refresher article on *Bolt v City of Lansing*.

**Local Limitations**

Village ordinances and resolutions of policy are instructive to both new and experienced officials. These local instruments often reflect provisions of the State Constitution, state statutes, and other regulatory requirements of the higher levels of government. Indeed they must be in compliance with them. Careful review and drafting by legal counsel and financial administrators should assure compliance.

**The General Law Village Act (GLVA)**

The GLVA establishes millage limits, debt limits, and the fiscal year. The Act also contains budget requirements, audit requirements, and reporting of financial conditions of the village on a regular basis.

General law villages are limited in the amount of general obligation debt they may incur to ten percent of their state equalized value (SEV) under the GLV Act. Specified types of debt are not counted in calculating the 12.5 general operational mill limitation. Not included in the total are special assessment bonds, motor vehicle highway fund bonds, combined sewer overflow bonds, pollution-control bonds, and revenue bonds.

The chart below lists general law village millage limits. These millage limitations most likely have been rolled back to establish new, lower maximum rates for your village due to the Headlee amendment to the Michigan constitution and its implementing legislation. The rolled back limitation becomes your new statutory limitation. Consult your county equalization department for information on your current millage limitations.

**Village Ordinances**

Ordinances are often necessary to implement state statutory requirements and those of the GLVA to limit and regulate

financial management in more detail than is permitted or desirable by the Act. Ordinances are more easily amended than the Act and greater detail can be accomplished. Finance related ordinances deal with such things as administering blanket purchase orders, counter-signatures on checks, depositories for funds, and credit card control.

### **Summary**

By now you have probably concluded that those financial aspects of the tasks of local officials aren't getting any easier and they are growing in importance. Good financial planning and management is a way of life. Good, sound systems and practices are the product of a series of decisions over a period

of years. They are not the products of a short-term budget crunch or a financial crisis with quick-fix solutions. The task is to make thoughtful policy decisions with a view toward continual improvements over a period of time.

Local officials should always seek advice and counsel from their chief financial officer, assessor, manager and municipal attorney when embarking upon changes of policy and practices in the conduct of the financial affairs of their local government.

**Chapter by League staff** based on materials provided by **A. Frank Gerstenecker**, retired city manager and former consultant for the League's Executive Search Service.