STATE SUPERVISION OF LOCAL FINANCE IN MICHIGAN

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This is to certify that

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Denzel C. Cline

H. H. Patton

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STATE SUPERVISION OF LOCAL FINANCE IN MICHIGAN

by

MILTON BARTRAM DICKERSON

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CHAPTER I

INTRODUCTION

Definition of Problem. Under our system of government, all municipalities (the general term which includes cities, towns, villages, townships, counties and special districts) are created by, and derive their authority from, the state. Thus there is an implied supervisory relationship between the state and its subdivisions; that is, the state is in a general way responsible for what its subdivisions do. This thesis will describe the state supervision of local finance existing in Michigan, suggest possible improvements, and compare the supervision or control exercised in some of the other states with that in Michigan.

Supervision and control are taken by many authors to mean the same thing. However, they are not truly synonymous. State control means that the responsibility is primarily the state's; the local units are mere agents.[1] State supervision recognizes that the primary responsibility lies with the localities and that the state is responsible for aiding and improving local administration, but not for the detailed acts of that administration. Of course, if supervision is carried to extremes it becomes control, leaving nothing for the localities to do but obey orders. This thesis is entitled "State Supervision" because what little regulation Michigan has must perforce be called supervision.

Three successive stages are necessary for adequate supervision:[2]

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[1] Wylie Kilpatrick, State Supervision of Local Budgeting, p. 12.

[2] H. L. Lutz, Public Finance, 3rd ed., p. 149.

first, the establishment of standards of service and the goals to be achieved; second, the guidance and instruction needed to assist local officials to comply with the standards established; third, the authority to inspect local units and to improve their work if necessary, which means that the state supervisory agency must have unquestioned authority to require compliance with its general rules and principles. This last stage is the "big stick" part of state supervision. Although necessary, it should be kept subordinate to the first two stages for best results.

Scope and Methods of State Supervision. State supervision of local finance is, of course, a very broad subject. Many phases of local finance in which the state has an interest have been excluded from this thesis. For example, local purchasing, personnel, school finance, welfare finance and highway finance have been omitted. Each of these is worthy of a separate monograph and it would unduly broaden the scope of this study to include them. The aspects of state supervision to be treated in this study are the assessment and collection of local property taxes, property tax rate limitation; budgeting, accounting, reporting, auditing; and local indebtedness. In Michigan there is almost no supervision of some of these at the present time.

The methods used in supervising local affairs fall under four headings: constitutional, legislative, administrative and judicial. Each method has been used in Michigan to some extent, but the main reliance has been on legislative supervision. This has also been the case in other states. The western European countries have traditionally used the administrative method of supervision,[3] which is generally conceded

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[3] Schuyler C. Wallace, State Administrative Supervision over Cities in the United States, p. 35.

to be the most flexible. In this country the inflexible constitutional method has too often been used.

Any study of this subject of supervision, whether it covers one state or many states, shows that many different forms of supervision have been used but without any attempt at a complete process. Every state that has supervised one or more phases of local finance well has at the same time neglected other phases. Undesirable local conditions may be expected to continue until the entire scope of local finance is brought under unified state supervision.

Methods and Data Used in This Study. Since Michigan has relied so extensively upon legislative supervision, the compiled laws and public statutes of the state have been a main source of information. In addition, court decisions interpreting the laws, and interviews with officials who enforce the laws have also been utilized. Books, pertinent articles in technical journals, and personal observations complete the sources of data.

In writing this thesis, what might be called a functional rather than an historical approach has been used. Each aspect of local finance is treated separately with its supervisory history, results and recommendations for improvements included in the same chapter.

PART I

STATE SUPERVISION OF LOCAL TAXATION

CHAPTER II

SUPERVISION OF LOCAL ASSESSMENT

The first phase of local finance to come under state supervision in this country was the administration of the property tax. Supervision in this field has been almost universal, although it often has been very weak. It had as its original purpose the improvement of the administration of the general property tax, and has usually passed through three stages:[1] first, creation of central boards of review and equalization of assessments; second, transfer of assessment of public service corporations from local assessors to a state board; third, establishment of state tax commissions with more or less effective supervisory powers over local tax officials.

Michigan, in company with most other states, has passed through these three stages, but, it must be admitted, without much improvement in property taxation procedure. Most of our present system of property tax assessment and collection by townships was in use before Michigan was admitted to statehood in 1837.[2] General property was not extensively taxed until 1817, the revenue before that being derived from license fees and professional incomes. During the territorial period in Michigan's history, an interesting development took place. The power of taxation was gradually shifted by the central authority to local units. By

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[1] R. S. Van de Woestyne, State Control of Local Finance in Massachusetts, p. 148.

[2] M. A. Schaffner, Territorial Tax Legislation of Michigan, pp. 27-28.

this shift, the county became the tax administrative unit in 1817. The first general property tax law[3] provided for one county assessor, to be appointed by the governor. The assessor was also the collector of the tax and was authorized to enforce payment by levy and sale of the personal property of delinquent taxpayers or by jailing the non-paying citizen. By Act of Congress in 1825 the governor and the legislative council were empowered to incorporate townships. The township was made the unit for the assessment and collection of the property tax in 1827,[4] when most of our present procedure was evolved. In 1833 a territorial law required assessors to swear that they had assessed at fair cash value. It was the first time this principle of assessment had been specifically mentioned by law, although it had been commonly accepted before that.[5] An act of 1834 substituted a single county assessor for the township system in five less populous counties,[6] which was a very commendable act and should have been continued by our state legislature in the years following statehood. This lasted only until Michigan adopted its first Constitution.

Local Assessment Procedure. State supervision of property assessment in Michigan starts with the constitutional provision that all assessments on property shall be at its cash value.[7] This, then is the standard which is set for local assessors. The words "cash value" are held to mean

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[3] Territorial Laws, Vol. II, p. 109.

[4] F. M. Thrun, A Handbook of Michigan Tax Laws, Michigan State College Bulletin No. 153, December, 1934, p. 14.

[5] M. A. Schaffner, op. cit., p. 32.

[6] Ibid., p. 34.

[7] Michigan State Constitution - 1908, Article X, Sec. 7.

the usual selling price of the property at its location at the time of assessment.[8] It is the price that could be obtained at private sale, not at a forced or auction sale. The legislature has provided for the annual assessment of all taxable property by the supervisor of each township and by the chosen city or village assessor if the charters of such municipalities provide for such officer.[9] Before Michigan became a state, only that property specifically mentioned was taxable, but today all real property except that expressly exempted by law is taxable,[10] and the law defines the personal property which is taxable[11] and that which is exempt.[12]

The procedure of assessment is also prescribed by law. The assessor shall require every person whom he believes to have taxable property to file a true and correct sworn statement of all the taxable property of such person.[13] The law provides blank forms to be used by the assessor in obtaining the above statement. It also provides penalties for any person who wilfully neglects to make out and deliver such a statement or who refuses to answer questions concerning his property, asked by any assessing officer or member of the State Tax Commission. The property tax law of 1885 gave the assessor authority to require a statement from the taxpayer if he wished. The law of 1891, still in effect, made this

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[8] 1929 Compilation of Michigan Laws, Sec. 3415. (Hereafter Compiled Laws will be designated: C. L. 1929.)

[9] C. L. 1929, Sec. 3398.

[10] C. L. 1929, Sec. 3390.

[11] C. L. 1929, Sec. 3396.

[12] C. L. 1929, Sec. 3397, amended by Act 10, Public Acts, 1934, Extra Session. (Hereafter, Public Acts will be designated P. A.)

[13] C. L. 1929, Secs. 3406-3412.

duty mandatory on the assessor. Actually, few assessors require such statements from the taxpayers and the Supreme Court in at least one case[14] has decided that the absence of such statements does not invalidate the assessment if it was made in good faith. Guided by the statements received and his own observation and judgment, the assessor places a valuation on the property. The law allows the supervisor two months to do his work of assessing before he must submit his assessment rolls to the board of review. This board, consisting of the supervisor and two taxpaying electors, may approve or change any part of the assessment roll. It hears all complaints from individual taxpayers concerning assessments[15] and makes such corrections as it deems just and equal. Each city also has its board of review, the mayor and the city assessor being on this board.[16]

County and State Equalization. In addition to being subjected to review by the local board, the assessment rolls are required to be equalized for county purposes and for state purposes. The board of county supervisors is supposed to equalize assessments between the various townships and cities within the county by adding to or deducting from the total valuation of each unit a sum which seems just.[17] This is obviously for the purpose of equalizing county and state taxes among the local units. The county board has no power to equalize valuations as between individuals,[18] but can change township totals only.

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[14] Lumber Company v. Village of Oscoda, 97 Michigan 221.

[15] C. L. 1929, Secs. 3416-3421.

[16] C. L. 1929, Secs. 2164-2168.

[17] C. L. 1929, Sec. 3422.

[18] Tweed v. Metcalf, 4 Michigan 579, 600.

Michigan has long had a State Board of Equalization. When first established in 1853, it succeeded in one year in raising the valuation of taxable property from a few millions of dollars to one hundred and twenty millions.[19] The more recent history of this board starts with 1908. The Constitution of 1908[20] instructed the legislature to provide by law for a state board to equalize assessments on all taxable property in 1911 and every fifth year thereafter, and at such other times as the legislature wished. Accordingly, a State Board of Equalization was created in 1911,[21] consisting of the Secretary of State, the Auditor General, the State Treasurer, the Superintendent of Public Instruction, and the Chairman of the Board of State Tax Commissioners. Following the constitutional provision, this board was given the task of equalizing the total assessed valuations of counties every third and fifth year, in order to divide the state tax levy on general property more equitably among the counties. Each county may send representatives to the board to plead for a reduction in the total valuation of the property in their county as estimated by the State Tax Commission. In 1919 the personnel of the board was revamped to consist of the three members of the Board of State Tax Commissioners, the Auditor General and the Commissioner of Animal Industry.[22] In 1921 the last named member was replaced by the Commissioner of Agriculture.[23] The title of the tax commission was

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[19] W. O. Hedrick, History of Railroad Taxation in Michigan, p. 12.

[20] Michigan State Constitution-1908, Article X, Section 8.

[21] Act 44, P. A. 1911, Secs. 3696-3705.

[22] Act 330, P. A. 1919.

[23] Act 13, P. A. 1921.

changed in 1925 and again in 1927.[24] Today the equalization board consists of the three members of the State Tax Commission, the Auditor General, and the Commissioner of Agriculture. The change in personnel was undoubtedly for the better, since three of the five members were now either experts in the taxation field or were at least concerned solely with taxation problems.

Since 1921 the legislature has required an equalization annually instead of only twice in five years. This annual task is still being performed, although a great many reports of the State Tax Commission since 1921 have recommended that an equalization be made only every two or three years.[25] The annual expense, both to the counties which send their representatives to the meeting of the State Board of Equalization, and to the state, is not warranted by the changes taking place from year to year. A great deal of dissatisfaction, protest, and bitter feeling is generated by this annual meeting. A longer period would serve very well for equalization purposes.

The equitable distribution of the state property tax levy among the several counties was the original reason for the establishment of the state equalization board. Michigan abolished this state levy in 1934, following the constitutional 15-mill property tax rate limitation of 1932, because it was felt that the municipalities needed all the revenue that the limited property tax would thereafter yield. Since the state tax has been abolished, it might justifiably be asked why the board is still in existence. However, equalization is still necessary for the

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[24] Acts 155, P. A. 1925, and 360, P. A. 1927.

[25] Reports of State Tax Commission: 1921-22, 1923-24, 1925-26, 1927-28, 1929-30, 1931-32.

equitable distribution of state funds to local units, particularly in the case of welfare funds and school aid.

The State Welfare Board is charged with the distribution of state welfare money to counties on the basis of the local need for relief, the financial resources of the county and the amount of county funds spent for social welfare during the preceding year.[26] The welfare board takes the equalized valuation of each county, not the original assessed valuation, into consideration when comparing their financial resources. Although state grants were intended in general to be matching grants, that is, fifty per cent state and fifty per cent local, most of the counties north of the Bay-Muskegon line receive from the state much more than half of the total funds they spend for relief. It is up to the State Welfare Board to determine just what effect a change in the total valuation when equalized would have on welfare funds, because the law is silent on that point.

Year by year the amount of state money distributed to the school districts is increasing. This means a constant problem of allocation among the several thousand school districts. Under the present system, the funds distributed are based in part on the figures of the State Board of Equalization.[27] Each district is allowed between forty and seventy-five dollars for each pupil in average school membership, depending on the type and the size of the school.[28] Each district's total al-

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[26] Act 280, P. A. 1939.

[27] Report of the State Board of Equalization, 1938 - Statement by Eugene B. Elliot, Superintendent of Public Instruction, p. 14.

[28] C. L. 1929, Secs. 7339-7345, as amended by Act 236, P. A. 1933; Act 16, Extra Session 1933; Act 249, P. A. 1937; Act 19, P. A. 1939; and Act 346, P. A. 1939.

lowance is made up of funds from five sources: 1) a share of the primary school interest fund, apportioned on the school census basis; 2) a share of the primary supplement fund, apportioned on the school census basis; 3) the tuition receipts of the district; 4) a sum equal to a two and three-quarters mill tax on the valuation of the property of the district, after being adjusted for both the county and state equalizations; 5) a grant from the school equalization fund of whatever sum is necessary to make the total revenue equal to the minimum required. This grant from the equalization fund is made only if the school district has levied at least a three mill tax on the local assessed valuation and will not be given to any district having too large a surplus of funds left from the preceding year. The first condition seems to mean very little because the assessor could adjust his local assessment to any figure he desired and thus could eliminate the effect of the three mill requirement. The second condition also seems ineffective, for the law defines too large a surplus as being more than the amount spent the preceding fiscal year. Thus a district which has spent one hundred thousand dollars the preceding year could have ninety-nine thousand dollars surplus and yet get equalization fund aid.

Without the requirement of a two and three-quarters mill levy on the equalized valuation, there would be competitive reductions in assessed valuations in order to get more state aid. Without it, the supervisors of County A might assess all property in 1941 at just half of its assessment in 1940. This would mean that the local contributions of the school districts in County A would be less and thus their share of the equalization fund would be more. However, that is prevented by the equalizing process of the state board, as it attempts to bring all county

totals up to the same level. Of course, the problem is not solved completely, for individual school districts within the county may be assessed inequitably, and equalization would not correct this inequity. The state equalizing body, no matter what it is called, should have the authority to equalize all assessments, not merely county totals.

Each year the State Tax Commission submits to the State Board of Equalization its estimate as to the true cash valuation of the property in each county, which serves as its recommendations for equalization. Before 1919 there was usually no close correlation between the Tax Commission's estimate and the board's equalization figures, because the personnel of the two bodies was separate. Since 1919, however, the Tax Commission constitutes the majority of the Board of Equalization and could, being a quorum, conduct the equalization without the other members. As might be expected, the final equalized valuations follow very closely the Tax Commission's recommendations. In 1938 the Tax Commission adopted the equalized valuations of 1937 as their estimate because the majority of its members were newly chosen[29] and had had no time to make adequate investigation of the various properties in the state.

State Tax Commission--Its History and Functions. The original state tax supervisory agency was the Board of State Tax Commissioners, established in 1899.[30] This commission, consisting first of five members and then of three, continued until 1925 when it was replaced by a State Tax Department.[31] Two years later the State Tax Department in turn was abol-

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[29] Report of the State Board of Equalization, 1938, p. 5.

[30] Act 154, P. A. 1899.

[31] Act 155, P. A. 1925.

ished and its powers and duties transferred to the present State Tax Commission.[32] These two changes were mainly in name only, although there was a complete turnover in the membership of the commission in 1927.

The commission was criticized earlier in its history for political entanglements,[33] but most of the criticism was of men other than tax commissioners. Several governors have misused their power of appointment by removing one man to appoint another with no regard for efficiency in office. Of course, the few instances where this has happened are much more conspicuous than the many good appointments which have been made. The political manipulation of the tax commission has been greatly reduced since Lutz made his study in 1918. Not as proof, but merely as evidences for this belief, the following facts are cited. The average term of office of the tax commissioners has nearly doubled since 1916. One member of the present commission was appointed by a governor of the opposing political party. This member had never held any political office and had had several years experience in assessing work. The present members have been serving, twelve, fourteen, and four years, respectively, the last two serving continuously. Lutz recognized the fact that the worst political favoritism was shown by the board of equalization, which at that time consisted of elective officials who placed more reliance upon pleas of constituents than upon the carefully compiled estimates of the tax commission and its staff.[34] The tax commission itself has often endorsed the principle of selection by merit when considering its own

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[32] Act 360, P. A. 1927.

[33] H. L. Lutz, The State Tax Commission, p. 293.

[34] Ibid., p. 298.

employees.[35] A large part of the present staff were under civil service under the 1937 act. Under the civil service amendment to the constitution, passed in November, 1940, the present civil service law seems to put all the commission's staff but one on the classified list. All new employees of the tax commission will be selected on their merit and the efficiency of their work will tend to rise accordingly.

The first tax commission had three members and a term of only two years.[36] In 1901 the legislature gave more duties to the commission and enlarged its membership to five.[37] Under these first two laws, the tax commission had almost absolute authority over taxation. It had mandatory power over property assessment for state, township, county and municipal purposes and thus could have assessed all property at full cash value. It did raise the assessed valuation very materially and its early work was widely approved. The commission could also remove assessing officers if they did not perform their legal duties.

Several things, however, conspired to make the commission's effectiveness short-lived. It was identical in membership with the State Board of Assessors,[38] who had the task of placing a valuation on railroads and of determining the rate at which they should be taxed. This gave them the power to equalize the taxation of railroad with other property merely by raising the general property assessment to its true value. If all other property in the state had been assessed at its full cash value and the average tax rate in the state had then been computed

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[35] Reports of Board of State Tax Commissioners: 1902, pp. 35-49; 1912, p. 6; 1914, pp. 11-12.

[36] Act 154, P. A. 1899.

[37] Act 173, P. A. 1901.

[38] Act 173, P. A. 1901.

and applied to the actual cash valuation of the railroads, the desired equity between these two types of property would have been attained. The tax commission, however, attempted to realize the same result by other means.[39] They added several millions to the total valuation of general property, as a weight to bring the value up to what they considered an ideal valuation of general property. This resulted in so low an average tax rate that the railroads' contributions to the schools were materially lowered and so the schools appealed to the courts.[40] The Supreme Court decided that the board of assessors had exceeded its powers; it was merely supposed to do the mathematical computation of the average rate of taxation of general property.[41]

At the same time, the local assessors, realizing that the tax commission intended to level all assessments up toward full value, became violently opposed to the state tax body.[42] The political power of the local assessor is, to a certain degree, dependent on his ability to assess property as he chooses. To force him to assess all property at full value would tend to weaken his political position. Through their state supervisors' association, the assessors by 1905 had become powerful enough to contribute to the commission's downfall. The railroads were also opposed to a strong state tax commission. Due to these several reasons, the law was amended, cutting the membership to three and greatly

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[39] W. O. Hedrick, op. cit., p. 51.

[40] Report of the State Board of Tax Commissioners - 1900, p. 119.

[41] Detroit Board of Education v. State Board of Assessors, 121 Michigan Rep., p. 133.

[42] H. L. Lutz, op. cit., p. 291.

curtailing the commission's powers.[43] Its authority over general assessments was taken away and it was left only those powers of an advisory nature. However, in 1911 the lost authority was restored and the commission was supported in its advocacy of full cash value assessments.[44] The legislature has added other duties at various times since 1911. Today the tax commissioners are appointed by the governor for staggered terms of six years.

The duties and powers of the State Tax Commission are very extensive. Its function in regard to the general property tax is the function of primary concern here. The Commission has general supervision over administration of the tax laws of the state and over supervisors and other assessing officers.[45] It has supervision over assessment rolls, with power to inspect and correct the rolls on its own motion or upon complaints of taxpayers.[46] It can require sworn tax statements from taxpayers,[47] and can re-assess any local unit it desires. It hears appeals from the townships and cities aggrieved by county equalization and can order changes made in such equalization.[48] It has the duty of preferring charges to the Governor against any tax official who fails in the performance of his duties and may enlist the aid of the Attorney General to such an end. Since the passage of the fifteen-mill amend-

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[43] Act 281, P. A. 1905.

[44] Act 17, P. A. 1911.

[45] C. L. 1929, Secs. 3545 and 3713.

[46] C. L. 1929, Secs. 3543-48.

[47] C. L. 1929, Sec. 3410.

[48] C. L. 1929, Secs. 3422, 3425, 3426.

ment, which will be discussed later, the tax commission has additional duties. It hears appeals from local units in regard to allocation of tax rates and may prescribe budget and statement forms for local units.[49]

The State Tax Commission has three additional duties which come under the heading of state finance, not local. The commission, with the Governor, constitutes the State Board of Assessors. This board annually assesses the property of all companies engaged directly or indirectly in railway transportation or in telephone or telegraph communication and determines the average rate of taxation on other property in the state, which is then applied to the property of these corporations.[50] The Commission also supervises, computes, assesses, and collects the gas and oil severance tax.[51] Another of its duties was the supervision of the mortgage tax on real property[52] but this was changed by the passage of the intangibles tax law in 1939.[53] This law exempts intangible property from the general property tax and subjects it to a new specific tax administered by the state tax commission. Thus they lose one duty and gain another.

In the discussion of state equalization of property assessments, the duties of the Tax Commission in the process were described. The Tax Commission constitutes a majority of the State Board of Equalization. It also recommends certain figures to the equalization body as its estimates of what the equalized value of each county should be. As would be ex-

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[49] Acts 62, P. A. 1933, and 30, P. A. 1934, First Extra Session.

[50] C. L. 1929, Secs. 3552-3572.

[51] C. L. 1929, Secs. 3604-3618.

[52] C. L. 1929, Secs. 3643-44.

[53] Act 301, P. A. 1939.

pected, the commission, acting as the equalization board, usually accepts its own estimates. The commission is also charged with the duty of furnishing the equalization body with any information required.[54]

From the above discussion it can be seen that there are constitutional, legislative, and administrative methods of assessment supervision in Michigan. How have these methods worked in realizing the standard of cash value assessments set by our constitution? Has our supervision been effective? What can be recommended that would improve the assessment procedure and practice? These are the questions that must now be answered.

In order to criticize the assessment of property in Michigan, a table of the total assessed valuation of all taxable property in the state, real and personal, for the years 1900 to 1940 has been compiled. There are three other valuations used in Michigan which are also shown in Table I. The value placed on property by the township supervisors and other local assessors, village or city, is shown in column I. The second column lists the value as equalized by the eighty-three county boards of supervisors. The estimates of the total valuation as made by the State Tax Commission and recommended to the State Board of Equalization make up column III, while column IV lists the final value as equalized by the board. Figure I presents a graph based upon the statistics contained in the table. The valuation as equalized by the eighty-three county boards is not shown on the chart since it is always just slightly below the original assessment. Before 1921, the recommendations of the tax commission and the state equalization were made only at intervals so that Figure I shows those years with a cross or a dot. Figure I shows how the tax commission has

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[54] C. L. 1929, Secs. 3696-3702, 3422.

TABLE I

ASSESSMENT FIGURES FOR THE STATE OF MICHIGAN

Year	I Assessed Valuation (Original)	II Valuation as Equalized by County Supervisors	III Valuation Recommended by State Tax Commission	IV Valuation as Equalized by State Board of Equalization
1900	$1,317,450,028	$1,249,877,479	$	$1,578,100,000
1901	1,335,109,918	1,235,806,025		1,578,100,000
1902	1,418,251,858	1,406,818,486		
1903	1,537,355,738	1,499,108,944		
1904	1,529,996,350	1,517,197,602		
1905	1,574,422,770	1,543,648,648		
1906	1,598,935,606	1,579,572,934	1,931,000,000*	1,734,100,000
1907	1,654,371,892	1,646,390,584		
1908	1,648,671,411	1,624,340,755		
1909	1,687,155,697	1,678,268,011		
1910	1,739,652,458			
1911	1,898,057,358	1,797,658,194	2,963,533,822†	2,288,000,000
1912	2,078,694,409			
1913	2,345,695,709			
1914	2,765,439,636	2,712,145,396	3,324,500,825	2,800,000,000
1915	2,968,236,813			
1916	3,625,142,971	3,238,646,721	3,633,832,007	2,800,000,000
1917	4,027,364,717			
1918	4,218,781,678			
1919	4,503,980,981	4,320,855,664	4,935,883,000	4,500,000,000
1920	5,319,702,886			
1921	5,483,535,114	5,383,094,274	6,706,421,000	5,000,000,000
1922	5,628,621,291	5,507,035,503	6,491,574,000	5,000,000,000
1923	5,906,199,715	5,828,128,409	6,545,065,000	6,540,000,000
1924	6,458,613,848	6,424,673,339	7,007,917,000	7,007,917,000
1925	6,948,318,253	6,930,036,335	7,361,080,000	7,361,035,000
1926	7,553,552,768	7,589,000,178	7,715,865,000	7,709,790,000
1927	7,891,195,856	7,917,981,000	8,380,500,000	8,045,000,000
1928	8,168,069,289	8,126,361,000	8,209,120,920	8,201,420,920
1929	8,362,913,114	8,364,994,197	8,570,675,000	8,564,698,000
1930	8,460,234,945	7,804,313,652	8,450,030,000	8,447,141,000
1931	7,854,628,979	7,189,383,533	7,853,914,000	7,853,514,000
1932	6,603,821,037	6,472,244,696	6,819,420,704	6,614,308,000
1933	5,821,072,389	5,739,832,842	5,830,784,000	5,829,284,000
1934	5,685,263,349	5,607,366,377	5,573,884,000	5,564,884,000
1935	5,652,288,256	5,590,915,010	5,575,054,000	5,575,054,000
1936	5,720,274,670	5,671,025,723	5,630,426,000	5,630,426,000
1937	5,912,306,455	5,851,171,680	5,762,721,000	5,762,721,000
1938	6,055,858,530	5,983,872,580	5,762,721,000	5,762,221,000
1939	6,122,089,325	6,046,217,458	5,882,961,000	5,882,961,000
1940	6,028,028,754			5,883,000,000

*Federal census estimate in 1906, $3,000,000,000.
†1911 Assessed Valuation only 61.6% of full value.

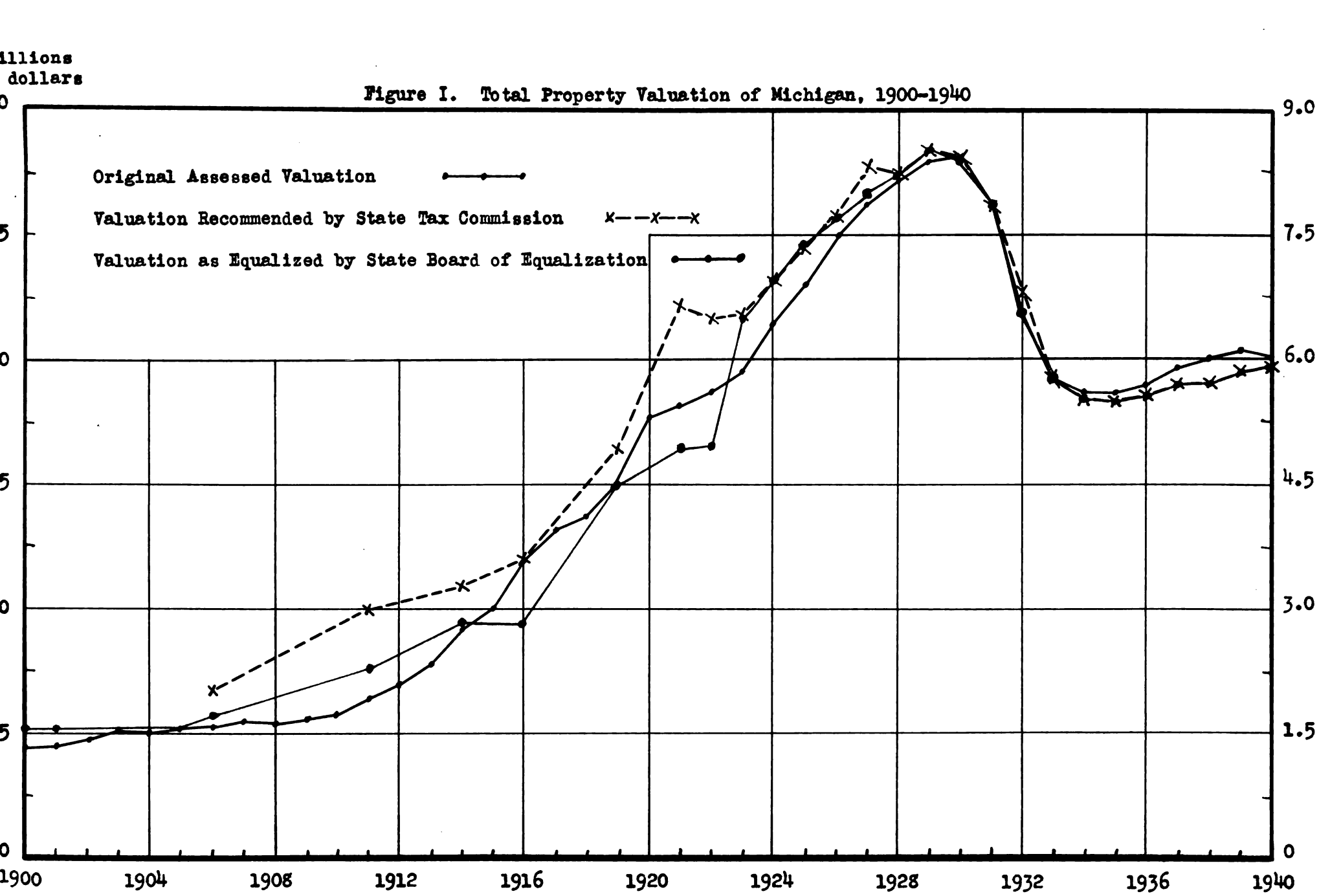

Figure I. Total Property Valuation of Michigan, 1900-1940

continually pulled the assessments up toward full value. In analyzing the trends and changes shown by the table and the graph, it must be born in mind that Michigan was growing rapidly during part of the forty year period; therefore, the figures will contain an indeterminate growth factor.

Criticism of Local Assessment. Michigan has 1266 township supervisors who have as one of their multitudinous duties the task of assessing the taxable property in their respective townships. In addition, there are 164 cities, 37 wards, and 318 villages, a total of 1785 assessment districts.[55] In only ninety-one of the cities is the assessor appointed; all the other districts have an elected assessor, usually with a short term of office. Township assessors (supervisors) are elected annually. No special training is required in most cases and the compensation is ordinarily low. In most of the rural districts, and many of the urban, the annual assessment rolls are prepared by hand and many errors are made. Of 1,500,000 descriptions on township tax rolls examined by the Rural Property Inventory Project, over ten per cent were found to be erroneous.[56] Considering the number of officials and their manner of selection, it is surprising that they do not make more errors. In 1940 a field examiner of the tax commission found one Michigan city of nine thousand people in which the city assessor did not even have a city land map. How could he tell if he had assessed all the properties?

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[55] Robert S. Ford and Frank Landers, Property Tax Administration--Bureau of Government--University of Michigan, 1939, p. 3.

[56] Report of the Tax Study Commission, 1939, p. 60. This commission was appointed by Governor Frank Murphy on December 22, 1937, pursuant to authority vested in him by Act 195, P. A. 1931. It was instructed to recommend to the Executive and the Legislature "an orderly, stable, and just system of taxation and revenue distribution for state and local governments." The membership and staff included many of Michigan's citizens most experienced in taxation.

One recent development which is helping local assessors is the practice in some counties of preparing assessment rolls by machine, thus eliminating the chance of erroneous descriptions.[57] Another aid, or potential aid, is the Rural Property Inventory, a Works Progress Administration project sponsored by the State Tax Commission. The inventory covers eighty-two counties, excluding only Wayne county and all incorporated cities. The work of the project is to correct all property descriptions, prepare township maps denoting property boundaries, take a field inventory of property, and transmit this data to permanent records for the use of assessing officials.[58] As Commissioner Libcke describes the situation, the lack of effective use of land maps is due primarily to the local assessor's inexperience with them, and the next few years should see much improvement, thanks to the W.P.A. project.[59] Wayne county is now completing an extensive project (using Federal funds) which is a cadastral survey and inventory.[60] Most local assessors have only a short time in which to make the assessment of property. There are about fifty working days from the time of election till the time of completion of the rolls. Village assessors usually assess the entire village in two or three days, while the township supervisors take more time but far too little to do the task right. Here there is an unnecessary duplication of effort, since both the village assessor and the township supervisor assess all village property, often traveling about together. They do not always reach the

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[57] Property Tax Administration, p. 5. Also letter from assessor in Van Buren County.

[58] Report of State Tax Commission, 1937-38, p. 27.

[59] Interview with Tax Commissioners McPherson and Libcke, September 19, 1940.

[60] Report of the Tax Study Commission, 1939, p. 61.

same valuation, however, as they may be governed by different motives.

As Dr. Hedrick found in 1928,[61] annual assessments do not always mean annual revaluations. It is freely admitted by assessors that most of the valuations are copied from the previous year's roll. Being elective officials, they are reluctant to create ill will by raising valuations. When the assessment roll is completed, it is turned over to the local board of review, consisting of the assessor and two taxpayers. By law, this board is supposed to review each assessment, but in practice, only a small number are actually reviewed. Any taxpayer may appear before his local board to protest his assessment, and if he then fails to get satisfaction, may appeal to the State Tax Commission. The Tax Commission then makes its own appraisal of the property in question and usually brings about a compromise between the taxpayer and the local board of review. It is the opinion of the present tax commission that most taxpayers are not aware of their privilege of appealing to the commission. Those who do appeal often are the largest taxpayers. Many appeals have recently come from the light and power companies, who are still assessed by local assessors, although some public utilities are originally valued by the tax commission through its membership on the State Board of Assessors. Because many municipalities have built their own power plants, some of the value of the private power plants has been destroyed. Failing to get a commensurate reduction in their assessments from the local assessors, these private companies have appealed to the supervisory agency. The ordinary local assessor has no qualifications for such a technical job. The property of electric and gas companies should be assessed

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[61] R. Wayne Newton and W. O. Hedrick, Farm Real Estate Assessment Practices in Michigan, Michigan Agricultural Experiment Station Bulletin No. 172, p. 22.

by the State Tax Commission, like that of transportation, telephone, and telegraph companies.

Besides assessing the property in their respective townships, the local supervisors have the collective task of equalizing the valuations between townships. These county boards usually make a slight reduction in the total assessment, the total equalized valuation of all counties in the state being higher than the original assessment in only three out of the last forty-two years. (Table I) Township equalization does not solve the problem of unequal assessments because it cannot correct inequalities between individuals but only between townships. In fact, the board of supervisors is unlikely, for political and other reasons, to make a full equalization between townships. Equalization is attempted only for real property. Often this tends to accentuate inequalities in original assessments, rather than reduce them. Personal property is forced to bear either more or less than its fair share of taxes, accordingly as the total real property valuation is increased or decreased.[62] This is true because, within the township, taxes are not spread against individual properties on the basis of the equalized valuations, but are apportioned according to the original assessment figures as set by the township board of review. Thus an increase in real property valuation of a township or city by the county board means that the county tax on personal property assessed therein is also increased. Also, this increase would mean that Mr. Doe, with property assessed at ninety per cent of full value would bear relatively more of the increased taxes than Mr. Roe whose property is assessed at only sixty per cent of full value. Any

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[62] Newton and Hedrick, op. cit., p. 29.

township or city may appeal to the tax commission to change the county equalization. Upon such an appeal, a member of the commission meets with the county board of supervisors, and he can equalize the townships as he wishes. There have been four to six appeals of this nature annually in recent years. The commission is the final authority, for their valuation or equalization is not reviewable by the courts.[63]

Results of Michigan's Supervision. As mentioned before, the commission has had its powers and duties changed rather often. Before 1911, it accomplished very little, except perhaps to better acquaint some assessors with the law. Before 1905, the commission had tried to raise assessments toward full cash value, but angered voters rescinded its powers. However, the commission was reinstated in 1911 and then began its active campaign to reassess the entire state.

In 1909 assessments in Michigan varied from thirty per cent of full cash value in one county to eighty per cent in another.[64] It was the firm intention of the commission to raise the level of assessments throughout the entire state to as near one hundred per cent of full value as possible. In working toward this end, they employed a large staff of well-trained men to make complete assessments of the state, county by county. The law forbids local assessors to change the valuation set by the tax commission for a period of three years,[65] thus insuring the maintenance of the tax rolls at cash value for a time. The results of the diligence of the commission are shown in Table I on page 20. In 1919, when the re-

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[63] C. L. 1929, Sec. 3422; Case v. Dean, 16 Michigan 12, 25.

[64] Report of the State Tax Commission, 1917-18, p. 26.

[65] C. L. 1929, Sec. 3547.

assessment was nearly completed, the assessment ratio had risen to ninety per cent, while it had been only sixty-one per cent in 1911. The assessed valuation more than doubled in these eight years, rising from $1,898,057,348 to $4,503,980,981.

The commission was most careful in its dealings with local officials and completely avoided its experience of 1900-1905. Both taxpayers and assessors seemed to realize that cash value in the law meant cash value and were glad to coöperate. The local officers even hired the employees of the tax commission to bring their assessments up to full value.[66] Much of the commission's success during this period was due to its helpful, educational attitude and the excellent work of its field men. The tax commission published a new "assessor's manual" and a pamphlet on "cash value assessments." The manual was filled with helpful advice and suggestions for assessors and the pamphlet outlined the commission's plan of coöperation, explaining the potential benefits of full value assessments. These two publications raised the prestige of the commission in the eyes of taxpayers and local assessors.

One of the assessors of Detroit has criticized the tax commission for its apparent refusal to allow local assessors to use Federal Income Tax reports.[67] Upon inquiry, it was found that the tax commission does not have the authority to give those returns to local officials. The commission asked for just that power four years ago and the governor changed their request so that the Bureau of Internal Revenue granted only the

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[66] Reports of the State Tax Commission, 1919-20, p. 20; 1917-18, p. 26.

[67] K. J. McCarren, "Righting of Tax Wrongs Called State-Local Duty," Michigan Municipal Review, July, 1937, p. 106.

State Tax Commission authority to examine income tax returns. Again in 1939 the commission made their request, but this time it was refused at Washington. They may ask again next year but the commissioners are of the opinion that the value of the income tax returns to assessors is sometimes overrated. The assessor must still use his own judgment and the availability of the reports will not make his task materially easier. However, they should be available if the local assessor wishes to use them, since any aid is beneficial. Their use is also something of a silent threat to force the taxpayer to declare his property at the correct value.

In the years following 1921, the tax commission was required to make an annual estimate of the property valuation, real and personal, in each county of the state, for the use of the State Board of Equalization. Before 1921, this estimate of full value was made only once or twice every five years, thus leaving the commission free to do reassessment work. This task of reassessment has never been undertaken again, for several reasons. First, the commission has too much other work to do because of annual equalizations. Second, the funds and staff of the commission were reduced in 1921 and its funds have never been restored. Indeed, the tax commission has never received appropriations adequate for the full performance of its legal duties.[68] Third, the commission has felt, and feels today, that the work of 1911-19 is no longer necessary. Most of the local assessors have kept their rolls at a very satisfactory percentage of full value, once it was ascertained by the commission. The advantages of full value assessment and the advice of the commission, coupled with the lat-

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[68] Report of the Tax Study Commission, 1939, p. 10.

ter's power of hearing appeals, have all served to keep the local assessor from materially lowering assessments. The commission's viewpoint seems to be supported by the picture shown in Figure I on page 21, where we find the local assessed value drawing closer and closer to full value, as estimated and recommended by the State Tax Commission. As is to be expected, the commission's figures change more rapidly; they were the first to rise during the period from 1923-29. Since 1932 the commission's estimates of the total valuation of the state has generally been below the total of the local assessments.

While there has been much to criticize in the assessing of property in Michigan, most observers agree that the assessment ratio is higher here than in any state except Wisconsin, which has a very successful system of district supervision of local assessors. This observation appears to be substantiated by the figures collected by the Department of Agriculture.[69] They collected sales data for farm real estate transfers in some thirteen counties for several years from 1900 to 1935 and compared these with the assessed valuations of the same properties for the corresponding years. In all but one county tested, Marquette, the assessment ratio kept well above seventy per cent in nearly every year since 1921, and for the last few years would average well above ninety per cent. Any comparison of this with other states would be to Michigan's advantage. (Florida's assessment ratio ranged from ten to fifty per cent, with a large proportion below thirty per cent.) Of course, merely to say that a county or a state has a high assessment ratio does not mean that inequal-

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[69] Ratio of Assessed Value to Consideration in Voluntary Transfers of Farm Real Estate, United States Department of Agriculture, 1939, p. 32.

ity does not still exist between individuals. This inequality is what must be reduced, and it can be done by proper state supervision.

Recommendations. As most students of the subject have concluded, our primary assessment districts are too small and too numerous.[70] By 1927 only eleven states besides Michigan still used the small township assessment system. Six of these (Massachusetts, Minnesota, Iowa, New York, Pennsylvania, and South Dakota) were recommending the change to county units as long ago as 1924. The five remaining were all New England states with a local government structure peculiar to themselves and not adaptable to our Michigan conditions.[71] By making the county the assessing unit, we could reduce the number of assessment districts from 1785 to 83 and the number of assessors from 1800 to 83, with staff help for assessors in the larger counties. There would be other advantages resulting from this change. The assessors would have a year-round task and could be paid a salary large enough to attract capable men without materially increasing the cost of assessing. If a better job is done, the social cost would certainly be less, even if the dollar cost is slightly higher. These county assessors should be appointed for long terms by either the tax commission or the county board of supervisors after an examination, and should be subject to approval and removal by the State Tax Commission. This change would eliminate the 1750 local boards of review and their expense, and only eighty-three boards, one for each county would be needed. The county equalization, which has been rendered impotent

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[70] Newton and Hedrick, op. cit., p. 57; Landon, op. cit., p. 16; Loren B. Miller, Local Finance and Procedure, a report to the Michigan Commission of Inquiry into County, Township, and School District Government, 1933, p. 37.

[71] Newton and Hedrick, op. cit., p. 57.

by the 15-mill tax rate limitation,[72] would also be abolished, since all the property in the county would be assessed by the same official and would need no equalization.

If we are to retain the present township-village assessment system, there are several improvements vitally necessary. All assessment and tax rolls should be prepared by mechanical equipment in some county office, preferably that of the treasurer. It has already been mentioned that some counties have adopted this procedure, and others should be encouraged or forced to do so, since it would eliminate many merely mechanical errors, such as incorrect names of owners, wrong legal descriptions, and no descriptions. The tax commission should continue to guide, educate, and equip local assessors.

Every assessor should be furnished with detailed land maps and soil surveys, such as have been prepared by the Michigan State College Soils Section and the Conservation department of Michigan. Simplified instructions explaining to assessors how to go about their duties of assessment should also be furnished, along with all information relating to property values which the tax commission has available. Wisconsin has done more than any other state along this line, by creating district supervisors of property assessment. Each supervisor has jurisdiction over from three to eleven counties and engages in an intensive, year-round study of conditions in his district, as a basis for guidance and instruction of the local assessors.[73]

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[72] See Chapter III, p. 35.

[73] H. L. Lutz, "State Supervision of Local Finance," American Economic Association, Round Table Conference, December 29, 1934, p. 5.

A state tax supervisory agency should prepare an assessment manual and instruct assessors in its use. In Michigan assessment booklets were distributed in 1893, 1910, and 1914, but only the 1914 manual contained useful instructions.[74] In 1937 the Michigan State Tax Commission secured the services for a few months of Charles D. Rosa, noted for his excellent work with the Wisconsin state tax department, as an expert in assessment practices. Under his direction an "assessor's manual"[75] was prepared and distributed to all local assessors. This manual should be of considerable aid to assessors, because it not only defines the law but also offers practical suggestions and information for the assessment of property. However, it has not yet lived up to expectations, primarily because no effort was made by the State Tax Commission to educate local assessors in its use. Merely distributing such a book to local officials is largely ineffective for assessors must be taught how to use the manual to best advantage.

Early in 1940 the State Tax Commission held a meeting of all local assessors to explain the new intangibles tax and how it affected their work. Meetings of this nature are very difficult to hold when there are 1785 local officials. They could be held more easily and more successfully if there were only eighty-three county assessors. At the present time there is an organization, the State Association of Supervisors, which could do much to improve the assessment work of its members if it wished to do so.

It is necessary to mention one further criticism of the present

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[74] Michigan Municipal Review, May, 1938, p. 68.

[75] Michigan State Tax Commission, Assessor's Manual, 1938.

supervision process. As shown in Table I and Figure I, the final equalized valuation of the state was somewhat higher than the original assessment but always lower than the estimate of the tax commission during the period 1900-1914. In 1916 the equalization board drastically reduced the assessments reported by local officials, mainly because of political reasons. Since 1921 the tax commission has constituted the majority of the board of equalization and of course usually accepts its own recommendations. There is no longer any need for a separate State Board of Equalization, since all powers and duties of that body are now, and should be, performed by the State Tax Commission. The same criticism applies to the State Board of Assessors. The tax commission is the board of assessors in practice, except in rare cases when the governor overrules the other three members because of some political pressure on him. This situation is very objectionable and should be eliminated by dropping the governor from the assessing body.

If the State Tax Commission is to be retained in its present capacity as the supervisory agency over all valuation of property, it should be relieved of its duties in connection with the gas and oil severance tax. There should be a state department of finance to administer all state taxes, including the severance tax and the intangibles tax. The tax commission's functions could easily be coordinated with such a centralized tax department, to avoid any overlapping of work.

It may seem that too much time has been spent on the assessment of property and proper supervision over such assessment, but this problem is most important. The property tax still accounts for the major part of the revenue of local governmental units and the assessment of property

is the very heart of the tax. An inequitable assessment results in an unjust tax, making more difficult the collection of the tax. If taxpayers know that the assessment of property is efficient and impartial, they will offer fewer objections to the payment of their taxes.

CHAPTER III

SUPERVISION OF PROPERTY TAX COLLECTION

There is very little state supervision over the collection of property taxes in Michigan. What supervision we do have is of the legislative variety, for our law designates who shall collect taxes and how they shall collect them.

Current Tax Collection. Property taxes are "received" in Michigan by the local treasurer of township, village, or city.[1] These are elected officials whose prime consideration is, naturally, the retention of their offices. This desire to keep the goodwill of the electors is sometimes at variance with the most efficient collection methods. The township and village treasurers are usually paid from fees added to the taxes. The law states that they shall add a one per cent fee on all taxes collected before January tenth and they shall add a four per cent fee to all taxes collected on or after January tenth.[2] However, there is no consistent policy in regard to this fee. Many township treasurers never charge more than one per cent, regardless of when the tax is paid, while others vary the amount of the fee according to personal friendship or political affiliations.[3] There have been other instances where collection efforts have purposely been lax before January tenth in order to collect the larger fees after that date. These discriminatory practices certainly do not

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[1] C. L. 1929, Secs. 3434-3445.

[2] Act 88, P. A. 1931.

[3] Loren B. Miller, Local Finance and Procedure, Michigan Local Government Series, 1933, p. 42.

obey the law, for the law reads "shall" and not "may" in regard to the addition of the four per cent fee.

In cities and townships where the taxes levied amount to $50,000 or more, the treasurer is paid a salary of not less than $600 annually, fixed by the city council or by the township board. In these larger townships, there is no fee added to the taxes if they are paid before January tenth. The above provisions in regard to a salary in lieu of fees for the township treasurer are only applicable to those townships in which the electors have adopted the change at a general or special election.

It is very apparent that the appointment, rather than the election, of tax collectors would improve the tax collecting function.[4] All collectors should be compensated on a fixed salary basis and the salary should be large enough to attract capable men. These changes should greatly reduce the favoritism now possible under the fee system, since the collector, no longer dependent directly on the voter's goodwill, could collect taxes without fear or favor. In order to utilize a full-time collector, the county should be the collecting unit for county, township, city, village, and school taxes. Taxes could be paid by mail or at the county seat with no hardship to the taxpayer in this day of speedy transportation. Branch collection agencies could also be established where the density of population warranted it. A county treasurer, receiving a decent salary and appointed for a long term but removable for incompetency, would make our property tax collection much more efficient. He would be

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[4] R. S. Ford and Frank Landers, Property Tax Administration, Bureau of Government, University of Michigan, 1939, p. 17.

a "collector" of taxes and not merely a "receiver." Today most of our elected collectors receive too little income to feel that they should exert themselves in collecting taxes. They receive those willingly offered, but the initiative rests with the taxpayer. It might be well to allow payment of all property tax levies in instalments as the Federal government does with income tax payments and as Michigan has done in the case of certain delinquent taxes.[5] Certainly, application of more businesslike collection methods would reduce current tax delinquency.

Delinquent Tax Collection. In any discussion of state supervision of local taxation, the problem of property tax delinquency and tax limitations must be considered. This is especially true in Michigan where the last decade has brought dozens of new statutes attempting to solve the problem of delinquency and to stop the wholesale reversion of land to the state when taxes are unpaid. Many states, including Michigan, passed laws providing for moratoria on the payment of delinquent taxes and the waiving of various penalties. These depression laws undoubtedly had many ill effects, although they seemed necessary at the time.

The procedure outlined in the following paragraphs was the legal procedure until 1932. The discussion is in the present tense because the depression tax laws beginning in 1932 changed only portions of the basic law. Following this description of the earlier delinquent tax collection process, the various changes from 1932 to 1939 will be reviewed.

A. Procedure Before 1932. All taxes not paid by the first of March become delinquent. The township treasurer, or local collector, then pays all state and county taxes collected to the county treasurer and also

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[5] Act 126, P. A. 1933.

gives the latter a statement of all unpaid taxes,[6] with a complete description of the property concerned. The county treasurer then sends a copy of this statement to the Auditor-General of the state.[7] The delinquent taxpayer may pay his taxes, with interest at the rate of three-fourths of one per cent per month and a four per cent collection fee added, at any time between March one and the date of the tax sale. Such payment can be either to the county treasurer or to the Auditor-General. All lands upon which taxes remain unpaid one year after being returned delinquent to the Auditor-General are subject to sale.[8]

The tax sale takes place twenty-six months after the March one on which the taxes became delinquent. The tax sale in Michigan is conducted by the county treasurer[9] but is managed by the Auditor-General. At two different times in our history (1844 and 1891) there was county management of tax sales, but in each case this function was returned to the Auditor-General by the succeeding state government.[10] Most states have county management of tax sales. In Michigan it has often been urged on the legislature by governor's messages and it was recommended by both of the last special State Tax Commissions (1923 and 1930). Detroit and Grand Rapids manage their own tax sales and use different methods than those of the state. Both Professor Hedrick and Mr. Ford have concluded that the

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[6] C. L. 1929, Sec. 3446.

[7] C. L. 1929, Sec. 3448.

[8] C. L. 1929, Sec. 3451.

[9] C. L. 1929, Sec. 3462.

[10] Robert S. Ford, Realty Tax Delinquency in Michigan, Bureau of Government, University of Michigan, 1937, p. 4.

state can best manage these tax sales.[11] There will be more efficient collection of back taxes and less laxity if the job is done by more neutral and experienced state officials.

After the twenty-six month period the Auditor-General petitions the circuit court for a decree in favor of the state.[12] When granted, the order and the petition are published in the local newspapers as notice of impending sale. The county treasurer also notifies the owners of tax delinquent lands, who may contest the validity of the tax sale in court.[13] Each parcel of land is sold separately. The tax lien goes to the buyer who will pay the full amount of the lien for the smallest portion of the land, or, the price is set and the amount of land is the variable factor. The tax sale is not a foreclosure, since the buyer merely gets a certificate which entitles him to a tax deed only if the owner does not redeem.[14] Ordinarily the buyer is in fact lending money to the owner for a short period at a substantial rate of interest.

The owner of the property is allowed eighteen months in which to redeem the land, with payment of the sale price plus interest at one per cent a month. Tax liens not sold to private persons at the sale are bid off to the state and are again offered for sale at the next yearly tax sale. If not sold then, they become "state tax lands," and may be sold to the public or deeded to the state and turned over to the Conservation

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[11] Robert S. Ford, op. cit., p. 4, and W. O. Hedrick, Farm Tax Delinquency in Michigan, Special Bulletin No. 264, 1935, Michigan State College, p. 36.

[12] C. L. 1929, Sec. 3452.

[13] C. L. 1929, Secs. 3453, 3459.

[14] Ford, op. cit., p. 5.

Department. The latter has the right to reserve these lands for public use or to sell them at public auction. Today there are Land Use Planning Committees in forty-seven northern counties, which are working with the Conservation Department in determining what land should be returned to private use, what land should be deeded to cities for parks, and what land should be used for state or national parks. Perhaps eventually we can expect all land which is economically unfit for private ownership to be withheld from resale by the state.

Since 1933 many laws have temporarily modified the foregoing procedure. In other words, we have had state supervision through legislation in an attempt to solve our tax delinquency problems.

B. Depression Tax Laws. Many of the following laws seem now, and undoubtedly were, extremely radical. However in 1932 and 1933 there appeared to be a pressing need for immediate relief to owners of tax delinquent lands. Private debts were lightened by foreclosure stay laws[15] and there was seeming justification for relaxing the collection procedure of tax debts, which had become a widespread obligation after the first three depression years. These tax relief laws will be reviewed as nearly as possible in chronological order.

The redemption period offered to any owner of land sold in 1932 was extended to 1934 if forty per cent of the tax sale price was paid before May, 1933.[16] Those owners of land which had already been sold were further protected by an act which forbade the sale of state bids or state tax lands to any but those with an interest in such land.[17] The tax sale of 1933 was

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[15] Act 98, P. A. 1932.

[16] Act 10, Extra Session, 1932.

[17] Act 26, P. A. 1933.

delayed partially[18] and then postponed entirely.[19] This prevented the sale of lands delinquent for taxes of 1930 and prior years, which sale would ordinarily have taken place in May, 1933.

One of the most interesting laws was the Moore-Holbeck Act of 1933.[20] It was so drastic that the legislature felt it incumbent upon them to justify it by a preamble which reads as follows:

> Section 1. The governor of the state has declared that a public emergency exists in the banking business. The legislature has declared that such emergency exists. The legislature has also declared that an emergency exists in the matter of loan values and cash surrender values of insurance policies. Any one of these emergencies directly affects the ability of citizens to pay taxes, both current and delinquent. In the year nineteen hundred thirty-one nearly one-half of the acreage assessed for taxes in this state was returned tax delinquent. The sale of lands for delinquent taxes has been cancelled for a limited time. Many people are unable to pay their current or delinquent taxes. The safety and security of property and home ownership in this state is in grave danger, unless relief is granted by the legislature to citizens whose property is tax delinquent. The legislature acting in the exercise of the police power of the state declares that an emergency exists in the matter of tax delinquency and that legislation being necessary to meet such emergency, does hereby enact the following:

This Moore-Holbeck Act[21] had two features: 1) it cancelled penalties and fees on taxes delinquent for 1932 and prior years if paid, at least partially, before September 1, 1935, and 2) it also permitted the payment of these taxes in ten equal annual instalments, beginning September 1, 1935, with interest at four per cent per annum on each instalment from the date of the first payment till the date of each individual payment.

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[18] Act 30, Extra Session, 1932.

[19] Act 2, P. A. 1933.

[20] Act 126, P. A. 1933.

[21] Act 126, P. A. 1933, early amended by Act 11, Extra Session, P. A. 1934 and Act 73, P. A. 1935. Also Ford, op. cit., p. 9.

The act thus postponed collection of these delinquent taxes from 1933 to 1935. Since 1935 the Moore-Holbeck Act has been amended[22] to continue the emergency in taxation, extending the ten year instalment payment plan to taxes delinquent for 1933, 1934, and 1935. Any property owner could take advantage of the plan if he met certain conditions in regard to taxes prior to 1933.

One other act should be mentioned in this review of the emergency legislation passed by our legislatures. This act[23] cancelled all penalties, fees, and interest charges on taxes delinquent for 1935 and prior years if the taxes were paid between the effective date of the act and September, 1939. This law offered an additional three or four months to pay with no penalties and was enacted to encourage prompt payment--much the same idea as a discount for cash. This was the last evidence of legislative leniency to taxpayers--or non-taxpayers--during our depression-born tax emergency.

The editorial staff of the Michigan Municipal League has voiced some criticisms of the early tax emergency legislation enacted in 1933, 1934, and 1935.[24] The legislature did not attempt to answer several important questions which should have been answered before any emergency tax laws were passed. They did not know what portion of the total number of parcels of property was delinquent, what classes of property were most delinquent, or what the average term of delinquency was. Using Washtenaw county as a sample, the League staff found that 90.4 per cent of the par-

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[22] Act 28, P. A. 1937.

[23] Act 50, P. A. 1939.

[24] "XYZ in the Delinquency Problem." Michigan Municipal Review, January, 1936, p. 6.

cels upon which taxes were delinquent were vacant or unimproved and that 80 per cent of these parcels were outside the cities and villages. These figures should not be taken to mean that it was farming land which was tax delinquent. The majority of the delinquent parcels were unimproved platted lots, the result of the real estate "booms" around our cities. Thus, contrary to the conclusion reached by the legislature in June, 1933, the majority of our homeowners were not in danger of losing their homes because of tax delinquency, for most of their taxes were paid.

In general, the results of the depression tax emergency legislation have been unsatisfactory. Once the taxpayers witness actual leniency or have reason to anticipate leniency, tax delinquency increases rapidly. Our depression laws encouraged a good deal of non-payment of taxes among those who could have paid, but who did not, because they were led to believe that immediate payment was unnecessary and that final payment would be postponed or even cancelled. The legislature never tried out-right cancellation, but they did institute the device of the salvage sale, which will be explained later. The instalment plan of delinquent tax collection was never utilized by as many people as was originally anticipated.[25] Only one-third of the total tax delinquency was affected by some payment under the Moore-Holbeck Act. Again, the terms of this act were too liberal. Ford believes a ten-year instalment period is too long, and that the down payment is too small, although he believes in the general effectiveness of the instalment plan for delinquent tax burdens.[26]

By 1937 the emergency in tax delinquency was evidently over and our

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[25] Ford, op. cit., p. 38.

[26] Ibid., p. 85.

laws reflected that feeling. The tax sale began again in 1938, for any delinquent taxes of 1933, 1934, or 1935, or for any unpaid instalment of delinquent taxes that were being settled under the Moore-Holbeck Act.[27] This 1937 act outlined the tax sale procedure for 1939, 1940, and 1941. The law also made an important change when it reduced by one year the interval between the date taxes become delinquent and the date of the tax sale, this change to begin with the sale of 1940. The redemption period for the lands bid off to the state was also shortened and the penalty which a property owner must pay to a tax title buyer was reduced from fifty to ten per cent.[28] All these changes appeared likely to reduce delinquency and to encourage prompt redemption once delinquency occurred. They are the opposite of tax leniency. However, these desired changes were short lived, for the legislature in 1939 reverted to the old standards.[29] It reestablished the longer interval between tax delinquency and tax sale so that 1938 delinquent taxes would be sold in 1941 and not in 1940.

Although the tax emergency was over, it left a great deal of land, either owned or soon to be owned by the state because of tax delinquency. To provide taxpayers and the local units relief from the accumulated delinquency of the depression years, the legislature provided in 1937 for the salvage sale.[30] The salvage sale is intended to restore to private ownership lands which have been tax delinquent and which have reverted

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[27] Act 325, P. A. 1937.

[28] Act 283, P. A. 1937.

[29] Act 37, P. A. 1939.

[30] Act 155, P. A. 1937.

to the state since the tax sale procedure has been restored. The lawmakers believed that much of this tax delinquent and state owned land was not marginal and that future current taxes could be paid, even though the present accumulation of back taxes could not. In many cases, the back taxes and penalties were several times the total assessed valuation of the land.

The salvage sale procedure is to last for four years--1940 to 1944. It differs from the tax sale in that the former is a sale of the land itself to the highest bidder, while in the latter case only the tax title liens are sold. The lands in southern Michigan which revert to the state each year will be sold at the tax salvage sale the next February to the highest bidder, at a price not less than twenty-five per cent of the last assessed valuation of the property. The previous owner is then allowed thirty days to redeem the property. The owner himself may purchase the land on the instalment plan, or by cash, but any other buyer must pay cash. Any municipality in the southern part of the state may buy these lands for public purposes by meeting the highest bid, provided that the previous owner does not offer that much. If a parcel is once offered for sale and not sold, it will not be offered again.

The salvage sale act[31] created the State Land Office Board, consisting of the Auditor General and two other members appointed by the Governor. This board has charge of the sale of state owned tax-reverted land in the southern part of the state. The Conservation Department has control over the lands north of the tier of counties, Muskegon to Gratiot, and north of Bay county. After 1944 the Conservation Department will

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[31] Act 155, P. A. 1937.

again have sole control over tax-reverted lands. It is the intention to put back into private hands only those lands which will remain there. How successful the salvage sale device will be remains to be seen. It is clearly not a complete remedy, for with no other changes, the land sold may soon be tax delinquent again.

If assessment methods and collection procedure are improved, we may later conclude that these salvage sales, though often virtually an outright cancellation of taxes, were successful in meeting the taxation emergency and were a beneficial exercise of state control. The property tax collections would be more efficient if there were more state supervision, but not necessarily legislative supervision of the kind we have had. The Auditor-General has recently[32] been given more power to prescribe uniform practices for county treasurers and to enforce compliance with them. This seems to be a good place for improvement in collection methods to begin.

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[32] Act 37, P. A. 1939.

CHAPTER IV

SUPERVISION OF PROPERTY TAX RATE

Property Tax Rate Limitation. One of the most extreme kinds of state supervision or control over local finances is the over-all tax rate limitation--either when fixed by the constitution or by statute. Contrary to popular opinion, this method has been tried before in Michigan. In 1828 the territory of Michigan had a tax rate limitation law[1] which limited the taxes to one-quarter per cent for Wayne and one-half per cent for the rest of the territory. In 1829 the law was changed to one-half per cent for Wayne and one per cent elsewhere. Now, one hundred and five years later, Michigan again has an over-all tax rate limit. We are not alone in this type of control, for no less than fourteen states have constitutional tax limits and others have statutory limits.[2] The trend is toward more rigid and widespread tax limits and is in general a protest against the extremely harsh taxation of real property. Although there are several types of tax limits in use, the most common are limits on tax rates.

The Michigan constitutional tax rate limitation amendment, commonly known as the 15-mill amendment, was fostered by the Michigan Farmer, a well-known farm magazine, which put forth the plan in its columns, circulated with success the referendum petitions for place on the 1932 election

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[1] Margaret Schaffner, Territorial Tax Legislation of Michigan, p. 30.

[2] William O. Suitor, "State Limits on Local Property Taxes," Municipal Year Book, 1936, p. 328.

ballot, and presented these petitions to the state officials.[3] The support for the plan was mainly from rural interests, which was only natural since it was these rural taxpayers who were particularly burdened by the property tax during the depression years. It was the "tax revolt" of the property owning group which passed the 15-mill amendment. Although the amendment passed by a majority of only 29,000 votes out of 1,300,000, it carried in 65 out of the 83 counties. In only ten counties in the lower peninsula was there a majority against it. The large negative majorities in counties with big cities (Wayne, Washtenaw, Kent, Jackson) made the total vote very close. Thus these cities almost succeeded in killing the amendment which the Supreme Court ultimately decided did not even apply to them. Of course, that decision could not have been forecast in 1932.

The amendment limited the total property tax rate for all purposes in any one year to one and one-half per cent of the assessed valuation,[4] with certain exceptions. These were: 1) the rate may be increased to not more than five per cent of the assessed valuation for not over five years at a time by a two-thirds vote of the electors; 2) the tax limit may be exceeded by the taxes levied to pay debt service on debts contracted prior to 1932. In 1933 the State Supreme Court added a third exemption when it decided that cities and villages do not come under the act unless they vote to do so.[5] So far only eleven cities have chosen to subject themselves to the 15-mill limit.

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[3] W. O. Hedrick, op. cit., p. 59.

[4] Michigan State Constitution, Article X, Sec. 21.

[5] School District v. City of Pontiac, 262 Michigan 338.

The machinery for administering the amendment has been provided by three acts of the legislature.[6] The first act created a county tax commission, later replaced by the county tax allocation board, to distribute the fifteen mills among the various units. This board now includes six members, three ex officio county officials and three members appointed by the probate judge of the county. If a county includes a city subject to the 15-mill limit, that city selects one of the board members. The law requires that each local unit shall submit a budget to the board by the second Monday in May; the form of such budgets may be prescribed by the Auditor-General. On the basis of these budgets, the county board determines the tax rates necessary for each unit for the next year. The law ordered the Auditor-General to notify the county board of the amount of the state tax levy, which was to be subtracted from the fifteen mills to get the "net limitation rate." Since the state levy was abolished in 1934, the net rate is the fifteen mills. From this rate the board allows one tenth of a mill to all municipalities not under the limitation, three mills to the county, four mills to the school districts and one mill to the townships. These are the minimum rates unless some local unit has needed less than this for the past three years. If so, the average rate of these three years will be taken as the minimum for such unit. The Board then divides the balance of the fifteen mills as it sees fit. It makes a preliminary order, then holds hearings after which a final order is issued with maximum rates. Any unit may appeal the final order to the State Tax Commission, which may change the rates in case of error by the county board. If the process of county equalization of assessments of

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[6] Act 62, P. A. 1933, Amended by Act 30 Extra Session, 1934 and Act 30, P. A. 1937.

local units results in any increase in a township or city tax rate previously set by the board, the excess is deducted from the rate for township purposes. In practice this means that the county equalization is even more useless than formerly.

As Dr. Cline mentioned in his bulletin,[7] the effect of the fifteen mill amendment on Michigan property taxes undoubtedly has been exaggerated. More than half the taxes are levied in cities not under the amendment and in many rural areas the total tax rates are several mills under the limit. Nevertheless, the rigid tax rate limitation is serious enough to warrant detailed criticism.

Criticisms. The earlier use of the tax rate limitation had some element of flexibility about it, but this is seldom so today. More and more of the states are adopting rigid limits in their basic laws, limits which the legislatures cannot change. The primary reason for these new tax limits is to force the states to broaden the tax base, to introduce substitute taxes on the theory, entirely justified, that property should bear only part of the total tax burden. However, property taxes have been high because governmental costs have been rapidly growing.[8] Tax rate limits in most instances do nothing to lower the high costs, but merely force the use of substitute taxes which are in general regressive. These fall more heavily in proportion to income on the laborer, the small home owner, and the average farmer. Those who benefit most from tax limitation are the large real estate holders and the wealthier farmers. The former property tax burden on these groups was undoubtedly excessive, yet

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[7] D. C. Cline, Michigan Tax Trends, Michigan State College Special Bulletin No. 301, p. 11.

[8] H. L. Lutz, Public Finance, 3rd. ed., p. 557.

many of them had capitalized the heavy property taxes when they bought their land and therefore were not injured as much as was commonly believed. The depression did cut land incomes excessively and assessed valuations do move very slowly, so that land owners cannot be blamed for seeking tax-limitation to quickly slash their burdens.

In many cases assessments have been raised or held steady when tax rates were limited. In 1934 a constitutional tax limit of twenty mills became effective in New Mexico.[9] Under this limit the average property tax rate declined from $3.38 in 1933 to $2.43 in 1934 per $100 of assessed valuation. However, the total valuation of the state increased so that tax reduction was more apparent than real. Actually, the state levy remained the same, the school and city levies were increased and the average county levy was reduced by forty-six per cent. The county was the only unit which suffered. It is quite likely that because of the tax rate limit some assessments in Michigan have remained at a higher level than they would have otherwise. That is only natural, since a rate limit leaves the affected unit but one variable, the assessed valuation, which may be raised if the unit needs more money.

City, school, and other local units also lose in fiscal responsibility. If tax rates are rigid, local units must be subsidized or borrow money or slash essential services. Ohio passed a tax rate limit law in 1911. The local debt in Ohio grew from $39.25 per capita in 1910 to $113.84 in 1922 and to $146.85 in 1930.[10] In 1917 the Auditor of State reported that eighty cities in Ohio had total tax levies which were insuf-

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[9] H. L. Lutz, op. cit., p. 559.

[10] Ibid., p. 806.

ficient to pay the debt service; these cities were operating entirely on borrowed funds. All the blame for Ohio's debt-ridden cities should not be placed on the tax rate limit because all cities in the country were incurring debts during that period, but the rate limit certainly was harmful. Since 1934 Ohio cities have reduced their debt burdens, but only because of state aid for support of schools, poor relief and other functions.[11] The state has passed numerous tax laws which have tended to centralize government and shift the responsibility for financing local government to the state. The total taxes on property have not been reduced, at least within the cities, by the new tax laws, but the debt is being reduced.

West Virginia has a two per cent tax limit and her local units have lost a good deal of independence as a consequence.[12] In many instances essential services such as fire or police protection or lighting have been discontinued or curtailed because of the limit. In the state of Washington the introduction of a forty mill tax rate limit reduced revenues so much that it was necessary to substitute a sales tax, a cigarette tax, and various business taxes. Moreover, school and highway support had to be shifted to the state. It would seem that a forty mill limit was too high to be effective anyway, but that is not true in Washington. The assessed valuation of property in Washington ranges between twelve and forty per cent of actual value,[13] much lower than in other states. There-

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[11] C. S. Dargush and J. N. Hart, "Ohio Tends Her Tax Limited Cities," National Municipal Review, July 1939, p. 518.

[12] J. W. Martin, "Tax Limitation--A Dangerous Device," National Municipal Review, September, 1939, p. 618.

[13] Ratio of Assessed Value to Consideration in Voluntary Transfers of Farm Real Estate, United States Department of Agriculture, 1939, p. 184.

fore it is forced to maintain an extremely high tax rate in order to produce the necessary revenues.

Oklahoma and Rhode Island have rigid tax limits but they are high enough and are accompanied by more intelligent planning with better results. Indiana has a flexible over-all rate limitation (no constitutional limitation) and administrative supervision has gradually eliminated the hardships imposed on townships and cities. In Michigan some of the above mentioned changes have already taken place. The state was forced to impose substitute taxes, the most productive being the regressive sales tax. The state has virtually taken over the support of rural highways and is contributing more and more to the support of education and welfare. Yet there is at least one community in Michigan which regards the allowable fifteen mills as a minimum tax rate.[14] Because of oil revenue, this community recently has needed no property tax money for the township. Nevertheless it levies the maximum amount and assigns more millage to schools and other units. When the oil revenues are gone, the units which are getting so much today will have to retrench severely. It is alleged that in some instances, local units have evaded the law by excluding from the 15-mill limit not only the legally deductible debt service on debts contracted prior to 1932, but also debt service on debts contracted since the adoption of the 15-mill limit.

In no instance can it be said that a rigid tax rate limitation has been entirely successful. Many and varied are the ill results, and the benefits could be achieved at less cost in other ways. State supervision

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[14] Bloomingdale Township, Van Buren County.

of local tax limits is desirable, but it should be administrative supervision of a flexible limit. Of course, any supervision of taxes is, in a way, putting the cart before the horse, for effective supervision should be of the expenditures for which the taxes are levied.

PART II

STATE SUPERVISION OF LOCAL FINANCIAL ADMINISTRATION

CHAPTER V

SUPERVISION OF LOCAL BUDGETING

Nature of Public Budgeting. A budget, briefly defined, is an estimate of proposed expenditures for a given period for specified purposes and the means of financing those expenditures. The budget has been called "the work program with a dollar sign in front of it."[1] The budget of any unit, large or small, should express in dollars the program of specific services for which those dollars are expected to pay. It thus properly becomes the basis upon which functional control of expenditures can be built. Secondary in importance and secondary in order of preparation is the budget estimate of how the dollars are expected to be raised. Too many localities reverse both the order of preparation and the importance of the two sides of the budget. Of course, the two sides of the budget should balance, showing all proposed expenditures and all expected revenues, whether from taxation or from borrowing. Although obvious, this primary requirement of budgeting should be emphasized. Without the basic foundation of a budget to build on, the improvements which are desired can not be erected.

The fact that many localities have budgets which do not balance or which end the fiscal year with a deficit, makes it desirable to comment on possible safeguards against budgetary failures. The often debated question of whether to use a "cash" or "accrual" system bothers budget

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[1] Wylie Kilpatrick, State Supervision of Local Budgeting, p. 50.

makers as well as accountants. The strict cash basis recognizes as expenditures only the amounts paid out during the current year, while it excludes from revenue the amounts becoming due but not paid during the year. The accrual system recognizes all liabilities as expenditures when incurred, even if not yet paid, and considers all receivables as revenue when earned, even if not yet collected. Thus the cash system is weak in the recognition of expenditures, while the accrual system is weak on the revenue side. There is no objection to recognizing revenue when earned, either in governmental or commercial accounting, but both types should make adequate allowances for uncollectible receivables. Therefore, more and more people are coming to favor what is commonly referred to as the "cash basis," but which strictly speaking is the accrual system with a conservative estimate of the receivables.

New Jersey adopted the so-called cash basis budgets for its municipalities by the new budget act of 1936.[2] Here again the term may be slightly confusing. In short, it is another, and to date successful, attempt to require municipalities so to make their budgets as to balance their anticipated current expenditures with their estimated current income, or what they can reasonably expect to have to spend. The budgeted revenue for each period is confined to the percentage of taxes actually collected the previous year and the size of the tax levy is fixed accordingly.

This change was made necessary in New Jersey by the huge and continued growth of the floating debt of her cities--debt built up by keeping delinquent taxes on the books as bona fide collectibles and borrow-

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[2] Arnold Frye, "New Jersey and Her Cash Basis Budgets," National Municipal Review, 1937, p. 578.

ing against them. The forerunner to the present act was Chapter 60 of 1934--an act permitting the funding of floating debt only if the city used the above conservative estimate of tax collections. The present act extended this requirement, on a cumulative basis, so that by 1932, seventy-one cities were using the cash basis for their budgets. By 1944 all municipalities are expected to be on the improved budget plan. This law has not resulted, as many critics feared, in any extensive increase in the tax levies of the affected cities and could well be adopted by other states.

Aims and Purposes of Budgeting. Before describing the actual state supervision over budgeting which we have, or have not, enjoyed in Michigan, it may be well to set forth briefly the aims and purposes of good budgetary supervision. State supervision of local budgets and financial programs, developing chiefly since 1920, takes two general forms:[3] On the one hand, some states supervise budgetary procedure by prescribing the forms to be used and requiring that copies of local budgets be filed with a state agency. On the other hand, some states (Indiana, Iowa, New Mexico, and Oregon) control budgeting by reserving the power to modify local programs in various ways. Both Indiana and Iowa can veto contracts proposed by local governments. The New Mexico State Tax Commission has authority to revise local budgets, which must be submitted to it. In practice this control has been unsuccessful, for the commission has examined very few budgets critically.[4] In general, the supervision of budgetary

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[3] Leonard White, Trends in Public Administration, p. 74.

[4] Wylie Kilpatrick, "Tax and Expenditure Control," Illinois Municipal Review, May, 1932, p. 108.

procedure has worked much better than the attempted control of local affairs.

State supervision should be primarily concerned with budgetary procedure. Procedures do not determine the purposes or amounts of local budgets, but do specify the steps, rules, methods, and machinery for administering the budget.[5] The state has both the power and the duty to prescribe local fiscal procedures both by statute and by administrative rulings. A uniform procedure coupled with advisory assistance from the state would be highly desirable. Examination reveals that most of the local objections to state supervision are based on the false notion that it means state control of local expenditure and revenue, leaving the community only the shell of local government. Small wonder that local citizens object, for it has been amply shown that the best results have come from supervision of procedure rather than from strict control. State supervision has made more progress than the more publicized forms of control. This supervision is not an extension of the sphere of the state, it is merely exercising better a duty which has been present all the time. Local officials welcome certain types of state supervision, such as that over budgeting and bond limitations, but dislike what they consider undue legislative interference.[6] They would welcome supervision still more if state laws had been uniformly well written and competently administered.

Extent of Supervision in Michigan. Two-thirds of the states have local budget laws[7] covering all or part of the municipalities within the

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[5] Wylie Kilpatrick, State Supervision of Local Budgeting, p. 118.

[6] M. L. Wallerstein, "What Local Officials Think of State Financial Control," National Municipal Review, September, 1932, p. 557.

[7] Wylie Kilpatrick, "State-Local Financial Relations, Deadlock or Constructive Reform?", Tax Policy League Symposium, December, 1937, p. 143.

state. Although Michigan is probably included in that category, she has very little right to be. Thirty-one states require cities to use forms drafted by the state, and thirty-four states do the same for their counties.[8] In Michigan no budget is required of the counties or of the cities, but budgets are required of the school districts, under the supervision of the State Department of Public Instruction.[9]

In 1931 Michigan passed a comprehensive law[10] which should have accomplished the desired results for local budgeting. It gave to the state treasurer the power to prescribe or approve the forms used and the procedure of making local budgets. It also stated that all estimated revenues and all expenses for the fiscal period covered were to be clearly indicated. The governor was authorized to appoint a special commission which would recommend the proper forms to the treasurer. Like many other laws, it failed in execution and was quickly repealed.[11] It had no effective means of enforcement and its administration was lax and unintelligent. Harold Smith, Secretary of the Michigan Municipal League, commented on its administration as follows: First, there was no attempt to educate the local units to understand the law and much opposition to it resulted; second, the governor held up the accounting forms for the school districts for political reasons.[12] This may have been partly true, but a

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[8] Wylie Kilpatrick, "State Administrative Supervision of Local Financial Processes," Municipal Year Book, 1936, p. 340.

[9] Act 319, P. A. 1927.

[10] Act 315, P. A. 1931.

[11] Act 41, P. A. 1933.

[12] American Municipal Association, Proceedings, 1931, p. 172.

different version has been given by the staff that had charge of the distribution of the forms.[13] The forms for townships, cities, and villages had been distributed and the local units were experiencing great difficulties in filling them out. It was felt that the school districts would have even more trouble than the other units. Moreover, when the school forms came from the special commission to the State Treasurer's office, an error was discovered in the wording too late to correct the forms. Consequently, they were never sent out. Another objection of the staff to the act was that it failed to provide funds or personnel for its administration. Any work that was done on the budgeting forms was done by the regular staff of the State Treasurer's office in addition to their regular duties.

The actual repeal was by enactment of one of the "Brown-Hartman" bills and was recommended by these two legislators to effect a saving of at least $100,000 to the state and its subdivisions while at the same time getting all required information on the subject of expenditure by other means.[14] Brown and Hartman had been members of a legislative commission studying state (not local) expenditures and their recommendation, although entirely without substantiation, was supported by the economy-minded legislature. Brown had advised county supervisors not to comply with the law. The failure of the law gave a "black eye" to state supervision of any kind over local budgeting in Michigan.

As mentioned in Chapter IV, there is a measure of state supervision

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[13] Interview with Mrs. Many, Acting Secretary of the Public Debt Commission, May 16, 1941.

[14] L. B. Miller, Local Finance and Procedure, Michigan Local Government Series, 1933, p. 50.

over municipalities in regard to the apportionment among local units of the 15 mills to which the total tax rate on property is now limited by the Constitution.[15] The form of the budget to be submitted to the county tax allocation board may be prescribed by the Auditor-General. Although forms have been devised for this purpose, the county allocation boards generally do not require their use and there is no state supervisory agency with power of enforcement. Despite the law, true budgets are not usually submitted, but merely requests to levy a specified millage tax on property.[16] The tax rate limitation would be more effective if all municipalities were required to have an adequate budget.

Supervision in Other States. A rigorous type of state control over local budgets has been in operation with some success in Indiana for several years. Local budgets can be appealed to the State Tax Commission by ten taxpayers. There have been many instances of substantial savings due to the commission's careful scrutiny of appealed budgets.[17]

Recently this method known as the "Indiana Plan" has been introduced in Iowa. In that state there is a State Board of Appeal which has the power, in cases brought to it, to reduce or approve any local budget but not to increase it.[18] The appeals are initiated by petition of one-fourth of one per cent of the electorate. The advisability of any new item added

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[15] Act 62, P. A. 1933.

[16] Statement of D. C. Cline, Department of Economics, Michigan State College, based upon his investigations of county tax allocation boards.

[17] F. G. Bates, "State Control of Local Finance in Indiana," American Political Science Review, 1926, p. 352.

[18] "The Indiana Plan in Iowa," National Municipal Review, May, 1937, p. 215.

to a local budget must be proven by the local unit. During the first year of the law's operation, there were ten appeals and seven budgets were cut for a total saving of $344,000.[19] In both these states, the greatest benefit should be the increased desire of public officials to listen to their taxpayers' protests. It should force those officials to improve their budget presentation in order to get public sanction and approval. The budget, when properly drawn, gives the taxpayer a clearer picture of what he is paying for, and any law or supervision which clarifies that picture should be welcomed.

One of the most troublesome aspects of good budgeting is the wide variation in conditions among local units of government. Supervision must apply not only to the small rural township, town, or county but also to cities and more populous counties. It is this difficulty which has helped prevent many states from having effective supervision. Some states have attempted to make their statutes all-inclusive, but without success. Elasticity without laxity is needed, and administrative supervision by some state agency set up to deal with local finance is the best way to solve the difficulty.

The problem of adequate budgeting for the county would be greatly lessened if there were some executive head of the county government, some person who would have the responsibility of assembling the necessary estimates and drawing up the budget. This same official should also have the task of making periodic reports on the actual expenditures and revenues, as compared with the budget estimates. Today our county budgets,

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[19] G. C. Robinson, "Municipal Budget Review in Iowa," National Municipal Review, December, 1937, p. 606.

where they exist, are usually drawn up by the finance committee of the board of supervisors and then approved by the same men. Some counties (such as Ingham) have at least one member of the board of supervisors who is well enough informed and personally so influential and conscientious that he does a good job of budget preparation, even in spite of the lack of sound budgetary procedure. However, this is the exception rather than the rule and cannot be cited as an argument for the status quo. The lack of an executive head is one reason why county government needs drastic reorganization.

Local budgets should be all-year plans, set up before the fiscal year begins and reviewed at least twice during the year. Uniform budgeting is not necessary but adequate budgeting is. Accounting and budgeting must not only be the same in classification and terminology, but must also be consistent in practice. In many states the emphasis has been on uniform accounting, but accounting is not a goal in itself. It serves only to record operations and thus to aid the budget process. Accounting should be viewed as a handmaiden of budgeting, and although it is here treated separately, this relationship should not be forgotten.

Recommendations. Michigan should enact a law providing for a uniform system of budgets for all municipalities, because every local unit should use a budget. The law should provide for a state agency with broad powers of administrative supervision. A uniform system of budgeting should be uniform with regard to procedure but this does not mean that all budgets must be exactly alike. The supervisory agency should be able to adjust the budget process to fit the needs of the particular locality, and yet retain the necessary standardization. For example, many states with state supervisory agencies today allow each local unit to de-

termine the purposes and amounts of local expenditures, with one notable exception. They require each locality to provide for debt service in its budget in order to protect bondholders by levying taxes to pay interest and principal. This certainly should be a standard requirement.

The state agency should be concerned only with local financial problems and should not be subject to political pressure each election year. The staff of this agency necessarily should be well-trained in municipal administration and should be under civil service. The common practice of placing new duties and responsibilities upon an elected official whose primary concern is with state problems should be avoided. Lastly, the law should provide for adequate powers of enforcement. Although the principal effort of the new agency would be to get voluntary and willing coöperation, it would need the authority to enforce compliance if necessary.

CHAPTER VI

SUPERVISION OF LOCAL ACCOUNTING, REPORTING, AND AUDITING

It should be emphasized again that budgeting, accounting, auditing, and reporting are not separate but are closely related processes. Any exaggeration of the importance of one to the neglect of the others will prevent the reaching of the major goal: efficient financial administration.

Accounting. A. Aims and Purposes. In order to point out the aims and purposes of state supervision over local accounts, some of the common faults should be reviewed. Faulty municipal accounting does not permit comparison of the expenses of one local unit for a given purpose with those of another unit for the same purpose. Such comparisons are needed as indications of the relative efficiency and economy of the spending agencies. Another fault is that many books are kept on a strictly cash basis instead of on an accrual basis. When revenues are accounted for when received in cash, and expenditures are accounted for when paid, the system of accounting is said to be on the cash basis. When revenues are accounted for when earned or due, even though not yet collected, and expenditures are accounted for as soon as liabilities are incurred, whether paid or not, the system of accounting is said to be on the accrual basis. Thus, this latter system would record as revenue any or all taxes, licenses, and other assessments when due, and would record as expenditures all liabilities when incurred, notwithstanding that the receipt of the revenue or

the payment of the expenditure may take place, in whole or in part, in another accounting period.

The use of the cash basis violates the sound accounting principle that the records should show the relation of services rendered to the expense incurred if one would know what public services cost. Revenues and expenses are fundamentally different from receipts and disbursements, in a municipality as well as in a private business. "Costs" and "Cash Paid" have very different meanings, as do "Receipts" and "Revenues." A statement of revenues and expenses is a summary made up from the accounts having to do with the cost of operation and with the provisions made for meeting this cost. Statements of receipts and disbursements, on the other hand, are summaries of transactions of the "paying" and "receiving" tellers of the municipalities.[1] Any accounting system (with the possible exception of that used in the smallest towns) should furnish both types of statements. Merely showing the cash flowing in and out is not enough.

Another fault with many of our present accounting systems is the practice of allowing each department to handle its own accounting and sometimes its own funds. This means that no complete financial statistics can be presented for the municipality. Local officials are prevented from rendering an accurate, intelligent accounting to the citizenry and therefore the latter fail to become better acquainted with the financial aspects of their government. Certainly one of the basic needs of a democratic form of government is the constant and intelligent scrutiny of the work of all public officials by the electorate. Without it, waste and inefficiency are encouraged and dishonesty and incompetency can oper-

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[1] Van de Woestyne, op. cit., p. 92.

ate without discovery. State supervision of local finances should always point both toward improving the actual operations and clarifying their presentation.

The legislature itself often needs financial statistics of local units as bases for legislation. Ford[2] found that it was almost impossible to ascertain the amount of taxes delinquent against any property because of inadequate county and city accounting records. Any statute based on inadequate information concerning local finances could not be expected to succeed.

Today most states have some supervision over local accounts. Twenty-eight install or recommend accounting systems for cities and thirty-six do the same for counties.[3] Only part of these states have compulsory statutes, for much is now being done by voluntary education of local officials. In accounting, as in other phases of financial administration, supervision succeeds best when it is accepted willingly on the part of the recipient. However, as recommended in Chapter V, the supervisory agency must have a "big stick" to use if necessary. There always seem to be some local officials who will not cooperate until forced to do so.

B. Supervision in Michigan. The Michigan Constitution of 1908 stated that the legislature should provide by law for the keeping of accounts by all state officials, boards, and institutions, and by all county officials; and should also provide for the supervision and audit thereof by competent state authority. Such accounts should provide for accurate records of all financial and other transactions, maintain checks upon

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[2] Ford, op. cit., p. 84.

[3] Wylie Kilpatrick, "State Administrative Supervision of Local Financial Processes," Municipal Yearbook, 1936, p. 340.

all receipts and disbursements and should be uniform for all county officials. All public accounts and the audits thereof should be open to public inspection.[4] A law was passed under this mandate in 1911,[5] which charged the Auditor-General with the installation of uniform systems of accounts in counties and with the auditing of county books once a year. However, the law applied only to those counties which wished to have the supervision. It was entirely voluntary, with the initiative resting with the county and no particular effort was made to get local approval. It is not surprising, therefore, that it accomplished little and was repealed by the 1919 mandatory legislation providing for a uniform accounting procedure for all counties.[6] By the later law the Auditor-General is charged with the duty of formulating, prescribing, and installing a system of uniform accounting. Annual reports must be made to the Auditor-General by each county office on uniform forms prescribed by him. The refusal of any local officer to comply with any provision of this act is cause for removal by the governor after such refusal is reported by the Auditor-General. Other sections of the act were quite specific in the definition of the contents of the accounting systems to be used, but at the same time gave the Auditor-General wide latitude in the supervision of county accounts. While the uniform accounting procedure for counties has been said to be successful,[7] it has several drawbacks. It places the emphasis on the accounting procedure and neglects the main goal of ade-

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[4] Article X, Sec. 18.

[5] Act 183, P. A. 1911; C. L. 1915, Secs. 265-275.

[6] Act 71, P. A. 1919; C. L. 1929, Secs. 299-313.

[7] Loren B. Miller, op. cit., p. 50.

quate budgeting. Uniform accounting is valuable, but it is a tool of financial administration, not a goal in itself.

The present Auditor-General recognized the need for better accounting practices in many of the counties in 1940 by having his department prepare a series of extensive manuals for distribution to all counties.[8] Each manual is devoted to a separate county office. It lists the various laws affecting the county official, describes the accounting records and forms required of him, and includes a sample copy of each form. The manual should be revised from time to time to be kept up to date, and county officials should be instructed in their use, particularly when taking office for the first time. The manuals should have been compiled and sent out years ago. However, it is encouraging that at last the Auditor-General's department is taking a more active interest in attempting to improve county accounting practices and methods.

The county accounting law has been fairly adequate since 1919 but its administration has not. The Auditor-General is an elective official in Michigan. Naturally he does not wish to antagonize anyone who may help to re-elect him. Some county officials do not comply with the law entirely and leave much of their work for the state auditors to do. Most of the Auditor-Generals have been reluctant to attempt a rigorous enforcement of the law. An elected official, rarely expert in the financial field, should not be given the task of supervising local finance.

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[8] Standardized System of Fiscal Procedure, Accounting and Reporting for the Counties of Michigan, prescribed by Vernon J. Brown, Auditor-General of Michigan. Prior to May 1, 1941, manuals had been distributed for the following county offices: clerk, treasurer, register of deeds, sheriff, and probate judge.

A serious fault of the accounting and auditing law is that it applies to counties only. There was no legislation providing for state supervision over other local units in this field until 1931.[9] The 1931 act, which was repealed in 1933, included uniform budget procedure and uniform accounting for all municipalities other than counties. It has been generally recognized as an admirable but unfortunate law. It provided for the keeping of accounts so as to furnish required uniform reports and for the devising of a system of accounts for each type and class of municipality. The state treasurer was charged with the administration of this act but was to be aided by a temporary commission of men familiar with the problem. The commission was to devise and recommend to the state treasurer the proper forms and procedures and he was to see that they were adopted. As mentioned before,[10] the law had no adequate enforcement provisions and was quickly repealed.[11] The law would have done about all that was desired of it had it been accompanied by a concerted effort on the part of those administering it. This necessary effort could not be expected without an increase in funds and personnel for the supervisory agency. It appeared to the local units as an attempt of the state to control their finances. The resulting antagonism meant that the law was never really given an opportunity to demonstrate its usefulness. The supervisory agency should not be subject to political pressure from local officials, and the state treasurer, an elective official, should not have been made the administrator of this act.

Michigan has two additional statutes which provide some state super-

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[9] Act 315, P. A. 1931.

[10] Chapter V, p. 56.

[11] Act 41, P. A. 1933.

vision over local accounting. One gives the Superintendent of Public Instruction authority to compel school districts to keep adequate records and accounts, and empowers him to audit any district when he deems it necessary.[12] Another law gives the Michigan Public Utility Commission authority to prescribe and install a uniform system of accounts for a public utility owned by a municipality.[13] The city involved must also make annual reports to the commission on prescribed forms. The accounts and reports required should be similar to those required of privately owned utilities. These two laws are admirable in themselves, but they force the job of accounting supervision on agencies primarily concerned with other matters.

C. Supervision in Other States. Massachusetts and Oklahoma are two of the states that have attempted to supervise local accounting instead of controlling it. The experience of Massachusetts with accounting supervision illustrates both the advisability of fostering voluntary cooperation if possible and of using force only when necessary.[14]

Since 1906 Massachusetts has required cities and towns to fill out for the state bureau of statistics certain schedules and reports of their financial activities. From the first, this bureau has been ready and eager to make expert audits of any municipality's books and to install or to recommend systems of accounts which would be more satisfactory than the one being used. However, this service was extended only upon the request of the local unit. In complying with the reporting law of 1906, local of-

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[12] Act 319, P. A. 1927; C. L. 1929, Sec. 7331.

[13] Act 38, P. A. 1925; C. L. 1929, Sec. 11086.

[14] Van de Woestyne, op. cit., p. 105.

ficials soon realized the deficiencies of their accounting systems. As a result two acts were passed in 1910 which gave the bureau of statistics definite responsibility with respect to municipal auditing and accounting.[15] Under the terms of these acts, any municipality could request the auditing or accounting services as formerly and the bureau was forced to comply. A report of its findings was to be made by the bureau to each town's governing body. Provision was also made for the appointment of a town accountant to keep any newly installed system. He could hold no other town office involving the handling of money. It was recognized that a system once installed is worthless unless properly administered.

Later legislation made the fiscal year uniform for all units and made available to all, at cost, the proper accounting forms and records. After twelve years of this voluntary improvement, cities and towns representing well over fifty per cent of the population (outside of Boston) had taken advantage of the bureau's services. However, so many cases of waste, and worse than waste, were uncovered by the audits that mandatory legislation was finally passed in 1920. This new law merely instructed the director of the bureau of accounts to make audits of all cities and towns once every three years (later changed to two years). The number of requests for audits was so large, however, that it was several years before the first general audit throughout the state could be made. In 1922 a new law required all cities and towns which had never petitioned for an accounting installation to vote on such a proposal. Over ninety units voted for an installation the very next year, and subsequent years have seen a steady increase in the number using improved systems.

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[15] Van de Woestyne, op. cit., p. 105.

The auditors sent out by the division of accounts in Massachusetts do a great deal of advisory work with local officials in addition to the technical auditing of accounts. This aid is continually requested by the local units and proves their appreciation. Although called uniform, the approved system of accounts is flexible enough to fit all different communities. Thus by pursuing a moderate policy of state supervision, Massachusetts has succeeded in getting the adoption of municipal audits and sound accounting methods by most of the local units, so that today she is the recognized leader in this respect.

In Oklahoma there are two state administrative officials with general authority over state and local accounting and audits: the examiner and the auditor.[16] The former is the only one of importance in state control of local finance. He has the duty of auditing the books of all county treasurers at least twice a year and of publishing the results, with the cost of these audits borne by the counties themselves. The examiner is also empowered to prescribe a uniform system of bookkeeping for "all treasurers" and for "any county official." In the first of these lies his only power over local units other than counties. Another of his duties is the preparation of certain forms which must be used by local units. The most important of these are the budgeting statements used by county boards and local governing bodies. The law does not clearly state that the examiner is to prepare these budgeting forms but he has assumed that duty to be implied and has acted accordingly, with the voluntary support of local officials. This is only one more proof that some phases of state supervision can best be placed on a voluntary basis. Most local officials

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[16] R. K. Carr, State Control of Local Finance in Oklahoma, p. 212.

are entirely willing to accept state advice and assistance when it is clearly designed to help their municipalities.

Saskatchewan gives additional proof of the advisability of friendly relations between the local units and the supervisory agency. That province established in 1908 a Department of Municipal Affairs, headed by an appointed minister. Nearly two decades later it was reported that this department was working in harmony with local officials.[17] It inspects local accounts and has established uniform accounting with marked success.

Indiana has a Department of Inspection and Supervision of Public Offices which prescribes uniform systems of accounts and the reports which local officials shall make.[18] This department also audits the accounts of all public offices. Indiana has usurped local power in several ways but has saved the taxpayer many dollars by so doing. It is possible, however, to gain the same end by supervision rather than control, and so to escape the local opposition that control brings.

D. Recommendations. Michigan should have state supervision of accounting for all municipalities, not merely for counties. The need for this supervision is especially apparent in townships and rural school districts but it is also necessary for villages and cities. A statute, somewhat similar to the law passed in 1931, but with an adequate enforcement clause, should be enacted. The present legislation for supervision of counties should be consolidated with the new law. Furthermore, instead

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[17] J. N. Bayne, "Saskatchewan's Central Supervision of Municipalities Gives Satisfaction," National Municipal Review, 1926, p. 689.

[18] F. G. Bates, "State Control of Local Finance in Indiana," American Political Science Review, 1926, p. 352.

of having several agencies supervising local units and operating under different statutes, a single state department should supervise local finances in Michigan.

A special state agency should be established which would be charged with the supervision of local financial administration--budgeting, accounting, reporting, auditing, and borrowing. A single agency to supervise these phases of local finance would result in much better coordination and more effectiveness. Accounting would serve its proper purpose of recording the actual operations performed under the budgets. This agency should be staffed with appointive officials, experts in the field of municipal finance, and not subject to political intimidation. Their work would consist not only in installing uniform systems of accounts and uniform budget procedures and requiring uniform reports from the local units, but also in constant educational and advisory work with local officials. The agency's goal should be to gain the confidence of the municipalities by its integrity, efficiency, and knowledge of the problems of the different local units so that its assistance would be voluntarily sought.

Not all local units should be asked to establish complete accrual encumbrance accounting systems, since many of the smaller units have not the personnel to maintain such a system. Success in installation of adequate financial procedures would be foredoomed by asking the impossible of untrained local officials. The supervisory agency should set minimum standards for each class of municipality, but constantly stress the desirability of improvement above that minimum.

The suggestion has occasionally been advanced that perhaps a state agency with enlarged personnel could do the accounting work for local units. The local official would keep the briefest of records and the agency ac-

countant would transmit these to the accounting books at frequent intervals. In this manner one well-trained man could keep the records of many localities, and keep them in good shape. Small private businesses often use this method, an accountant taking perhaps four or five hours a week to record permanently the transactions of that week. The accounting systems of our school districts and other small local units would be greatly improved by the adoption of the above plan, under which a trained, traveling accountant would do the actual work.

Reporting. Reporting refers to the collecting of information concerning local financial transactions and the furnishing of this information to the state and to the public. It is a third necessary step in adequate financial administration of local units. Uniform reporting is a by-product of uniform budgeting and accounting and is easily and inexpensively accomplished if the first two steps have been done properly.[19]

A. Aims and Purposes of Reporting. As mentioned earlier in this chapter,[20] uniform statistics of local finance are extremely important from several points of view. Wise legislation is impossible without these statistics. Any supervision or control by a state agency must be built on these local reports. They serve the same purpose to the taxpayer as the financial statement of a corporation does to the investor. Information should be available so that the citizen may be enlightened with regard to the conduct of public business and the financial condition of his community. Uniform reports are valuable to the local officials themselves as an aid to municipal administration. They should be able to compare the

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[19] Miller, op. cit., p. 52.

[20] Page 68.

cost of the services their locality furnishes with the cost of similar services elsewhere. If local costs were shown to be abnormal these officials would either have to reduce costs or justify the high costs to an informed citizenry. These reports should be as useful to municipal officials as uniform cost records are to industrial and commercial associations. Finally, uniform statistics are invaluable to the research student of governmental problems, for they make his task of obtaining information easier and the results of his studies much more meaningful.

In order to achieve uniform reporting, there must be uniform classification of all expenses and revenues of local units. A great deal has already been accomplished in this direction by the larger cities of the country through adoption of the municipal accounting terminology developed by the expert committee of the Municipal Finance Officers Association. The National Municipal League and the Bureau of the Census of the Federal Government have both done pioneer work in formulating a scientific classification of items used by municipalities in financial reports.[21] The constant improvement of this classification has traveled along functional lines--that is, segregation of expenditures by functions and of revenues by sources. The system might be called governmental cost accounting, for it allows us to see what any service costs and thus better decide if it has been worth the expense. A private business must know its costs in detail if it is to operate efficiently. Similarly, a governmental unit should be able to report to its citizens the exact costs of any function it performs.

In Massachusetts uniform reports have been required from all muni-

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[21] Van de Woestyne, op. cit., p. 90.

cipalities since 1906.[22] The bureau of statistics devoted its efforts to securing voluntary compliance and thus it was six years before all of the local units were furnishing uniform financial statistics. At the time of the adoption of the law, local officials were decidedly hostile, but this opposition has disappeared. Many local improvements in methods of finance have come about as a consequence of these reports. The necessity of gathering and furnishing information has improved the practices of local officials.

B. Supervision in Michigan. Michigan has required counties to furnish annual financial reports since 1919[23] on forms prescribed by the Auditor-General. Although this law could have been made effective for the counties, it has never been fully successful. Many of the county officers let the state auditors gather their own information and only submit reports which are inadequate, to say the least. Dr. Cline, in his investigation of county finance, found it impossible to determine the total expenditures and revenues of counties either from these reports or from the reports of the state auditors. It was found necessary to go directly to the county seats and examine the books to get the desired statistics.

The ill fated 1931 act[24] required all municipalities other than counties to furnish annual reports of all financial transactions, and an asset and liability statement. These reports were to go to the state treasurer, who was authorized to prescribe the necessary forms. As mentioned earlier, there was an unnecessary duplication of effort because of

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[22] Van de Woestyne, op. cit., pp. 92-101.

[23] Act 71, P. A. 1919.

[24] Act 315, P. A. 1931, repealed by Act 41, P. A. 1933.

the different authorities involved. The supervision of local reporting should be done by the same state agency charged with budgeting and accounting supervision.

Today only the counties are required to furnish financial reports and with these the supervision is lax. Reports should be furnished by every unit of local government and should cover all funds, not just the general fund. They should include not only the financial transactions of the year but also the budget adopted by the municipality. Reports should be constantly and closely tied to the budget, otherwise they lose a great deal of their value. However, even if a municipality is using an adequate budget procedure, has a system of accounts approved by state authority, and is making reports on forms prescribed by the state agency, the entire responsibility of the state is not fulfilled. It has the additional duty of checking on each local official, by the auditing of his books either periodically or when the need arises.

Auditing. A. Aims and Purposes of Auditing. The auditing here discussed is the function sometimes termed "post-auditing," or the examination of the financial transactions of a municipality after they have taken place and have been recorded. This examination is for the purpose of verifying the accounts and discovering any violations of statutory requirements or accepted standards.

No person would question today the need for an annual audit of the accounts of a private business and there is scarcely a single business of any importance which is not examined at least annually by independent public accountants.[25] Without these audits the stockholders or the creditors

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[25]Charles H. Langer, Municipal Accounting, p. L5-9.

would know little about the operations and transactions of the business, and would understand less. In the municipal field, auditing is of still greater importance. Even a small municipality receives and spends more money than a good-sized business. A private business can tell something about the efficiency of operations by the profit or loss figure for the period, but there is no such figure which would indicate whether public money is being wasted or not. Citizens, as stockholders of a municipality, are entitled to the information concerning its financial administration that will be revealed only by an audit. Thus it might be said that auditing is a tool of the legislative branch of the government (or of the citizens themselves) while accounting is a tool of the administrative branch. Without this check on public officials, there exists an open invitation to override legal restrictions imposed upon them and perhaps even to divert public funds into their own pockets.

Since audits are made to check the regularity of accounts, they should be conducted by someone not connected with the government of the municipality, which generally means either private independent accountants or representatives of the state supervising agency. While, on the whole they are satisfactory, both agencies have common weaknesses. State auditors usually emphasize the strictly legal provisions and frequently condone practices contrary to sound accounting principles, if the law does not specifically forbid them. Private accountants commonly fail to pay sufficient attention to legal provisions. Obviously, both weaknesses should be corrected.

The local audit should test not only legality of transactions and good accounting practices, but also compliance with or departure from

the budget,[26] because the budget is the key to better financial administration. Such a comprehensive administrative audit would not be needed every year but only at longer intervals and should be made by a small corps of state specialists who work on a roving commission, testing the units where danger appears, or merely test-checking between annual audits. It may be some time before this goal is reached, but it is surely a necessary part of a complete supervision.

Seven states authorized central inspection of local accounts as far back as 1900[27] and this number has gradually increased so that forty-four states now audit counties and thirty-three audit cities.[28] Of course, these audits differ widely in scope and frequency.

B. Supervision in Michigan. In Michigan there has not been a great deal of state supervision of the auditing of local books. The Auditor-General is supposed to conduct an annual audit of the books of the counties.[29] This audit is generally considered to be working fairly successfully although the period between audits is usually more than a year. The work of the state auditors would be much more satisfactory if they were selected on merit and were under civil service. There has been a very high turnover in personnel, evidence of the part patronage has played in the selection of these men. Usually two auditors travel together, one experienced, and one not. The first civil service act[30] put these traveling auditors in the classified service,

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[26] Wylie Kilpatrick, State Supervision of Local Budgeting, p. 79.

[27] Leonard White, Trends in Public Administration, p. 66.

[28] Wylie Kilpatrick, "State Administrative Supervision of Local Financial Processes," Municipal Yearbook, 1936, p. 340.

[29] Act 71, P. A. 1919, being C. L. 1929, Sec. 303.

[30] Act 346, P. A. 1937.

but the two "Ripper Acts" of 1939 removed them and many others from the merit system.[31] However, the auditors are back under civil service today, by the provisions of the constitutional amendment passed by the voters in November, 1930. The amendment will not improve the personnel of the present staff, since they will be blanketed into the classified lists, but additions to the auditing staff will henceforth be made only after competitive examinations have selected competent men. The legislature has never given the Auditor-General sufficient funds to do a complete and satisfactory job and it must therefore be charged with some of the responsibility for the inadequate supervision of the past.

The rest of the municipalities in Michigan have almost complete freedom in determining when, how, and by whom auditing shall be done. A committee of the legislative body of a township or village usually examines the books of that municipality.[32] In the smallest units this process might be satisfactory if the committee had some knowledge of accounting. Larger villages and small cities commonly have the audit, when undertaken, conducted by some resident with bookkeeping or accounting experience, while the larger cities have certified public accountants perform their audits. There are no uniform specifications for these audits and the quality of the work done varies correspondingly.

There is a Michigan statute[33] in force which has seldom been used that gives the Attorney-General power to investigate, examine, or audit the books and accounts of townships or school districts but only on the petition of ten per cent of the electors. The Auditor-General is obliged

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[31] Acts 97 and 245, P. A. 1939.

[32] Loren Miller, op. cit., p. 54.

[33] Act 52, P. A. 1929, being C. L. 1929, Secs. 195-199.

to help with such examination when asked. The law is very weak on two counts: first, the Attorney-General is not competent to do the auditing; second, the supervisory agency should not be forced to wait on a petition from electors before taking action. Whenever this law has been used, the Auditor-General has actually done the auditing, which might soften the first criticism. Another objection to this law is that the expense is borne by the Auditor-General's department, when it should be charged to the local unit being audited. Even if the Auditor-General could audit these units on his own initiative, the expense involved would deter him.

The short lived law of 1931[34] failed to embrace an important point. It did not include a provision for state supervision of auditing along with those for budgeting, accounting, and reporting.

C. Supervision in Other States. Massachusetts now requires the state supervisory agency to audit the accounts of local units once every two years, or annually, at the request of the local unit.[35] Many municipalities have requested the audit as often as possible.

Oklahoma requires the state examiner to audit the books of county treasurers at least twice a year.[36] Although these officials were at first hostile and uncooperative, today most treasurers have their books in good shape, in anticipation of the audits. During the eight years from 1926 to 1934, twenty-nine local officials were sent to the penitentiary because of shortcomings in their books. That record is no indication of the total value of the audit work, since most shortcomings are not crim-

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[34] Act 315, P. A. 1931.

[35] R. S. Van de Woestyne, op. cit., p. 109.

[36] Robert Carr, op. cit., p. 224.

inal in character and are corrected by the advice and assistance of the examiner. Moreover, the Oklahoma law does not require the audit of the books of cities, towns, or school districts. The examiner can audit these units but only on the request of the local officials or on the petition of the voters themselves. As might be expected, these requests or petitions seldom come in time to prevent serious losses. Auditing of all local units should be included in the powers of the state examiner.

Tennessee is another state which is attempting to improve the financial management of its counties. Under the Cash Basis Act of 1937 any county may reorganize and centralize its accounting and financial records but is not forced to do so.[37] This act gives a great deal of authority over auditing to the State Director of Local Finance. He may require reports of county finances and may audit their records if he wishes. Even this permissive legislation was a step forward. In his investigations, Professor Read found only one county in that state where the records were audited by a certified public accountant. Much of the auditing done consisted merely in testing the addition of the figures as reported by the county official. Tennessee, like Michigan, has a staff of state auditors who audit county finances, but this staff is woefully inadequate in size and therefore severely limited in its accomplishments.

D. Recommendations. Michigan should have state supervision over the auditing of all municipalities. This does not mean that the task will be so very difficult if it is undertaken as a part of a larger program of financial supervision. A central state agency should have the power to audit all local units, both on its own initiative and on the petitions of

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[37] W. H. Read, Accounting Manual for Counties of Tennessee, p. 16.

local citizens. This should be the same agency that supervises local budgeting, accounting, and reporting. If the latter three are properly supervised, auditing will be made much easier. The state agency should audit the larger municipalities at least annually, with additional audits as necessary.

If the central state agency is not supplied with sufficient competent personnel to do municipal auditing, it should supervise the work of the independent auditors. It might well set up specifications as to the type of audit to be done and see that the auditors hired are competent by forcing them to be licensed upon approval of the state agency. In many states the central agency does the auditing but the cost is borne by the local units. This plan should work very well in Michigan. Whether conducted by state or by private accountants, local audits will become easier to make and more satisfactory as uniform accounting and reporting are adopted. For most units, a correct system of accounting would entail the performance of a current pre-audit throughout the year by a responsible local accountant. This pre-audit would simplify the task of post-auditing. While any one of these programs is very useful by itself, it becomes many times more useful when coupled with the other members of the supervisory family of budgeting, accounting, reporting, and auditing.

Inspection of local financial transactions and practices is not designed to impose a Procrustean program on municipalities, but to secure the beneficial results of publicity and regularity of procedures.

PART III

STATE SUPERVISION OF LOCAL INDEBTEDNESS

CHAPTER VII

SUPERVISION OF LOCAL BORROWING

The increase in local indebtedness, in Michigan as in other states, is primarily a product of the twentieth century.[1] The states in general had borrowed extensively since 1830 but the debts of all local units amounted to less than one billion dollars in 1890. This figure increased to $15,217,881,000 in the comparatively short time of forty-two years. The municipalities of Michigan were cast in the same mold as the rest of the country, for the net local debt of Michigan rose from $52,908,000 in 1912 to $719,299,190 in 1932.[2] Michigan local debt increased six hundred per cent from 1912 to 1922 and an additional one hundred and thirty per cent from 1922 to 1932.

Local debt in Michigan, as well as in other states, has shown a tendency to concentrate in certain local units. In 1924 the city debt in Michigan accounted for sixty per cent of the total for all units.[3] By 1938 seventy per cent of the local debt of Michigan was from Wayne County and was mostly city debt.[4] For the nation as a whole, the figures are similar. In 1912 eighty-three per cent of all local debts had been issued

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[1] H. L. Lutz, Public Finance, 3rd ed., p. 799.

[2] Financial Statistics of State and Local Governments, U. S. Department of Commerce, Bureau of the Census, 1934, p. 48; Financial records of the Michigan Public Debt Commission for 1932.

[3] Report of the State Tax Commission, 1923-24, p. 23.

[4] Detroit News, September 27, 1939.

by cities, towns, and villages[5] but this percentage has declined somewhat since then, reaching sixty-one per cent in 1922 and sixty per cent in 1932. Second to city debt in amount is school district debt. In some cases part of the city borrowing has been done for school purposes.

There have been many reasons for the rapid growth in local debt.[6] One was the general belief that loans are less burdensome than taxes. Expansion of local units was hastened by postponing the time of payment for public improvements, such as highways and schools. Improvements were quickly constructed in order to attract population and then the increased population demanded more improvements. Local officials encouraged this growth by borrowing, not taxing, for these improvements. The avid demand of investors for any and all types of municipal bonds was an additional incentive for more borrowing, Tax limitation, by constitutional provision or legislative enactment, caused an increase in local borrowing in some states. Ohio's sad experience under the 1911 tax rate limit law has already been mentioned.[7] In ten years time the per capita local debt in Ohio rose from $39.25 to $113.84.[8] The combination of the above reasons with the general psychological atmosphere of the country from 1910 to 1930 explains much of the rapid growth of local debt.

Aims and Purposes of Supervision. The need for state limitations on local borrowing is apparent from the foregoing statistics. It is essential that the state not permit a few over-optimistic local units to affect the

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[5] H. L. Lutz, op. cit., p. 800.

[6] Ibid., p. 803.

[7] Chapter IV, p. 47.

[8] H. L. Lutz, op. cit., p. 806.

credit of other units. When one community defaults on its obligations, it seriously undermines the credit standing of all. Moreover, the state has the duty of protecting both taxpayers and bondholders from the sometimes irresponsible debt contraction of local officials. There was a tremendous number of defaults, involving billions of dollars, during the depression following 1929. Had there been effective supervision, the majority of these defaults never would have occurred. The truth of this statement seems to be substantiated by a comparison of the defaults in the states leading the debt rush with the average defaults of all states. For the whole country, 1.68 per cent of all governmental units were in default in March, 1935. In Florida, 44.5 per cent of the local units were in default, in Louisiana the percentage was 19.48, in New Jersey 14.8, Tennessee 13.53, North Carolina 11.96, and Michigan 2.59.[9] The proper aim and purpose of state supervision is to prevent any recurrence of further widespread defaults.

Another abuse of local borrowing was centered in the plan of repayment. Sinking fund bonds were used in most instances and the accumulation of these funds brought trouble. Local officials often were guilty of mismanagement of public funds, not only from a desire for personal profit, but also from lack of experience and knowledge concerning the intricacies of finance involved in the investment of sinking funds. This mismanagement of sinking funds has led many states to require the use by local units of serial bonds only.

Supervision of Local Borrowing in Other States. Almost all of the states have attempted to control local borrowing in one way or another.

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[9] B. U. Ratchford, "State and Local Debts and Defaults," The Annalist, November 22, 1935, p. 4.

Thirty-six state constitutions limit local debts and forty-four states limit the terms of local bonds.[10] Nearly all the limits are stated as a percentage of the assessed valuation of all property in that municipality. Twenty-five states required serial issues by 1936 while only ten states had the same requirement in 1924, illustrating clearly the trend away from sinking fund bonds.

Although other states have had a longer history of debt limitation, North Carolina has had the most rigid control. A County Advisory Commission was created in 1927 but it failed to get the necessary local cooperation[11] and was superseded by the Local Government Commission in 1931. This commission, with six out of its nine members appointed by the governor, has stringent control over local debts and debt service.[12] All bonds and notes must be approved by the commission and the investment of all sinking funds is controlled by it. The director of the commission can appoint a receiver for any local unit in default on its obligations and all finances of the unit are under the control of that receiver.

North Carolina's rigid control has been only partly successful. From 1931 to 1936 the Local Government Commission act was amended several times and was weakened each time.[13] Although the commission was supposed to supervise local accounting systems, very little progress toward uniform

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[10] Lane Lancaster, "State Limitations on Local Indebtedness," Municipal Yearbook, 1936, p. 313.

[11] Paul Wager, "State Centralization in North Carolina," American Political Science Review, 1931, pp. 996-1003.

[12] Chester B. Masslich, "North Carolina's New Plan for Controlling Local Fiscal Affairs," National Municipal Review, June, 1931, p. 328.

[13] B. U. Ratchford, "Work of the North Carolina Local Government Commission," National Municipal Review, Vol. XXV, June, 1936, p. 323.

accounting has been made. The commission has prevented some unwise borrowing and has succeeded in getting lower interest rates for municipalities. It has also supervised auditing contracts and has performed additional advisory services for local units.

Massachusetts has had state limitations on local debt since 1875. The original law did not prove effective, partly because of special acts passed by the legislature during the period from 1885 to 1912.[14] These special acts often defeated the very purpose which the general laws were designed to accomplish and indicated that the debt limits were too rigid or that the legislature was too acquiescent to local appeals. Other reasons for the failure of the earlier legislation to control debts were a general disregard or evasion of the law and the looseness of the wording of the statutes. The growth of debt up to 1912 forced the passage of legislation in 1913 which was designed to eliminate the following evils of local financial administration: 1) borrowing for current purposes; 2) excessive borrowing in anticipation of taxes; 3) incurring liabilities without making provision for their payment; 4) diversion of trust funds from their proper uses; and 5) inefficient management of sinking funds.

Massachusetts had attempted to control local borrowing entirely by legislative means. The laws of 1913 and subsequent amendments established no administrative agency to approve or disapprove of local debts, but set forth detailed rules and regulations which the local units were to follow. These acts raised the debt limit to three per cent for towns and two and one half per cent for cities (excluding Boston). Borrowing for certain purposes was authorized outside the limits of the act.

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[14] R. S. Van de Woestyne, op. cit., pp. 43-46.

Although local debt in Massachusetts has increased since 1913, the ratio of debt to assessed valuation has remained about the same. Special acts of the legislature permitted borrowing during the early thirties, which pushed the debt load up. A policy of paying for at least part of all permanent improvements out of current revenue was encouraged and generally adopted. Borrowing from trust funds was eliminated. By 1932 over ninety per cent of all debt service applied to serial type bonds for no new sinking fund bonds had been issued since 1913.[15]

In Oklahoma the attorney-general is also the bond commissioner. This additional duty was given to him in 1910. He oversees the issuance of local bonds by forcing all local units to follow certain procedures but has little actual authority to refuse to permit local borrowing if the unit has complied with the necessary legal provisions.[16] By restricting the state's activities to supervision and by not attempting to control local borrowing, Oklahoma has enhanced the credit of municipalities and at the same time has left them the responsibility of shaping their own policies.

Supervision of Local Borrowing in Michigan. Michigan has several limitations on local borrowing imbedded in the Constitution. No county can incur any indebtedness which would increase its total debt beyond three per cent of its assessed valuation, except counties having a valuation of five million dollars or less, which counties can increase their total debt to five per cent.[17] No direct limit was placed on city, village,

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[15] R. S. Van de Woestyne, op. cit., p. 85.

[16] R. K. Carr, State Control of Local Finance in Oklahoma, pp. 195-210.

[17] Michigan Constitution of 1908, Article VIII, Section 12.

or township debt, but the Constitution authorized the legislature to provide for debt limits for these units. It also left mortgage bonds, issued by a city or village to finance a public utility, outside of the general limit of local debt as established by law.[18]

From 1908 to 1925 many different laws were passed by the legislature under its authority to control local debt. Home rule cities are limited to a general net debt of ten per cent of their assessed valuation.[19] Emergency debt, special assessment bonds, and public utility bonds are not included within the stated limit. Adding the individual limits for these three to the general limit brings the total possible debt to twenty and six tenths per cent.[20] Villages are also subject to a net general obligation debt of ten per cent with several internal limits within the general limit.[21] As with home rule cities, several types of borrowing are excluded from this general limit, with limits of their own. These other types bring the total permitted direct and indirect village debt to eighteen and six tenths per cent.

Townships may borrow for emergency purposes to an amount of $1,000 or $12,500 if the assessed valuation is over ten million dollars.[22] Townships may borrow for water mains up to five per cent of the assessed valuation and may issue special assessment bonds up to five per cent. Under the Covert Road Act,[23] the township could issue bonds for its share

[18] Michigan Constitution of 1908, Article VIII, Section 24.

[19] C. L. 1929, Sec. 2231; Act 353, P. A. 1921.

[20] Loren B. Miller, Local Finance and Procedure, Michigan Local Government Series, 1933, p. 71.

[21] Ibid., p. 70.

[22] C. L. 1929, Sec. 1052.

[23] Act 59, P. A. 1915, as amended.

of the cost of rural highway improvement, with no specific limit as to amount. This authority to issue bonds ceased in 1932 when the issuing sections of the Covert Act were first suspended for five years and later repealed.[24] Other borrowings permitted bring the known total for townships to thirteen and one-half per cent.

School districts (except in Detroit) are limited to a debt of fifteen per cent of their assessed valuation.[25] School borrowing must be approved by a majority of the voting property owners of that district. The Detroit school district is permitted only a five per cent debt.

If a school district not within an incorporated city or village wants to borrow money, it must not only secure the approval of a majority of the property owners but it also must have a low enough tax rate so that the addition of the debt service will not make the total exceed fifteen mills. To exceed the fifteen mill limitation there must be approval of two-thirds of the electors of that assessment district; and this approval is hard to secure. People would often borrow willingly but hesitate to vote heavier taxes on themselves to pay the bonds. Even if the tax rate limit were raised to five per cent, this increase is in effect for five years only and it would be very difficult for a school district to pay off its bonds in that time. Investors are naturally reluctant to buy bonds with terms longer than five years if the tax used to retire those bonds is only assured for the five years. The above comments on the effect of the fifteen mill tax rate limitation also apply to the other local units subject to the limitation.

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[24] Act 39, P. A. 1932 (Sp. Sess.); Act 221, P. A. 1933.

[25] L. B. Miller, op. cit., p. 72.

Michigan local debt grew so rapidly under these overlapping constitutional and legislative limits that it was evident better controls were needed. The county, the township, the village, the school district, and perhaps others could all bond themselves using the same piece of property as a basis for that debt. There was no over-all limit as a percentage of the property valuation. In 1925 the legislature passed the "Evans-Baxter" or "Municipal Bond Act" to regulate all municipal indebtedness.[26] The section of this act on debt maturities was included within a "Model Bond Law" written by the National Municipal League, as an example of good procedure.[27] However, the Michigan bond act was not perfect and has been amended often. As amended, it forms the basis for all state supervision of local debts in Michigan today.

In order to better describe the existing supervision over local debts, the other major laws must be cited. The bond act of 1925 gave certain duties but no authority to the state treasurer as a supervisory official. In 1931 a "Loan Board" was created, consisting of the State Treasurer, the Attorney-General, and the Auditor-General.[28] In 1932 this board was superseded by the Public Debt Commission[29] which retained

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[26] Act 273, P. A. 1925; as amended by Act 332, P. A. 1927; Acts 28 and 43, P. A. 1929; Act 142, P. A. 1931; Acts 9 and 28, P. A. 1932 (1st Ex. Sess.); Act 131, P. A. 1933; and Act 19, P. A. 1933 (1st Ex. Sess.); Act 8, P. A. 1935; Act 88, P. A. 1937 and Act 2, P. A. 1937 (1st Ex. Sess); Act 11, P. A. 1939.

[27] L. B. Miller, op. cit., p. 65.

[28] Act 26, P. A. 1931 as amended by Act 35, P. A. 1932 (1st Ex. Sess.); Acts 46 and 214, P. A. 1933; Act 71, P. A. 1935; Acts 130 and 160, P. A. 1939.

[29] Act 13, P. A. 1932 (1st Ex. Sess.) as amended by Act 143, P. A. 1933; Act 42, P. A. 1935; Acts 56, 98, and 271, P. A. 1937; Act 128, P. A. 1939.

the same membership. All records, files, powers, and functions of the state treasurer and of the loan board in regard to local debt were turned over to the debt commission. Since 1932 Michigan has had a degree of administrative supervision through this commission, as year by year the legislature gives it more powers and duties in the control of local debt. The following paragraphs will discuss, first: the present laws under which the debt commission operates; second: the actual work of the commission and its results. The first part will be a consolidation of all the laws passed since 1925 which are still in force.

The Municipal Bond law as amended states clearly that it applies to all obligations of all local units. No municipality may issue any bonds to pay current expenses. No bond can be made payable on demand, nor can the net interest rate exceed six per cent per annum. Only serial bonds can be issued by any local unit today. The first instalment of principal of serial bonds must be paid not more than three years after the date of issue and no instalment of principal can be less than one-third the largest instalment. Bonds for certain long-lived public utilities may be issued for terms of forty years, while all others are limited to thirty years. No bond can be issued for a period longer than the estimated useful life of the property acquired. Special assessment bonds, calamity bonds, and other special types each have term limits.

The law requires every local official charged with the duty of determining the amount of taxes to be levied to include in the levy an amount sufficient to pay the debt service on all bonds to be paid out of taxes. Sinking funds (for term bonds issued prior to the present law requiring serial bonds) must be kept separate from other monies. The approval of the public debt commission is necessary before sinking funds can be in-

vested in bonds other than those of the issuing municipality. Any local officer who fails to perform any of the duties the law imposes on him becomes personally liable to either the municipality or the bond holders for losses arising from such failure.

All bonds of an issue over ten thousand dollars must be sold at public sale after seven days publication. The advertisement for this public sale must be approved by the commission. Before the local unit can sell its bonds, it must have a certificate from the debt commission to the effect that it has complied with the requirements of the law. The local unit must file with the commission a financial statement for the benefit of prospective purchasers. This statement must show the assessed valuation of the property subject to the taxing power of the issuer, the total debt of the local unit, the population of such unit, the overlapping debt of any other municipality and the tax collection record for the past four years.

The financial officer of every municipality in the state must file during July of each year, a financial statement showing all pertinent facts concerning local obligations, the assessed valuation of all taxable property, the condition of all sinking funds and any other information the commission may require. Failure to file this statement is punishable by fine or imprisonment. This is the only law in existence today that requires any report from all the local units of Michigan whether they have bonds outstanding or not. A more complete statement is required from each unit that wishes to issue bonds, including information on delinquent taxes, on the present tax rate and on the presence and extent of bond or interest defaults. The public debt commission also has the power to examine the records of any municipality to see if it is complying with the requirements

of the commission and with the Michigan statutes pertaining to debt.

In 1931 the legislature authorized local units to borrow on tax anticipation notes and on delinquent special assessments.[30] This act, as amended, was to provide temporary relief during the depression years and most of its provisions expire by 1941. Before the end of any fiscal year, a local unit could borrow up to twenty-five per cent of its next year's tax levy, until 1937 when the limit dropped to ten per cent. The act permitted the unit to borrow up to eighty per cent of unpaid current taxes and up to sixty per cent of delinquent taxes if such delinquent taxes totaled ten thousand dollars or more. The public debt commission (originally the loan board) had to approve of all such temporary obligations before they could be incurred. The funds borrowed under Act 26 of 1931 can be used only for payment of debt or for general maintenance expenses. This same act permitted use of scrip from 1932 to 1937, in case of a local emergency.

The law officially creating the debt commission[31] is usually known as the refunding act. It provided for the refunding of all obligations except Covert bonds (to be discussed later). Refunding was at first limited to those bonds which were in default as to principal or interest, or were expected to be in default shortly, but later was extended to any local unit for the purpose of reducing the interest paid. No refunding bond can bear more than six per cent interest and the commission can fix the maximum rate under this limit. The debt commission has full control over all refunding operations and does most of its work in this regard.

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[30] Act 26, P. A. 1931.

[31] Act 13, P. A. 1932 (1st Ex. Sess.)

When any local unit applies for permission to issue refunding bonds, the commission may: 1) permit the refunding, in whole or in part; 2) prescribe reasonable conditions and terms upon which to permit refunding; 3) deny permission to refund, if they believe it would be unsound municipal financing to permit refunding. The commission's powers in regard to examination of local books and sale of refunding bonds are the same as for other bonds. Sinking funds for refunding bonds are to be used to retire debt as fast as the funds are available or to invest as the commission directs. The terms of the refunding bonds are limited by the law and by the commission's orders.

The Public Debt Commission has its offices in the state capitol building where the three members can conveniently meet. The commission itself meets once a week, usually on Tuesday afternoons.[32] Each member of the commission has an opportunity to examine in detail the file of local applications before the meeting, for the permanent staff places them on their respective desks at least one day in advance of the meeting. A great deal of the actual work is done by the staff, thus saving the time of the three members. The commission decides major matters of policy and does the final approving or disapproving of a bond issue. The secretary of the commission, however, is constantly being consulted by local officials. She gives them advice on how to fill out the required statements and in general aids them in getting their requests into such form that they will be approved. Many of the local officials have very little or no accounting experience and as the financial statements required are rather complicated, they are grateful for assistance.

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[32] Interview with Mrs. Many, Acting Secretary of the Public Debt Commission, May 16, 1941.

The staff of the commission is now under civil service. Politics has played very little part in the debt commission's work, for the staff has in general held office since the establishment of the body. As far as can be determined, the commission itself has refrained from playing politics with special favors to certain localities or officials.

One way in which to judge the work of the debt commission is to compare the debt of Michigan localities since the creation of the supervisory agency, both as to total debts and per capita debt, with the debt before that time.

When the municipal bond act was passed in 1925, the total net debt of Michigan local units was $386,884,152.[33] Under this first attempt at supervision, the debt rose steadily till it reached $719,299,190 in 1932. A part of this rise was undoubtedly due to the early emergency borrowing of the depression years, but the growth was sufficiently steady to warrant more effective control. Since 1932 the net debt has decreased $145,000,000 to only $574,543,817 on July 1, 1940. The per capita debt has shown the same general trend. It was $27 in 1912, $94 in 1922, $158 in 1932 and $120 in 1940. The considerable decrease speaks well for the supervision of the commission. However, another measuring stick of the seriousness of local indebtedness is the number of defaults. Michigan has had the doubtful distinction of ranking very high in bond defaults for several years. In 1936 Michigan, with 184, was fifth among the states in number of defaults.[34] By 1938 Michigan had advanced to second place[35]

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[33] Statistics from compilations of the Public Debt Commission.

[34] Municipal Yearbook, 1936, p. 309.

[35] Municipal Yearbook, 1938, p. 520.

with 229; only Florida had more defaults. By 1940 the number of defaults in Michigan had fallen to 207, but that was still enough to be second among all states.[36] The number of defaults, however, is only part of the picture. The amount involved in each default is also important. Most of the defaults in the last few years have involved only interest or interest and a small principal. In 1940, one hundred and fifty-two of the Michigan defaults, or seventy-three per cent, were of school district obligations, which are usually smaller in amount than city or county issues. Many states do not report full statistics on bond or interest defaults. There might be other states with more defaults than Michigan who do not report them.

Gathered under a separate investigation, other statistics of local debt show that Michigan is in a better position than the average state.[37] There are twelve states with a greater percentage of their local units in default than Michigan has. Using income, wealth, and production to measure debt paying ability and then comparing this with the local debt, Mr. Ratchford found that the relative debt burden of Michigan local units was 97. In other words, Michigan was three per cent below the average in debt burden.

The local units most affected by the public debt commission's work are the cities, for they do most of the borrowing. Over eighty per cent of the present local debt is city debt.[38] Nearly sixty per cent of the present city debt consists of refunding issues, illustrating the extent of the refunding permitted by the debt commission since 1932. The com-

[36] Municipal Yearbook, 1940, p. 185.

[37] B. U. Ratchford, "State and Local Debts and Defaults," The Annalist, November 22, 1935, p. 4.

[38] Statistics from compilations of Public Debt Commission.

mission's authority is much stronger in connection with refunding issues than with original issues. If a municipality has complied with the requirements of the bond law, the commission is compelled to issue a certificate of approval. Even if a local unit were in default on an outstanding issue, the debt commission could not withhold approval of a new bond issue for another purpose if the legal provisions had been met. But the commission can approve, or not, of applications for refunding. They may refuse to grant a certificate if they believe it would be unwise to issue refunding bonds.

If a local unit has defaulted on an issue of tax anticipation notes, the commission can refuse permission for another issue. The amount of tax delinquency borrowing has been very small, and not much of a problem. Although the total amount of delinquent property taxes in Michigan was tremendous, there were comparatively few units with over $10,000 in delinquent taxes. This meant that only a few local units could borrow against delinquent taxes.

There does not seem to have been any increase in local borrowing because of the 15-mill tax rate limitation. This is due somewhat to the fact that cities are not under the limitation unless they vote to come under it. In some cases the local debt has actually been held down because of the tax limit. This has resulted from the requirement that a municipality under the limitation must provide for debt service in its tax levy before the public debt commission will grant a certificate of approval. If there is no room within the fifteen mills for new debt service, the bonds cannot be issued unless the voters approve of an increase in the tax rate.[39]

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[39] Page 95.

The granting of funds to local units under the Federal Public Works Administration has caused an increase in some local debts in recent years, for most municipalities had to borrow to finance their share of any public building project. At the same time, however, this Federal money given to the local units meant that they received improvements which they otherwise would have been unable to enjoy. In many cases the localities would have been forced to borrow more than they did, if the P.W.A. had not given a share of the funds. For the state as a whole, the increased grants of Federal funds undoubtedly kept the local debt down.

Local sentiment toward the debt commission seems to be divided. Some local officials are very antagonistic while others are grateful for the help of the commission. There is no doubt that some local officials have been restrained from borrowing which in their judgment was not excessive and consequently they resent the loss of local self-rule.

In 1915 the Michigan legislature passed the Covert Road Act,[40] which was to provide an additional method for financing public highways. A portion of the cost of improving a highway was to be charged to the owners of property fronting on that highway and the rest of the cost was to be assessed against the townships, counties, and/or cities affected. Owners of sixty-six per cent of the lineal frontage of the property touching the road concerned could petition for its improvement under the Covert Road Act. Such roads usually were financed by bond issues. These consisted of special assessment bonds to be retired by special assessments upon the benefited property, county bonds for the share of the cost borne by the county government, and township bonds for the share borne by the township.

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[40] Act 59, P. A. 1915.

Most of these bonds were issued in the southern part of the state.

These township and county Covert bonds were to be retired from property tax funds.[41] They were regularly retired until the depression of 1929 brought sharply curtailed tax receipts and finally tax rate limitation. These bonds were outside the tax limit but property could no longer pay for roads as heretofore. The issuance of new bonds was stopped by the legislature in 1932 and since then the old bonds have been rapidly retired.[42] This has been accomplished by the state returning more gasoline and automobile weight tax money to the counties and the use of some of these funds to retire Covert bonds. As of July 1, 1940, there was $15,142,170 in Covert bonds outstanding. As of May 1, 1941, there were only ten counties with Covert road indebtedness. It is expected that these counties will have these Covert debts paid off in a very few years. This change in the method of financing Covert road bonds is an example of how the support of rural highways in Michigan has shifted from owners of real estate to motorists and the Federal government.

Recommendations. The powers and duties of the present Michigan Public Debt Commission should be transferred to a proposed department of local finance which would supervise all local financial administration and local indebtedness. The present ex officio commission consisting of three elected state officials has had considerable success but this supervisory task should be in the hands of a permanent, experienced, non-political staff. No matter how well the present elected officials perform their

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[41] Covert Road Indebtedness of All Counties in the State of Michigan, July 1, 1940, Municipal Advisory Council of Michigan, pp. i-xiv.

[42] Act 39, P. A. 1932 (Sp. Sess.); Act 221, P. A. 1933.

duties, the possibility of a complete turnover in the commission's personnel is present every election.

The powers of the supervisory agency should extend to all bond issues to the same extent the present commission controls refunding issues. Unless this is done, an increase in prosperity will again bring increased borrowing by optimistic local officials, and there is no possible control of that borrowing under the present laws.

The present indefinite and multiple debt limits are unsatisfactory. They should be re-defined and consolidated into one act. All limits should be made to apply to net rather than to gross debt. There should be definite, over-all limits for each type of municipality which borrows money. The public debt commission considers the problem of overlying or overlapping local debt a very grievous one. The purpose of a debt limit, stated in terms of a percentage of the equalized valuation, is to limit the debt contracted per dollar of property value. This cannot be accomplished effectively until the law keeps all borrowing of all local units within one over-all limit. The supervisory agency should have full authority to either approve or disapprove of local bonding below this limit.

The supervisory agency should be given the task of handling all sales of local bonds. This procedure has worked very well in North Carolina, improving the credit of local units and reducing the rate of interest. The calculation of net interest rates is a highly technical job and would be better performed by a trained staff. Costs of advertising bond sales would be charged back to the respective local units. When selling bonds, the supervisory agency should be empowered to set maximum interest rates.

One of the serious problems concerning the debt commission is the lack of a uniform fiscal year among the local units. The reports required

from all municipalities come at different times so that it is extremely difficult to compile meaningful statistics on local debt. Much of the present day borrowing on tax anticipatory notes could be eliminated by re-adjusting the fiscal year of the local units. Some units are always six months behind on taxes and are forced to borrow for six months every year. The fiscal year should coincide with the tax collection period, so that this year's expenditures would be paid by this year's taxes.

Another aid to state supervision of local indebtedness would be the adoption of uniform accounting by the local units as recommended in Chapter VI. Uniform accounting would not only greatly facilitate the work of supervision but would also make it much easier for the local official to comply with requests and requirements of the state agency. If one central agency were supervising local budgeting, accounting, auditing, reporting, and borrowing, all these procedures and functions would be coordinated so as to secure better results at less cost.

CHAPTER VIII

SUMMARY AND CONCLUSIONS

Every state is in a general way responsible for the actions of the subdivisions of government created by it. In the past many states have failed to adequately discharge this responsibility. Local units have been accustomed to the freedom of extreme home rule and some of them have abused that freedom. But, whether it has been good or bad, home rule today faces drastic curtailment. The present trend is toward centralized government and the local unit faces consequent loss of its former powers and functions. The state collects a larger part of the total public revenues and it performs more and more of the functions of the police, education, welfare, and highway departments. Although some of our local units are undoubtedly outmoded, this trend toward state centralization of power is not without fault. It tends to overlook the fact that many functions still can be performed best by the local municipalities, if there are some improvements in local administration. If the local unit is to survive, these necessary improvements must take place and the state should exercise its responsibility to that end.

This thesis has examined what Michigan (with some mention of other states) has accomplished in the way of supervising local units with regard to finance. It has also been concerned with the improvements necessary to good local government which Michigan has so far failed to insist on. This supervision, part of which we now have and part of which is still needed, falls naturally into three parts: supervision of local taxation,

supervision of local financial administration and supervision of local indebtedness.

Supervision of local taxation in Michigan has meant supervision of local assessments, of tax collections, and since 1932, of the tax rate itself.

The assessment of property, real and personal, is done by local elected officials. The state has, by constitutional provision and legislative enactment, prescribed the procedure under which the assessment is made. The law also provides for county and state equalizations of assessed valuations, but ineffectively, since neither the county equalization board nor the state equalization board can change individual assessments, but only township and county totals, respectively. The State Tax Commission, although possessing a checkered history as to power, has almost complete authority, in law, over property valuation today. It can make its own assessments and force the local unit to use them; it is the final appeal body for aggrieved taxpayers, townships, cities, or counties; and it constitutes the majority membership of both the State Board of Equalization and the State Board of Assessors and consequently rules those bodies.

The Tax Commission has re-assessed the entire state at least once and has since succeeded in maintaining local assessments at a very satisfactory ratio of full cash value. It has distributed manuals, maps, and other materials for the use of local assessors but has made no effort to educate or train these officials to use the aids given to them. The commission has been fairly successful, in view of the laws under which it works and the constant lack of funds from which it has suffered.

There is almost no state supervision of the local collection of pro-

perty taxes aside from the laws under which the collection takes place. Taxes are "received" in Michigan by the local treasurer, an elective official who spends only a small portion of his time performing his official duties and receives only a small share of his income from this source. Businesslike methods are not commonly used and little uniformity exists.

During the recent depression, Michigan passed numerous laws which postponed or cancelled the usual penalties to which delinquent taxpayers are subject. There is good reason to conclude that our legislative leniency encouraged more delinquency than would have otherwise occurred. All of these emergency laws except the one instituting the salvage sale, have been repealed, and the collection of current and delinquent taxes is now back to normal.

Since the "tax revolt" in 1932 which resulted in the Michigan Constitutional 15-mill amendment on property tax rates, the state has supervised taxes of some local units directly through the rate. The Michigan Supreme Court decided that the 15-mill limitation did not apply to incorporated cities and villages unless they voted to place themselves under it. Only eleven cities have so voted, so that the 15-mill rate limit applies to less than one-half the total property taxes levied. The fifteen mills are allocated to the various local units by a county board and any appeals from their distribution are made to the State Tax Commission, which has final authority. In Michigan, as in other states which have tried rigid tax limits, the tax burden on the majority of people has not been reduced, but merely shifted through the use of substitute taxes. A flexible tax limit, administered by the state supervisory agency, would be more desirable.

There are a few basic improvements that Michigan needs in order to

make supervision more effective. All tax rolls and collection notices should be prepared by mechanical equipment to reduce chance of error. The introduction of more businesslike collection methods would decrease the amount of delinquency. The county should be the unit for both the assessment of property and the collection of taxes. With larger units it would be possible to secure trained and efficient financial officials, who work full time, receive an adequate salary, and are not subject to political intimidation.

State supervision of local financial administration covers budgeting, accounting, reporting, and auditing. In general, Michigan has less supervision or control over these processes than do most states.

There is no existing supervision over local budgets. Any unit of local government may have a budget, or not, as it sees fit. A proper budgetary procedure is the keystone of financial management; without it the other three processes lose most of their value. Supervision of local budgets means the insistence: first, upon the preparation of a budget; second, upon the use of a uniform procedure; third, upon the operation of the municipality within that budget. It does not mean state determination of the amounts and purposes of local expenditures.

The Michigan Constitution of 1908 charged the legislature to provide by law for adequate accounting procedures by county officials and for the audit of the books of these officials. Not until 1919 was any supervision attempted. Since 1919 the Auditor-General has had the duty of installing accounting systems and of auditing the books of counties. County officials are also ordered to make annual reports to the Auditor-General (which some neglect). School districts must keep accounts which are acceptable to the Superintendent of Public Instruction. The books of school districts

can be audited either by the Superintendent or, upon request, by the Attorney-General. The accounting, reporting, and auditing supervision by the Auditor-General has not yet succeeded in making county accounts uniform or the reports or audits intelligible. The Auditor-Generals usually have not been particularly interested in county finance, probably because of lack of sufficient funds and personnel.

The supervision of financial administration in Michigan is limited to the counties and even this is inadequate. In 1931 the legislature passed a law which would have given, if it had been enforced, adequate budgeting, accounting, and reporting to all local units other than counties. However, this act did not provide funds or personnel for its administration, did not include adequate enforcement provisions, and consequently was a failure even before its precipitate repeal. Local opposition to state control, coupled with little or no effort to explain or enforce the law, brought its early death. There is reason to believe that if a similar improved law were passed today and the administrators really sought to inform local officials as to its advantages, it would succeed where the former law failed.

Every local unit should be required to have a budget, and to have an accounting system which accurately records the transactions taking place under that budget. Each unit should be required to furnish periodic reports showing operations under the budget. These reports should be published in a clear, understandable form to arouse citizen interest in their local government. The books of all local officials should be audited, either upon the request of any local officer or group of citizens or upon the initiative of the supervisory agency itself.

Michigan has had state supervision of local borrowing in some degree

since the Municipal Bond Act of 1925. Because the rapid growth of local debt did not slacken, an administrative agency was established in 1931 to supervise borrowing. This public debt commission receives annual financial reports from all local units and can require additional reports if desired. Any municipality wishing to borrow money, either on an original issue or on a refunding bond issue, must apply to the commission for a certificate of approval, without which no bonds may be sold. The commission can refuse this approval if all legal requirements have not been met or, in the case of refunding bonds, if they believe that the issue is unwise. The commission has much more authority over refunding bonds than over original issues. More than one-half of all outstanding bonds of Michigan local units are refunding bonds, issued since 1932 with the approval of the debt commission.

Michigan has some constitutional debt limits and many legislative debt limits, stated usually as a percentage of assessed valuation. The municipal bond laws are more inclusive than the laws of most states, but they need codifying. Michigan has relied too heavily upon the mere passage of laws to supervise local indebtedness. To safeguard the credit of all local units and possibly of the state itself, there is needed a strong supervisory agency to administer the debt laws.

There should be established a state department of local finance which has the sole function of supervising local financial administration and local indebtedness. The staff of this central agency should be chosen for their experience, training, and tact, and not for their political affiliations. The law under which the agency would operate should outline the basic requirements and leave the details of administrative supervision to the agency staff. This change would centralize the supervision of all

local units in one agency and eliminate duplicate supervision. Tact is a requirement for the central staff because, although the power to compel compliance is essential, state supervision succeeds best if it can secure the willing cooperation of local officials.

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