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Joint Legislative Audit and Review Commission



**Recent Errors in the Sales Tax Allocation for  
Local School Divisions**

JLARC Staff Briefing to the House Appropriations Committee  
August 28, 2006



JLARC

# Study Mandate

- July 24, 2006, letter from House Appropriations Chairman to JLARC Chairman requesting
  - JLARC staff review of methodology for forecasting sales tax collections and calculating amounts distributed to school divisions, Transportation Trust Fund, and General Fund
- Second phase due November 2006
  - JLARC review of General Fund forecasting methodology

# Background

- Fairfax County public school staff noticed discrepancy between FY 2007 State aid tables published online by two State agencies, Education and Taxation
- Statewide, total discrepancy was \$137.2 million
- Resulted from two errors in the allocation of sales tax revenue, *not* in the sales tax forecast

# Errors in the Allocation of Sales Tax Revenues for Education

(\$ in millions)

	<u>FY07</u>	<u>FY08</u>
Effect of First Error	\$75.7	\$86.6
Effect of Second Error	<u>61.5</u>	<u>64.9</u>
Total	137.2	151.5

# First Error: Adding Instead of Subtracting

- Reduction in State sales tax on food meant an adjustment was needed to estimated FY 2007 sales tax collections to account for reduced food tax revenue
- TAX staff added an estimate of taxable food sales instead of subtracting it, causing projected collections to be wrongly increased

# First Error: Adding Instead of Subtracting

(\$ in millions)

	General Sales Tax Collection Estimates		
	FY 2006	FY 2007	FY 2008
Estimate of Total Sales Tax Collections	\$ 3,091.9	\$ 3,252.7	\$ 3,412.1
Less ABC & TTF Adjustments	-22.9	-23.9	-25.1
Less Food Tax Adjustment	<u>-128.1</u>	<u>+119.8</u>	<u>+125.6</u>
Adjusted General Sales Tax Collections	\$ 2,940.9	\$ 3,348.5	\$ 3,512.6

Adapted from Attachment B of Tax Commissioner's 7/25/06 letter to Drs. Knapp and Webb

# First Error: Adding Instead of Subtracting

- Adjusted sales tax is subsequently used to calculate a base of total taxable sales, to which tax rates are then applied
- Because adjusted collections were too high, estimated payments to local school divisions were also too high

## Second Error: Projecting an Inflated Food Sales Tax Base Into Future Years

- Second error stemmed from failure to account for effects of changing sales tax rate on food

### **Prior to July 2005: 4%**

1%	Local option – going to localities
1%	K-12 (based on school-age population)
0.5%	Transportation Trust Fund
1.5%	General Fund

### **Effective July 2005: 2.5%**

1%	Local option – going to localities
1%	K-12 (based on school-age population)
0.5%	Transportation Trust Fund

## Second Error: Projecting an Inflated Food Sales Tax Base Into Future Years

- Projections of sales tax revenue collections assumed old sales tax rate on food
- Adjustment to projections was needed to account appropriately for reduction in food sales tax revenues in future years
- Initial lack of adjustment resulted in general sales tax projections for future years being too high
- Consequently, projections of sales tax revenues for education in future years were too high

## Timeline: Nov – Dec 2005

- Nov – Dec: Projections with errors made and included in Budget Bill
- Dec 20-21  
DPB Director identified first error (adding instead of subtracting)  
Secretary of Finance met with DPB and TAX staff  
Group agreed there was additional problem but couldn't pinpoint it  
Meeting adjourned with expectation TAX staff would identify the problem
- Problems not communicated beyond the initial group – no amendments offered

## Timeline: June – July 2006

- June: TAX staff identify and correct second error without disclosing it
- July 12-14  
TAX and DOE staff make sales tax allocations public within 15 days of Appropriation Act being signed, as required by statute
  - TAX published corrected allocations
  - DOE published uncorrected allocations based on Appropriation Act
- Fairfax County public school staff subsequently notice discrepancy

## Consequences of the Errors

- The errors remained undisclosed
- The Budget Bill and Appropriation Act contained incorrect sales tax numbers under the Department of Education (Item 135)
- Has no impact on Transportation Trust Fund sales tax estimates
- The decision by the Secretary of Finance to defer immediate resolution and to not inform the Governor or legislative budget committees proved inappropriate given the ultimate magnitude of the errors

# Recommendations

- The Commissioner of the Department of Taxation should exercise greater oversight of the forecast function and should strengthen the process for ensuring the accuracy of the estimation and allocation of sales tax revenues to various statutory accounts.
  - A panel of reviewers including staff from other finance agencies and the Auditor of Public Accounts could verify that the estimates correctly incorporate policy changes embodied in statutory formulas, and that the calculations are correct
  - The Department of Taxation and the Department of Education should compare the data to be distributed to local school divisions prior to release

# Recommendations

- The Governor should consider establishing by executive order a process for disclosure and correction of significant errors or adjustments in the State revenue estimates after introduction of the Budget Bill. The process should include
  - a threshold amount of an error when disclosure and correction would be mandatory
  - a requirement for notification of the legislative budget committees, and
  - time limits on disclosure to ensure prompt notification

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## **JLARC Staff for This Report**

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## **For More Information**

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The report is available on our website.

