The Ohio Society of CPAs

Ohio Budget Advisory Task Force Report

Version 2.0
June 2010

TABLE OF CONTENTS

Founded in 1908, The Ohio Society of CPAs (OSCPA) serves 23,000 members statewide as the voice of the CPA profession in Ohio. Membership is comprised of CPAs working in a wide range of Ohio businesses and industries, CPA firms, government and education. OSCPA's mission is to protect the CPA credential and represent the interests of CPAs while serving the public interest.

In keeping with its mission, OSCPA actively monitors and addresses legislative and regulatory issues that could impact CPAs, their clients and employers, as well as the interests of the broader business community and Ohio taxpayers. Working closely with state legislators, the Accountancy Board of Ohio, state agencies, and Ohio's print, electronic and broadcast media, OSCPA constantly advocates for fair and equitable tax structure and a pro-business environment. For example: the Society worked to protect Ohio's Commercial Activity Tax rate and helped shape current legislative efforts to streamline regulatory procedures. In addition, OSCPA ensured that changes to the Internal Revenue Code were reflected in the Ohio Revised Code, minimizing the administrative burden for Ohio businesses and individual taxpayers. Over the past three years, OSCPA helped lead national efforts on the interstate practice mobility issue.

With their financial skills and business knowledge, CPAs are uniquely qualified to help Ohioans become financially fit. To help meet the growing need for greater awareness and education in personal finance, OSCPA manages a statewide initiative, Financial Fitness Ohio, as well as a variety of student initiatives that provide:

- Free tax preparation services to families of Ohioans deployed in the military
- Partnerships with media statewide to provide CPAs as financial resources for tax season and throughout the year on a wide range of financial topics
- In-school programs that mobilize thousands of CPAs who teach financial concepts in hundreds of elementary and high school classrooms
- College scholarships to accounting and business majors
- Minority students with information about careers in business and accounting through ACAP-Ohio – a week-long residency program hosted by OSCPA and the National Association of Black Accountants at the OSU Fisher College of Business.

This fall, the OSCPA Executive Board formed The Ohio Budget Advisory Task Force to provide the state with objective, third-party CPA expertise and perspective to help Ohio's leaders address the state budget situation. A think tank of CPAs met to discuss a wide range of approaches to controlling costs, streamlining operations, and enhancing revenue. Many of the suggestions put forth are not new; however, they represent areas of government that are ripe for greater efficiency or other changes.

OSCPA looks forward to addressing these recommendations with the Governor and General Assembly and assisting the state in identifying new approaches to current budget issues.

Times of crisis often require entities to prioritize, streamline or eliminate non-essential programs and to strengthen productive ones. Crises also provide opportunities to totally rethink current operations with an eye to what will be best for entities in the short and long terms, taking care to avoid knee-jerk reactions that don't look beyond the immediate issue at hand. Ohio is at such a point today. The state's economy is struggling and times like this call for dramatic change in order to emerge stronger and better prepared for the future. OSCPA's end goal is to assist the State of Ohio in its efforts to emerge economically strong, with the needed structure to attract business and residents, and be competitive regionally, nationally and internationally.

We applaud the numerous government leaders and entities across Ohio that have made hard decisions to cut costs and operate as efficiently as they deem possible without endangering essential or core services. As a result of these changes, the current biennium budget is approximately $3 billion lower than the 2008-2009 biennium. Despite those actions, Ohio remains in a position of unsustainable spending. Our state faces a shortfall estimated to be between $4 and $8 billion for the 2012-2013 budget. One-time federal funds and one-time state-based adjustments helped keep Ohio from making even harder choices this year, but those funds will not continue and we can no longer delay the inevitable: an implementation strategy, including significant operational and structural changes must be in place in 18 months if Ohio is to achieve a constitutionally mandated balanced state budget.

Our historically strong manufacturing base is evolving and its future is uncertain. Just as a business must do when its expenditures are unsustainable and it is facing financial distress, public entities must investigate new approaches to achieve even greater cost savings and efficiencies, and to identify new ways to thrive and grow. Everything must be on the table, from existing structures and operational silos to processes, programs and all contracts. The actions taken to date have been painful, but they are simply not enough. Many Ohio public entities cannot afford to continue operating as they are today, or to return to long-standing practices when the recession finally ends.

OSCPA formed the Ohio Budget Advisory Task Force in response to the state's loss of anticipated VLT revenue and Governor Strickland's recent request for guidance and recommendations on how to get Ohio back on firm financial footing. Given Ohio's need for a rapid response to the current $851 million shortfall and looming massive deficit projected in the next biennium, OSCPA felt the best approach was to provide a broad, "30,000 foot" overview of areas that could provide relatively quick remedies, yet also provide a roadmap for longer term, sustainable financial improvements. Several areas we discuss have been studied in the past or are currently under review by state or local committees. Others may require a vote of Ohio citizens. Still others may have valid reasons to remain unchanged. Almost all are likely to be viewed as controversial.

The Task Force is comprised of leading member CPAs from throughout Ohio who are committed to developing an understanding of the financial conditions facing Ohio now and in the future. Our basic approach, just as it would be for any client facing huge financial challenges, is to offer support and objective third-party recommendations to improve state revenue growth and reduce expenses.

This Task Force met to discuss a wide range of approaches to controlling costs, streamlining operations, and enhancing revenue. This robust series of discussions was distilled into the following recommendations.

INTRODUCTION

Any enterprise, public or private, must be accountable to those who provide the means to keep it operating. For the private sector, shareholders must be confident their investment in a given company is being used wisely and in a manner that will result in both short- and long-term success. Government entities have a unique structure which requires them to report to multiple levels, but every Ohio governmental unit, local or state, ultimately reports to Ohio citizens.

In recessionary times, it is more important than ever to ensure every dollar is being spent as intended and stretches as far as possible, and a critical eye must be given to non-essential services and programs. Responsible households do it, businesses that survive deep recessions do it, and many government entities do it too. But with Ohio's ongoing loss of employers, jobs and population, every government entity, at every level, must operate as efficiently as possible and be accountable for every dollar spent. Protecting longstanding practices or even new programs without ensuring a positive cost/benefit ratio is irresponsible. Recessionary periods, like the one Ohio is now experiencing, create opportunities to make necessary but difficult changes that otherwise could be off-limits politically.

Issue: Immediate Action Steps

As with any troubled entity, the first thing to address is the immediate problem at hand. For Ohio, it is the $851 million General Revenue Fund shortfall caused by the projected loss of video lottery terminal funds. Of the various immediate remedies available to state government, delaying the last 4.2% of the state income tax decrease for two years is likely the least painful and easiest to implement. But it cannot be the only immediate change Ohio makes.

Recommendations for concurrent action:

- **Identify cost and management efficiencies that can be gained, and identify and implement additional cost containment measures – ensuring all levels of government are accountable for the funds invested by taxpayers. (See Issue: Performance Audits)**

- **Suspend for one year any Controlling Board expenditures not necessary to maintain essential state programs and services. For example, in this tough economy, the Cleveland Browns and Cincinnati Bengals received $850,000 each for licensing fees to allow the Ohio Lottery to market products bearing their trademarks. Separately, a significant amount of funding has been disbursed by the Controlling Board to construct new buildings for higher education institutions. In a time of fiscal crisis, Ohio's government should not be building new facilities unless they are replacing these that are structurally damaged. We support the Ohio Board of Regents' position against "new net space" in the 2010 capital bill planning process.**

- **Require state agencies to use modified zero-based budgeting as they begin to plan for the 2012-2013 biennial budget process. Modified zero-based budgeting is a technique of planning and decision-making that has been used by the State of**

Ohio for some years. In the early planning stages of developing the budget, OBM often requires agencies to reduce budgets by 10% to 20%. The base is then set and proposed increases need to be justified. In general, this method has served Ohio well. However, in times of serious revenue shortages the existence of an agency, program, or division should be analyzed to determine if it provides a core function of government, and if it should continue to be funded. This can be done in part through sunset reviews.

- **Develop a plan to sunset state agencies. Every state agency should be evaluated at least every 10 years. While this is done with state boards and commissions, it is not done with cabinet-level agencies. This approach would more closely align the state with the principles of a true zero-based budgeting process without the time constraints imposed by the biennial budget, and will provide more opportunity for legislators to explore the operations of and continued need for the agency.**

- **Require paperless technology. The State of Ohio processes thousands of paper documents every day, which is a costly and time consuming way to collect and store data. One of the easiest ways to help narrow the budget deficit is to increase the number of on-line services. Currently the Department of Taxation and the Department of Job & Family Services are utilizing electronic forms for several initiatives. The expansion of the program across state government would reduce operational costs and increase employee productivity. For example, the Illinois Department of Human Services saved $6 million in administrative costs and $1.2 million in reduced paper printing and distribution costs in its first year. New Jersey and Pennsylvania have also adopted a paperless government initiative.**

Issue: Performance Audits

Being accountable means being able to show a return on the investment of taxpayer dollars by developing quantifiable metrics that show benefits gained for revenues expended. Financial audits routinely are conducted on all state agencies and many local government entities. These audits test the numbers being presented by management to ensure they are reliable. Financial audits do not, however, address the need for a deeper dive into management and administrative practices to ensure they are cost efficient and streamlined. Such assistance can be gained through a number of methods, but performance audits are among the best.

Performance audits are a valuable management tool structured around Government Auditing Standards that evaluate whether tax dollars are being spent in an effective, efficient and economically sound manner. These audits measure a program's actual performance against its goals and objectives and help to identify any waste, inefficiency or unneeded duplication of services, and identify best practices used by similar Ohio or out-of-state entities. On average, performance audits conducted in Ohio over the past three years resulted in a potential return on investment rate of $24 for every dollar spent. In addition to comprehensive performance audits, more targeted program-specific audits or compensation audits are also very beneficial.

Performance audits work, as evidenced by Ohio's results to date. They can be conducted by management consulting firms, CPA firms, or by the Ohio Auditor of State's performance audit team; the key is that these audits be performed by an independent body to ensure fairness and objectivity. The State Auditor's office currently conducts performance audits at the request of a government entity or the Ohio General Assembly, or in cases where a school district is in fiscal distress. No matter who performs them, we believe the number of performance audits should be greatly expanded, beginning in 2010.

In 2005, taxpayers in the state of Washington voted to give their state auditor authority to conduct comprehensive, independent performance audits of state and local governments, paid for through a portion of sales and use tax revenue. Ohio does not have such a mandate in place. We recognize the political sensitivities involved when an auditor of one political party is charged with evaluating the management and operations of those in a different party. Nonetheless, as with the case of all statewide officeholders, Ohio's Auditor of State was elected by Ohio citizens to serve government in the role of independent auditor. Politics must be set aside by all parties for the greater good of Ohio's future. Though past experience shows that Ohio's state auditor conducts performance audits only upon the request of a government entity, the Ohio General Assembly or the Department of Education, a review of the statutes suggest that the auditor may already have the authority to conduct these audits at her own initiative. They should aggressively begin a broader program of performance audits. If the State Auditor does not have that authority, Governor Strickland and legislative leaders should take steps quickly to give the State Auditor such authority and to provide the necessary funds. Prioritization for the performance audits should be given to those state and local agencies largest in financial size to deal with the biggest areas of gain first.

Performance audits conducted by a third party are different from an in-house performance review. Performance audits are conducted in accordance with specific government auditing standards by an independent party to ensure impartiality. Performance reviews are conducted by management. While often providing useful information, as in the case of school district report cards, the potential cost savings from the in-house performance review is lessened when compared to the more in-depth, independent performance audit evaluation that will result in greater savings.

Examples of areas where efficiencies and possible cost savings can be identified through performance audits include:

- **Economic development tax credit programs.** Millions have been distributed over the past 29 years in an effort to support businesses that commit to creating jobs in Ohio. A performance audit could independently ensure that the funds are being used for their intended purpose, and analyze through a cost/benefit lens the number of jobs created vs. tax revenue received in correlation to taxpayer investment.

- **Medicaid. Currently, almost half of the GRF is dedicated to health and human services funding.** A performance audit released in December 2006 identified over $400 million in potential savings, though a number of the significant cost saving recommendations have not been implemented. While there may be valid reasons for not adopting some of those recommendations, in view of the massive spending involved with the program and inherent fraud risks, we believe the Medicaid program is ripe for additional review. Particular focus should be paid to Ohio's level of funding of nursing homes compared to in-home care for the elderly or disabled.

- **Employee benefits.** For areas of state and local government where personnel costs are a significant percentage of the total budget, a compensation audit is prudent to ensure retirement, health and other benefits are on par with the private sector or with like-sized government operations across the country. A City of Columbus compensation audit identified $43 million in potential savings in 2008 alone. Recommendations for one agency likely can be reliable data for use by similar agencies across departmental or geographic silos. For example, in Columbus, a determination that paying an employee's 10% share of the defined benefit plan is excessive or unsustainable in one city or school district can likely be used by others when evaluating budgets. A separate analysis found the potential for significant pension fund savings by delaying the minimum age for the collection of retirement benefits from age 52 to age 60. Increasing it to 65, as is commonly done in the private sector, would save taxpayers even more.

Recommendation: Conduct performance audits on targeted programs or services provided by state agencies and key local entities, starting in 2010. Priority should be given to a "risk-based" approach, focusing first on the largest programs and riskiest areas with the largest potential for cost savings and improved efficiencies. One year or less after the results have been released, require the entity that was reviewed to report to the Governor and legislature regarding steps that have been taken to improve operations, or explain why recommended changes should not be made.

Issue: Consolidation

Ohio currently has approximately 5,600 units of government at the local and state levels. Among them are 24 state departments, 942 cities and villages, 1,308 townships, 88 counties, 667 public school districts, 631 special taxing districts, plus numerous law enforcement agencies, fire departments, health inspectors, health departments and building inspectors, to name a few. Most, if not all, require taxpayer dollars to function. What made sense when Ohio became a state in 1803 or in our manufacturing heyday of the 1960s cannot support the programs and services necessary in the 21st Century and beyond.

While a politically painful process, consolidation of service delivery entities in Ohio is a necessity. Ohio citizens pay far more than is necessary for the management of thousands of government entities. Citizens would be better served if redundant or easily shared services and/or management of local government entities, as well as school districts, were merged to limit overhead and/or to create greater group buying power through economies of scale. Care should be taken to avoid negatively impacting core services or efficiencies already gained.

A number of states across the country have taken steps to consolidate service providers, at the management level or beyond. Indianapolis, Indiana is thriving compared to other Midwest cities due in large part to Unigov, a regional agreement by county and multiple city government officials to put aside turf wars for the greater good of a thriving economy. We also have examples of enhanced efficiencies here in our own state. In Wayne County, the Wooster City School District and Rittman Local School District consolidated certain top administrative functions - being more accountable by saving taxpayer dollars and eliminating duplicative services. In Wayne County, the Wooster City School District and Rittman Local School District consolidated certain top administrative functions – and share a superintendent and other top administrators all while retaining the individual identity of each of the schools. They save an estimated $250,000 a year.

Consolidation of related services at the state and local levels is a key step government can take to operate more efficiently and achieve significant reductions in administrative expenses. Certainly, there will be instances where larger is not better, or where a closer look shows that consolidation will not result in greater efficiency, cost savings or better operations. But the fact remains that the potential exists for significant, positive gains in our state.

Recommendations:

- **Study the feasibility of requiring centralized administration and collection of municipal income taxes, such as through a piggyback tax on the State of Ohio return. The precedent has already been set through the State of Ohio's centralized collection of local school district income taxes. Doing so would ease the burden on taxpayers, save administrative costs at the local level, and help Ohio attract out-of-state employers through a decreased regulatory morass.**

- **Alternatively, many municipalities already participate in regional collection through existing non-profit entities such as the Regional Income Tax Authority. Ohio is one of very few states that permit taxation of income at the municipal level. A total 579 Ohio municipalities assess an income tax.**

- **Consider merging or otherwise sharing at a regional or county level redundant government services to limit overhead. For example:**

    - **Combine police and fire administrative personnel**

    - **Combine municipal and county building inspection operations**

    - **Combine municipal and county health inspection operations at least at the county level**

    - **Consider requiring municipalities, particularly townships and villages that are among the smallest in population or geographic size, to centralize services at all levels, possibly by merging with larger adjacent or overlapping municipalities. The lack of buying power of these small entities, combined with the high per capita costs associated with separate operations, dictate that the status quo should change. Such a change likely would require independent study, short- and long-term planning, and a vote of impacted residents.**

- **Continue to explore consolidation of related public entities, regionally or even statewide, for contractual negotiations on supplies, equipment and health insurance or other benefits.**

- **The state could employ the carrot and stick approach the federal government uses when dealing with states. The State of Ohio could essentially mandate that local entities consolidate certain programs, services or purchasing power by underfunding non-consolidated entities and fully funding those that are delivered across a wider spectrum. For example, 75 of Maine's 290 school districts were either eliminated or consolidated, saving the state a projected $36.5 million annually. Districts that opt out of consolidation receive a 2% reduction in state funding.**

INTRODUCTION

While accountability, efficiency and strategic planning are core principles of effective state spending policies, responsibly securing and prioritizing revenue streams to support demand for programs and services is equally important. The principles of fairness, stability, competitiveness and predictability are at the core of any effective strategy to raise revenue from a constituency. These core principles should not just be viewed through the lens of a two-year state budget.

Ohio's total tax rate is among the highest in the country when local taxes are factored in. State leaders must do all they can to lower rates to make our state economically competitive. Any support for increases should be conditional on a truly comprehensive review of state government. Only after all other avenues have been exhausted, if state government needs to explore shifts in taxation to achieve either additional revenue or further cuts, the following factors should be considered.

Issue: Personal Income Taxes

Since 2005, Ohio has made significant strides toward improving our economic competitiveness with surrounding states, and with easing the tax burden on citizens by lowering personal income tax rates across the board by 4.2% per year. Despite the decision to temporarily suspend the final 4.2% cut, Ohio's legislative and executive branch leaders should be lauded for their collective commitment to lower personal income tax rates. OSCPA agrees that a commitment to reinstitute this decrease is sound tax and economic development policy.

Any rate changes to the personal income tax should be done in a manner that does not disproportionately or negatively impact one sector of taxpayers more than another. When feasible, consideration should be given to further lowering rates that are overly burdensome to taxpayers who create jobs and economic opportunity in Ohio, particularly small businesses as they are the drivers of any state's economy. Employers of all sizes often have flexibility regarding where to locate their business. Since corporate leaders are typically in the higher income tax brackets, Ohio policy leaders must be aware of the correlation between a lower personal tax burden and the impact that has on recruiting and retaining employers.

At the same time, the tax burden should not be so high that lower income individuals are unable to purchase durable goods and services. Given the status of the state's economy, additional income tax burdens to Ohioans at any level could be devastating for positive population and business expansion.

Ideas for possible revenue sources:

- **Consider eliminating "double dipping" of personal exemptions and credit for dependents. Currently, taxpayers who cannot claim themselves on their federal tax return are still able to claim themselves on the Ohio return even though their parents have already claimed them.**

- **Establish uniform income tax policies for municipalities, including taxation of gambling and lottery winnings and deductibility of gambling losses. This will come into play much more in our state now that casino gambling has been legalized. Uniformity would result in an additional revenue source for municipalities that do not already include gambling and lottery winnings in their tax base.**

- **Conduct further study on the numerous tax credits available in Ohio. Are they achieving their intended purpose? Ohio's state tax return used to be one-half a page; now it is four pages long. Simplicity and fairness should be at the core of any tax policy.**

Issue: Sales Taxes

Currently the state sales and use tax rate is 5.5%. Counties and regional transit authorities may levy additional sales and use taxes which result in sales tax rates in Ohio that range from 6.25% to 7.75%. While OSCPA is in no way advocating it, increasing in the sales tax rate at the state level would be a uniform increase across consumers in all demographic categories and spread the burden to out-of-state consumers who purchase goods and services in the state. That being said, consideration should be given to any local increases in the sales tax rate by county or transportation district which could result in a disproportionately high sales tax rate. For example, counties like Cuyahoga with an already high overall sales tax rate would be particularly impacted by a statewide increase.

Idea: Consider reducing or eliminating discounts for payment of sales taxes and other payments to the state.

Issue: User Fees

Ohio could join the many other states that place heavier emphasis on permanent fee increases in place of taxes imposed on all, even those that do not benefit from a given program, facility or service. In other words, reduce or eliminate GRF allocations for the targeted service and replace them with fees on those who use the given service. We are in no way implying that *additional* taxes should be paid in the form of user fees, but rather that the form of payment could shift from a broad tax to a user fee based structure.

Idea: Investigate best practices of other states in our region to determine if reasonable new or increased user fees make sense. A number of states have lowered taxes by shifting revenue generation to user fees. A review of other states' fees should be undertaken to ensure that Ohio remains competitive and does not unduly burden its citizens.

Issue: Commercial Activity Tax

By design, the Commercial Activity Tax (CAT) is a broad based, low-rate tax assessed for the privilege of doing business in Ohio. The tax is predictable, relatively stable even in economic fluctuations and has few exemptions or credits. There is a delicate balance between continuing to provide adequate funds to local schools to replace some of the funding lost from the tangible personal property tax and providing a revenue stream for programs and services funded out of the GRF. The original intent, after a phase-in period, was to have CAT revenue flow to the GRF. Under current law, 70% of the CAT is permanently allocated to school funding.

While we don't support it, any effort to increase the CAT rate should take into account the need for businesses to have adequate time to plan for the increase in their expenses. Given today's tight credit market, unexpected business tax increases can force at-risk employers to reduce their workforce, or worse, close their doors. Ohio simply cannot afford to lose more jobs, or the related tax revenue those jobs generate.

Issue: Non-CAT Business Tax Structure:

A review of taxation policy and structure among industries not subject to the CAT would also be prudent. Businesses that compete for the same customers and provide similar services should be subject to the same level of taxation and not be picked as a winner or loser based upon their business structure.

Recommendation: Currently, some business sectors in Ohio are assessed business taxes other than the CAT even though their competitors are exempt. To ensure fair and equitable treatment, the state should undertake a periodic and regular review of business sectors subject to non-CAT business taxes that have exempt competitors.

Issue: Investigate the Sale of State Assets and Privatization of State Services

As is happening in other states, Ohio should undertake a cost/benefit analysis of relevant state assets to determine those that would benefit the state by being sold or contracted to a private vendor. Doing so could allow the state to jettison management-related costs of these assets and/or potentially raise funds. A number of states have privatized turnpikes and/or privatized healthcare for prisoners.

Another key example deals with the Bureau of Workers' Compensation. Ohio is one of only three states that have not privatized administration of workers compensation. Businesses operating in multiple states have pointed to Ohio's workers' compensation system as being much more expensive than those in other states, and a deterrent to locating in Ohio. Short of privatization, the door should be opened to allow competition from private insurers.

Recommendation: Undertake a cost/benefit analysis to identify state assets or services that could be more economically delivered by the private sector, particularly the Bureau of Workers' Compensation.

Issue: Public Employee Compensation Practices

Ohio public employees should not be permitted to retire from a position, be rehired to the same or similar position, and simultaneously receive both retirement benefits and salary – a practice referred to as "double dipping." Further, while it is appropriate for state government to pay the employer's portion of the state defined benefit plan, it is unfair to the taxpayers to also pay the employee's 10% portion. To prevent future crises with Ohio state pension funds and save significant expenditures, explore best practices with regard to raising the age at which employees can begin to receive pension payments.

Recommendation: As is done in the private sector, prevent public employees at the state or local level from concurrently receiving retirement benefits and salary for the same or similar job. Further, urge contract changes with regard to employee defined benefit plan payment practices to make sure benefits provided are in line with those offered in the private sector.

Issue: School Funding Challenges

<u>Primary and Secondary Education</u>

We agree that emphasis on primary and secondary education – the basis of a well-educated work force – is critical for our state. While we do not have a solution to the problem of how best to fund Ohio schools, there are a number of ways to achieve efficiencies and cut costs without impairing in-classroom instruction.

Ideas include:

- **Consider merging or otherwise sharing administrative and other services among school districts. While it may have made sense in an agrarian society to have 618 local school districts, with today's technological and transportation advances, that is no longer the case. It is possible to achieve efficiency and cost savings by downsizing administrative overhead through:**
    - **Merging Ohio's smallest school districts into adjacent districts.**
    - **Requiring all districts under a certain size to consolidate administration at the county or regional level. This also holds true for educational services provided outside of the classroom.**
    - **Consolidating commonly shared services such as health care delivery on a regional or possibly even state level.**
- **Focus on the 83% of school funding expenditures made up of personnel costs rather than the 17% of other education-related costs such as busing, sports, and extracurricular activities. Mandating changes across the state will eliminate the challenge local school boards have with attracting and retaining qualified educators and administrators. Examples:**
    - **Ban school districts from paying an employee's portion of the defined benefit plan.**
    - **Require pooling of healthcare benefits with other districts, and require employees to pay premiums at a rate comparable to the private sector.**

   - **Raise the minimum retirement age.**

- **Privatize services that fall outside the core educational mandate, such as busing, food service, and janitorial services, to eliminate related administrative, retirement and capital costs.**

<u>Higher Education Facilities Funding</u>

We applaud the Strategic Plan for Higher Education 2008-2017. Implementation of the proposed efficiency and accountability measures in a timely manner is critical, particularly since Ohio shoulders a disproportionate share of university facilities funding compared to other states.

In addition to implementing recommendations with the existing Strategic Plan, Ohio should:

- **Consider using state funds only to pay for the repair and maintenance for older buildings, such as those built before 2005.**

- **Expand to all impacted projects the option of General Contracting (single prime), Design Build and Construction Manager at Risk, rather than just multiple prime contracting and construction manager as advisor contracting to create flexibility and reduce costs.**

INTRODUCTION

It is imperative that executive and legislative branches take part in active study and planning for the future. The common goal should be to make government in Ohio an efficient and economically viable provider of basic and essential services to the citizens of this state. This can only happen through a comprehensive strategic planning process that partners government leaders with objective financial experts who can disregard sacred cows, rise above politics and make fiscally prudent, forward thinking recommendations.

The outcomes of strategic planning discussions will no doubt be difficult and even painful, but they are essential to returning to long-term fiscal stability and economic growth. There are a number of approaches we recommend.

Issue: Adopting a Long Range Financial Outlook System

Like any other business, Ohio must develop a tool both to avoid future budget problems and maintain greater financial stability between state fiscal years. It should include budgetary, economic, demographic and debt analysis to provide a framework for the financial projections and cover the upcoming fiscal years.

Further, understanding the implications of making changes to the tax code or fee for service structure over a long term period – minimally six to eight years – can assist the state in long-term planning and result in positive revenue numbers that can adequately cover for unplanned expenses that may arise.

Florida already has such a program in place: *The State of Florida Long-Range Financial Outlook*. This constitutionally mandated program was put in place by Florida voters, who recognized the need to set long-term fiscal policies for all of the state's departments and agencies. *Outlook* achieves this goal by looking at the amount of money that government is bringing in, and from what sources, as well as what government is spending taxpayer dollars on, and in what quantity. Those figures are then projected out over three budget cycles, factoring in significant events such as a recession, natural disaster, and changes made by the state legislature, federal government or voters that will impact future budgets.

The Florida study examines all state agencies but in particular looks at departments responsible for the bulk of increased spending from one fiscal year to the next. It examines the reasons why these agencies, and the services they provide, continue to pressure the state budget and what steps could be taken to reduce these negative effects.

While such an approach is not a substitute for the traditional budget process, it does allow government leaders to examine the causes of funding pressures beyond the sources of revenue that fund them. In Ohio, much of the work to produce such a plan is already being done. Unfortunately, it does not come together in one comprehensive document that is produced annually, allowing for serious study and application.

Recommendation: A similar approach in Ohio, that is made available to lawmakers and the public, is needed. Ohio should adopt a long-term strategic plan, updated annually by a standing body made up of public and private sector experts.

Issue: Increase the size of the Rainy Day Fund

As Ohio's budgets have grown, the size of the Rainy Day Fund has not kept pace. A prudent approach would be to maintain a Rainy Day Fund that is proportionate to the size of the state's annual budget to ensure that Ohio's main reserve account can adequately deal with short term budget problems and policy makers can make appropriate long term actions.

Recommendation: Determine the appropriate size of the Rainy Day Fund and work toward that goal.

Public entities at all levels must explore significant changes in operations and/or structure, starting immediately, to achieve a constitutionally mandated balanced budget by July 2011.

OSCPA believes that all programs and services relying on General Revenue Funds or dedicated Commercial Activity Tax revenue must be evaluated. Even traditionally “sacred cows” must be on the table. Evaluations must focus on the areas of cost containment, operational efficiencies, strategic planning and, only if the first three areas do not achieve needed financial goals, additional sources of revenue.

Performance evaluations are essential to identifying potential savings, eliminating costly inefficiencies or unsustainable benefits, and streamlining government. With thousands of public entities in Ohio depending on state funding, streamlining services or entire governmental bodies through consolidation should be seriously evaluated in a number of areas.

OSCPA's hope is that the preceding recommendations will serve as a catalyst for an ongoing, in-depth conversation between OSCPA, Governor Strickland and members of the Ohio General Assembly about approaches and solutions to the current and future budget dilemma. We stand ready to mobilize the resources of the Society’s 23,000 member CPAs across the state to help Ohio overcome the existing short- and long-term financial challenges.

INTRODUCTION

For decades, various academic studies and legislatively appointed study groups have looked at the efficiency and effectiveness of Ohio's tax code, particularly as it is applied to businesses. Prior to 2005, the state's tax structure had been labeled by some as the "perfect gateway to the economy of the 1930s." Ohio's ability to attract and retain jobs was being hampered by the imposition upon its citizens and employers of some of the highest tax rates in the country. Given the evolution of the state from a 20th century economy steeped in a heavy manufacturing employment base to 21st century economy featuring a service oriented, mobile and technologically adept workforce, state policymakers and business leaders recognized that change must occur for Ohio to compete regionally, nationally and internationally and that the 2006-2007 state operating budget was just the vehicle to make those changes.

Given the expertise and intellectual capital of its 23,000 plus members, The Ohio Society of CPAs also recognized 2005 as the right time to make the necessary changes to Ohio's outdated tax code. Utilizing the unique position that CPAs have as advisors to virtually every business sector in the state, OSCPA joined The Ohio Business Roundtable, The Ohio Manufacturers Association, The Ohio State Bar Association and Ohio State Medical Association, among others, to support the tax reform proposals put forth in Amended Substitute House Bill 66.

The Ohio Society of CPAs' involvement on tax reform

OSCPA surveyed all members in February 2005 to develop its position. Members were asked numerous questions about the pending reforms, as well as alternative approaches to reforming Ohio's tax code. Fully two-thirds of respondents favored a complete overhaul of Ohio's business tax structure, and a comparable number favored the imposition of what is now known as the Commercial Activity Tax (CAT) in conjunction with elimination or reduction of other specified taxes. Given that data, OSCPA pursued a position in favor of the tax reform package as a whole, strongly opposing attempts to create carve outs, exemptions, earmarks or adjust the phase in/phase out schedule of the CAT, corporate franchise, tangible personal property and 21 percent across-the-board cut on the personal income tax.

Given The Ohio Society's role as a leading advocate for tax reform, OSCPA testified several times during hearings on Am. Sub. HB 66 to show support for the package that was ultimately adopted. After the passage of Am. Sub. HB 66, OSCPA did not end its advocacy efforts to support the tax reform package and sought to ensure the changes were implemented completely and on schedule. Toward that end, OSCPA has testified in opposition to carve outs to the CAT, including in the House Economic Development and Environment Committee against HB 414 in 2006. On the legal front, OSCPA has consistently opposed legal challenges seeking certain industry exemptions from the CAT and, most recently participated in a coalition of business groups that filed an amicus brief in support of the state's position in *Ohio Grocers Assn. v. Wilkins.*

Making the case for tax reform

Prior to 2005, Ohio's tax structure was filled with barriers to capital investment, and disincentives for business relocation into and expansion throughout the state. In order to compete across state and national borders, Ohio had to foster new capital investment, especially in the manufacturing sector, and make the tax code simple, fair and equitable for businesses and employees seeking to locate or stay in Ohio.

Amended Substitute House Bill 66 – Key components of 2005's landmark state tax reform package

- **Tangible personal property tax:** Starting in 2006, Ohio's tangible personal property tax system began a four-year phase-out that applies to furniture and fixtures, machinery and equipment, and inventory. This tax punished investment in capital at a time when Ohio's economy was shifting away from a manufacturing base to a service economy.
- **Corporate franchise tax:** A five-year phase-out of the corporation franchise tax occurred at the same time as the phase-in of the CAT. The high "sticker price "was a disincentive for companies to relocate into the state. In addition, tax collections were modest at best due to the numerous credits and exemptions companies were given. This was commonly referred to as the "Swiss cheese" tax.
- **Across the board 21% income tax cut:** This reduction made the state's overall income tax rate structure much more comparable to other states in the region. Equally important was the relief it gave to s-corporations or pass-through entities. S-corporations were not previously subject to the corporate franchise tax but were, under the tax reform package, going to be subject to the CAT. This decrease gave these small business owners some necessary relief.
- **Commercial Activity Tax (CAT):** This broad based, low rate tax, applied equally across all sectors of the economy, introduced an important characteristic of responsible tax policy – predictability. Even more attractive was the fact that this tax would be applied to out-of-state companies selling goods and services into the state but not to Ohio-based companies selling goods and services outside of the state. Despite certain entities not being subject to the CAT – such as nonprofit organizations, financial institutions and their affiliates, insurance companies and their affiliates, and dealers in intangibles – it is the fairest and most equally applied tax imposed on business in many years.

Observations and Results to date

Ohio has been among the states hardest hit by the recession, and the projections set forth in 2005 have not been realized in large part to the national economy. Despite that, Ohio's new tax structure has been favorably reviewed by some respected authorities, including:

- The Small Business & Entrepreneurship Council released its ***Business Tax Index 2008***. In it the SBE Council ranked Ohio as having the best tax system in the Midwest.

Clearly this ranking would not have occurred had it not been for the reforms passed by prior legislatures and administrations and kept in place by the current administration.

- More recently, *Business Facilities Magazine* named Ohio as the best in the Midwest and 4th in the nation for its strength in the emerging bioscience industry.

Chair

J. Matthew Yuskewich, CPA
Columbus, OH
Chair, OSCPA Executive Board

Members

Allyn Adams, CPA
Cleveland, OH
Past Vice Chair of Finance, OSCPA Executive Board

John Davis, CPA
Columbus, OH
Member, OSCPA Council of Leaders

James Gero, CPA
Independence, OH
Member, OSCPA Executive Board

James Gottfried, CPA
Cleveland, OH
Member, OSCPA Council of Leaders

Steve Haxton, CPA
Columbus, OH
Member, OSCPA Council of Leaders

Thomas Hazelbaker, CPA
Middletown, OH
Member, OSCPA Council of Leaders

Jay Moeller, CPA
Dayton, OH
Immediate Past Chair, OSCPA Executive Board

David Reape, CPA
Shaker Heights, OH
Chair, OSCPA Tax Legislation and Policy Committee