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NASACT Seeks Assistance in the Senate for Repeal of 3% Withholding Law

NASACT, GFOA, NACo and several other state and local organizations have been urging action to repeal a provision included in the "Tax Increase Prevention and Reconciliation Act" of 2006 which requires, beginning in 2011, that all governments with expenditures of more than $100 million withhold three percent on most payments for property or services. The provision, while proposed in the Treasury Blue Book and the Joint Committee on Tax's Options Report, was not a part of either the House or Senate version of the reconciliation bill and was added without a hearing, without consultation, and with little knowledge during conference negotiations.

In addition to being an almost $7 billion dollar revenue raiser, the provision is an attempt to capture government contractors who do not pay taxes. Effective January 1, 2011, the provision would require governments (and political subdivisions exceeding aggregate payment of $100 million or more for goods and services) to withhold three percent on payments for goods or services. The law further complicates implementation by exempting several types of payments including payments made through public assistance or welfare programs where eligibility is needs- or income-based, payments of interest, payments for real property, payments to tax-exempt entities or foreign governments, intra-governmental payments, payments based on a classified or confidential contract and payments to a government employee not otherwise excludable with respect to their service as an employee.

There are currently two repeal bills and one good government contractor piece of legislation which includes the repeal language. HR 1023, introduced by representatives Kendrick Meek (D-FL) and Wally Herger (R-CA), has 242 co-sponsors and S. 777, introduced by Senator Larry Craig (R-ID), has 10. More recently, senators Norm Coleman (R-MN) and Susan Collins (R-ME) introduced S. 2394, the Good Government Contractor Act, which includes a provision calling for repeal of the three percent withholding requirement. There are also a three bills that include a provision for a one-year delay in the withholding

While the business community has managed to get the word out on the detrimental impact of this onerous provision, the state and local groups have been less vocal. We are asking NASACT members to contact their congressional delegation explaining the detrimental effect of this new law. Background information, talking points and a letter template titled "Senate 3% template" can be found on the NASACT Web site at www.nasact.org/washconnection/announcements.html.

The organizations seeking repeal are interested in reaching out to members of the Senate, particularly senators on the Senate Finance Committee (http://finance.senate.gov/sitepages/committee.htm). Because the provision originated in the Senate and is considered a good way to help close the tax gap, it will be particularly important to explain why it is detrimental to state and local governments in terms of administration and perhaps most importantly the increased cost that will be borne in procuring goods and services if the provision is not repealed.

Questions about this matter may be directed to Cornelia Chebinou, NASACT's Washington director, by e-mail at cchebinou@nasact.org or via phone at (202) 624-5451.

President's Budget Proposal Seeks to Accelerate Implementation Date of Information Reporting

The Bush Administration is once again proposing to accelerate the implementation date for information reporting. The Tax Reconciliation Act of 2006, which requires governments to withhold three percent starting in 2011, also included a provision requiring increased information reporting. Below is an excerpt from Treasury's Blue Book which provides explanations for the Administration's revenue proposals.

> **Requiring increased information reporting for certain government payments for property and services**. The IRS and Treasury Department would be authorized to promulgate regulations requiring information reporting on all non-wage payments by federal, state and local governments to procure property and services. The provision would be effective beginning January 2009. *(Raises $266 million over 10 years.)*
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> **Note:** Congress passed information reporting in combination with a 3% withholding requirement in section 511 of the tax reconciliation bill (H.R. 4297), effective beginning in 2011. The President's proposal would require information reporting beginning in 2009. It does not change the effective date of the withholding requirement.

Legislation on Business Use of Cell Phones to Be Introduced

The National Association of State Comptrollers' Payroll Information Sharing Group wrote to Steven Miller, director of the Tax Exempt and Government Entities Division at the Internal Revenue Service in the spring of 2007 seeking changes to a number of outdated fringe benefit regulations. Since that time, NASACT has been working with the IRS in an effort to find a reasonable policy on personal use of an employer provided cell phone.

According to the Internal Revenue Code, a state (or other employer) is required to undertake onerous recordkeeping and audit requirements because cell phones are included in the definition of "listed property." State comptroller offices have found it extremely difficult to draft a cell phone policy that complies with the IRS policy on taxation for personal use but that does not penalize the employee for personal calls that may be necessary in the course of their business.

Calculation of personal use is extremely difficult considering that today's cell phone plans provide free minutes, and in many instances unlimited calling.

NASACT was originally working with the IRS's Advisory Committee on Tax Exempt and Government Entities to develop a reasonable policy recommendation, keeping in mind that a longer term solution would be to seek a statutory change. More recently, however, Congressman Sam Johnson (R-TX) has expressed interest in introduce a bipartisan bill that would strike cell phones and similar devices from the category of "listed property" within tax code Section 280F(d)(4)(A)(v). NASACT will be working with Congressman Johnson's office on legislation to remove cell phones from listed property.

FFATA Pilot to Reveal Information that will be Required of Grantees

In 2006, President Bush signed the Federal Funding Accountability and Transparency Act (FFATA) requiring the U.S. Office of Management and Budget to develop a publicly available, free-of-charge, searchable Web site on federal funding. Federal funding includes grants, sub-grants, loans, awards, cooperative agreements, and other forms of financial assistance. Contracts, subcontracts, purchase orders, task orders, and delivery orders are also included. All individual transactions below $25,000 and any credit card transactions made before October 1, 2008 are exempt.

The Website is to contain the name of the entity receiving the award, amount of the award, transaction type, funding agency, CFDA number, program source, and descriptive award title. It additionally requires the location of entity, unique identifier(s) of both the entity and parent entity, and other information OMB deems "relevant." The act further requires that the data be made available within 30 days of the award.

The first phase of the new reporting system became available to the public via the Internet as of January 2008 and can be accessed at www.usaspending.gov. Sub award information will need to be captured and reported by **January 2009**.

While the federal government has announced that it will conduct a pilot with the grantee community as set forth in the law, no action has yet occurred. The pilot will identify the increased reporting burden and associated obstacles with implementing the sub-award piece of the law which is required by **January 1, 2009.** The federal government is relying on the grantee to:

- Ensure that information pertaining to the organization is accurate.
- Be prepared to meet reporting requirements as a condition of the award.
- Be prepared for heightened public scrutiny of dealings with the federal government relating to grants, contracts, and cooperative agreements.

State Groups Respond to SEC Request for Comment on Disclosure Concerning Ties with Countries Designated as State Sponsors of Terror

A group of state organizations, including NASACT, recently responded to an SEC request for comment concerning disclosure on business activities a company may have in or with countries that are designated as state sponsors of terrorism

NASACT, the National Association of State Retirement Administrators (NASRA) , the National Council on Teacher Retirement (NCTR) and the National Conference of State Legislatures (NCSL) have been urging the federal government to provide information on companies that by virtue of their business or business ties in terrorist sponsoring countries are acting contrary to foreign policy and humanitarian interests. Such information is needed to prudently make investment decisions: to date no such information is available from the federal government.
It its letter to the SEC, the group reiterates the difficulty in determining which companies operating in countries designated as state sponsors of terrorism are acting contrary to U.S. foreign policy or humanitarian interests. The letter specifically states that while there are broad trade embargos with Sudan, not all business is prohibited, and the government of Sudan is specifically exempt.

> “Over the last several years a large number of state governments, universities, pension funds and other institutional investors have made attempts to ensure that their invested funds do not directly or indirectly support terrorism. While they have repeatedly sought authoritative federal information relating to public company business activities in or with Sudan and/or other State Sponsors of Terrorism that conflict with U.S. Foreign Policy or humanitarian policies, such information is still not available.”

The letter further acknowledges the difficulty the SEC faced last year when trying to enhance access to company disclosure through an online database of companies operating in sanctioned nations. The letter states, however, that filing disclosures alone will simply not be sufficient. Information on the degree to which a company’s business operations conflict with U.S. foreign policy or with U.S. national interests is imperative for making informed investment decisions. Simply acknowledging a business interest in such a country will not reveal if the business operations are for legitimate means. The letter also acknowledges that there are NGOs and for-profit ventures that produce lists for purposes of divestment. The groups strongly believe that the federal government is the only credible source of information on companies that may be acting contrary to foreign policy or humanitarian goals and that such a judgment should not be effectively delegated to NGOs, no matter how well-respected or well-intended they may be. Furthermore, the letter states that other vendors of such information that may have interests in the matter are motivated more by profit that the foreign policy concerns of the United States.

In closing, the group references the new Sudan Accountability and Divestment Act and suggests as a first step in the right direction that the commission consider requiring companies to certify, subject to some sort of penalty, that they do not engage in business operations in Sudan covered under the new law - a provision that the act requires of federal contractors.

OMB Seeking to Utilize the Single Audit in Identification of Improper Payments

The U.S. Office of Management and Budget is seeking to establish a working group to review how the single audit may help in the identification of improper payments. The Improper Payments Information Act (IPIA) was passed in 2002 and requires “agency heads to annually review all programs and activities, identify those that may be susceptible to significant improper payments, estimate annual improper payments in the susceptible programs and activities, and report the results of their improper payment activities.”

While agencies have significantly made progress in identifying improper payments, OMB believes more could be done to help identify the root causes of error. The Office of Federal Financial Management within OMB is seeking avenues to identify improper payments in state administered programs and has recently stated that it will utilize AGA’s intergovernmental partnership to call for volunteers to participate in an exploratory workgroup that will look at the way single audits are currently conducted and how findings made during the single audit may assist agencies in identifying improper payments.

Single Audit Subject of Review

President Bush’s Council on Integrity and Efficiency released the results of a single audit sampling study in June of 2007. More recently, the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security of the

Homeland Security and Governmental Affairs Committee conducted a hearing on the results and recommendations of the report.

The hearing, entitled "Single Audits: Are They Helping to Safeguard Federal Funds?" focused on the PCIE report of the National Single Audit Sampling Project and how to implement its recommendations. Witnesses for this hearing were:

- Daniel I. Werfel, acting controller, U.S. Office of Management and Budget.
- Jeanette Franzel, director, Financial Management and Assurance, U.S. Government Accountability Office.
- Hugh Monaghan, director, Non-Federal Audits, Department of Education, Office of Inspector General.
- Mary Foelster, director, Governmental Auditing and Accounting, American Institute of Certified Public Accountants.

The hearing reveled that a number of initiatives are being taken by OMB and AICPA to address the three report recommendations to improve the quality of single audits: (1) revise and improve single audit standards, criteria, and guidance; (2) establish minimum professional education as a prerequisite for auditors to be eligible to conduct and continue to perform single audits; and (3) review and enhance the disciplinary processes to address unacceptable audits and failure to meet minimum training and CPE requirements.

The AICPA task forces include:

1. Sampling/Materiality Issues In A Single Audit Environment
2. Internal Control And Compliance Responsibilities In A Single Audit Environment
3. Schedule Of Expenditures Federal Awards Reporting Issues
4. Reporting Audit Findings In A Single Audit
5. Single Audit Training Needs And Continuing Professional Education Evaluation
6. Practice Monitoring In A Single Audit Environment
7. Compliance Auditing Considerations in Audits of Governmental Entities And Recipients Of Governmental Financial Assistance

OMB has also established it own work groups to address recommendations in the report. They are:

1. Revisions to A-133 and the AICPA guidelines to report audit findings.
2. Revisions to A-133, AICPA Audit Guide and OMB Compliance Supplement to document the required compliance testing.
3. Revisions to A-133 and AICPA for audit testing and sampling.
4. Revisions to A-133 to require single audit training. Development of training curriculum
5. Review of suspension and debarment process and identify alternative methods to address unacceptable audits.
6. Coordination with other SA constituencies for sanctions and punitive actions for substandard audits. Revisions to A-133 to any proposed sanction language.
7. Coordination with PCIE to issue uniform standards on QCRs.
8. The new and improved single audit process.

At the time of this writing, the OMB workgroups were just getting organized, however, the AICPA focus groups are already underway.

2008 Washington Issue Survey Underway

The NASACT Washington Office is currently soliciting feedback on important issues NASACT members are facing in the current federal and congressional environment. Many changes have taken place over the past year, and the survey has been amended to take into consideration those new issues.

Davis v. Kentucky Challenges Tax Exemption of In-State Bonds

In 2006, the Kentucky Court of Appeals ruled that the State of Kentucky violated the U.S. Constitution's dormant Commerce Clause by exempting in-state municipal bond interest from taxation while taxing interest received on out-of-state municipal bonds. The case, *Davis v. Kentucky,* is now before the U.S. Supreme Court. Oral arguments were heard in November and a ruling is expected this summer.

Many states exempt in-state municipal bond interest and a decision to uphold the Kentucky Court's ruling (i.e., disallow a tax preference for in-state bonds) could have a significant impact on the municipal market.

Walker Continues Quest to Educate America on the Nation's Fiscal Challenges

In an address to the National Press Club, Comptroller General Walker unveiled the U.S. Government Accountability Office's most recent report on the fiscal health of our nation. The report, "A Call for Stewardship," was released the same day as the consolidated financial statements of the United States. In his opening remarks, Walker states, "if the federal government was a private corporation and the same report came out this morning, our stock would be dropping and there would be talk about whether the company's management and directors needed a major shakeup." For the eleventh year GAO was prevented from expressing an opinion because of serious material weaknesses.

In a press release on the U.S. financial statements, Walker notes that three things prevent the U.S. government from obtaining a clean opinion: Department of Defense financial management issues, the federal government's capacity to adequately account for and reconcile intergovernmental activity and balances between federal agencies, and an ineffective way of preparing the consolidated statements.

Walker did however express some good news regarding this year's audit. Namely, that GAO was able to express an unqualified opinion on the Statement of Social Insurance which includes Social Security, Medicare, Railroad Retirement and Black Lung programs – programs that include some of the largest numbers in the financial statements.

Regarding the fiscal wake-up tour, Walker remarked on what has been learned. First, that the American people have little trust in the federal government's ability to address important issues. Second, the American people have little regard for either the legislative or executive branches of government or for either political party, and lastly, they are seeking truth and leadership.

Regaining confidence in the American people will take a number of steps according to Walker. Namely, re-imposing tough budget controls, engaging in comprehensive social surety reform and taking the first step toward comprehensive health care and tax reform. The new report to address fiscal challenges includes tools decision makers can use to address future issues today by creating a path for change.

A "Call for Stewardship" specifically lists 13 tools and process to be used in confronting the nation's twenty-first century challenges. They include the following: key national indicators and a government-wide strategic and annual performance planning for setting direction and for measuring performance; establishment of a meaningful commission to address long-term fiscal challenges; more integrated solutions in Congress and better mechanisms for partnerships across federal agencies; levels of government and sectors all to be used for better decision making and prioritization; executive branch financial and budget reporting; government-wide performance and accountability reporting for better information and increased transparency; a strategic management plan for the executive branch; Chief Management Officers and Chief Operating Officers at selected agencies; a revision of the Presidential appointment process; an enhanced government-wide acquisition and contracting capability; modernized human capital models; and GAO's high-risk list for use by decision makers to implement and execute change.

Walker continues warning that without changes today, by 2040 "our government could only have the resources to do little more than mail out Social Security checks and pay interest on the massive and growing national debt." He further states that change is possible and that Congress has tackled significant reforms in the past and has the ability to respond today. Change will involve tough choices and a reexamination of priorities. However, Walker states that it is a mistake to underestimates the willingness and ability of the American people to hear the truth and support the decisions needed to address our nation's challenges.

A full copy of "A Call for Stewardship: Enhancing the Federal Government's Ability to Address Key Fiscal and Other 21st Century Challenges" can be obtained on GAO's Web site at www.gao.gov.

GAO Also Releases "State and Local Governments: Growing Fiscal Challenges Will Emerge during the Next 10 Years"

Comptroller General David Walker often comments on the challenges that state and local governments will face as a result of the fiscal situation facing the federal government. Recently, GAO released a report explaining Comptroller Walker's concerns. The report uses simulations to determine that absent significant policy changes, in less than a decade state and local governments will begin to face significant fiscal challenges. Topping the list of issues that will contribute to fiscal strain is the growth in health-related expenditures, specifically, Medicaid expenditures and employer provided health insurance for state and local employees and retirees.

Walker believes that states will be challenged just like the federal government as "the federal government and state and local governments share in the responsibility of fulfilling important national goals, and these sub-national governments rely on the federal government for a significant portion of their revenues."

The report provides:

- Simulations of the state and local government sector's long-term fiscal outlook.
- An analysis of the underlying causes of potential fiscal difficulties for the sector.

- A discussion of the extent to which the long-term simulations are sensitive to alternative assumptions.
- An examination of how the state and local government sector could add to future federal fiscal challenges.

A full copy of the report can be viewed at www.gao.gov/cgi-bin/getrpt?GAO-08-317.

Senators Promote New Budget Task Force

Following the lead of Comptroller General David Walker's effort to address the issue of the nation's impending fiscal crisis, senators Kent Conrad (D-ND) and Judd Gregg (R-NH) of the Senate Budget Committee unveiled a bill to create a bipartisan task force to examine and improve the nation's long-term fiscal condition. In his comments, Sen. Conrad stated,

> "Our nation faces a fiscal challenge of unprecedented proportions. We cannot ignore the coming crisis and hope that future leaders will solve this problem. The longer we wait, the harder the choices become. We refuse to hand this problem off to yet another 'outside' commission. The time for action is now. With our legislation, we have a chance to adopt a bipartisan plan that will assure American economic security for generations to come."

According to the senators, the Bipartisan Task Force for Responsible Fiscal Action Act of 2007 would establish a 16-member task force comprised of eight Democrats and eight Republicans, designated by Congressional leaders and the President. Of the 16, 14 members would be current members of Congress and the remaining two members would be from the current Administration, with the secretary of the treasury chairing the task force. The task force would then review all aspects of the current and long-term financial condition of the federal government, identifying factors that jeopardize the government's long-term fiscal balance or that would create a gap between expected federal revenues and spending. The task force would also be asked to analyze all potential solutions and make legislative recommendations to Congress and the President on how to improve the long-term fiscal balance in a report due December 9, 2008.

In talking points that could have been lifted from any of Comptroller Walker's "Fiscal Wake-up Tour" speeches, Sen. Gregg posted a series of Q&As on his Web site, which included the following assessment:

> *Why is the Bipartisan Fiscal Task Force Needed?*
> Long-term projections show an unsustainable imbalance between government spending and revenues that simply cannot be corrected by economic growth alone. Next year, the first of approximately 70 million Baby Boomers will begin to retire, which will explode the cost of federal health and retirement programs. Health care entitlements and Social Security alone will absorb an increasingly larger portion of the federal budget – 20 percent of GDP by 2034, equal to the entire federal government today. There is currently no plan in place on how to handle this looming crisis.

House Also Proposes Fiscal Reform Panel

A week after Senators Kent Conrad (D-ND) and Judd Gregg (R-NH) of the Senate Budget Committee unveiled a bill that would create a bipartisan task force to examine and improve the nation's long-term fiscal condition, two House members have followed suit. Rep. Jim Cooper (D-TN) and Rep. Frank Wolf (R-VA) introduced bill H.R. 3654, the Securing America's Future Economy Commission Act (SAFE). This bill would also establish a commission to develop legislation designed to reform tax policy and entitlement benefit programs and ensure a sound fiscal future. However, the commission would have 16 voting members constituted by the director of the Office of Management and Budget, the secretary of the Treasury; four appointees by the Speaker of the House of Representatives; three appointees by the minority leader of the House of Representatives; four appointees by the majority leader of the Senate; and three appointee by the minority leader of the Senate. Left out of the voting block is the comptroller general of the United States and the director of the Congressional Budget Office, although they will "advise and assist at the request of the Commission." Within one year of this bill's enactment, it will be required to submit its list of policy options for addressing the long-term fiscal problems faced by the United States.

OMB Discusses Protection of Government Information and Audit Trails

The Office of Management and Budget (OMB), in conjunction with the Homeland Security Department, issued a paper focusing on the "Top 10 Risks Impeding the Adequate Protection of Government Information." The paper identifies common risks, or "mistakes," impeding agencies from adequately protecting government information. Each risk is associated with selected best practices.

OMB and DHS addressed the following 10 common mistakes:

1. Security and privacy training is inadequate and poorly aligned with the roles and responsibilities of employees.
2. Interagency contracts and those operating on behalf of agencies don't describe adequate procedures for processing and safeguarding information.
3. Information inventories inaccurately describe the types and uses of information and where it is stored, processed, or transmitted.
4. Information isn't appropriately scheduled, archived, or destroyed.
5. Suspicious incidents aren't reported in a timely manner.
6. Audit trails aren't appropriately created or reviewed.
7. Physical security controls where information is collected, created, processed, or maintained are inadequate.
8. Information security controls are inadequate.
9. Information accessed or processed remotely is inadequately protected.
10. Appropriate security and privacy standards and guidelines aren't incorporated into acquired IT security products.

Of note was number 6, "audit trails documenting how information is processed are not appropriately created or reviewed." OMB recommended the following best practices on this topic:

- Agencies move information into a managed data repository to develop and review audit trails, and verify whether the use of the information is consistent with any applicable

NARA-approved (National Archives and Records Administration) records retention and disposition schedules.
- Agencies log all computer-readable data extracts from databases holding sensitive information and verify each extract, including whether sensitive data has been erased within 90 days or its use is still required.
- Agencies use information provided by audit trails to identify anomalies in accessing information and determine whether information is no longer needed for the proper performance of agency function.

The full document can be found at http://csrc.nist.gov/pcig/document/Common-Risks-Impeding-Adequate-Protection-Govt-Info.pdf.

Treasury's New Strategic Plan to Focus on Government Finances

The Treasury Department recently released its Strategic Plan for 2007-2012. Of the four strategic goals mentioned in the plan, of note are "Effectively Manage U.S. Government Finances" and "Management and Organizational Excellence."

Under the "Finances" goal, Treasury outlined several factors that would help close the tax gap:

- Reform and simplify the tax law.
- Reduce opportunities for evasion, and improve efficiency.
- Make a multi-year commitment to research, which is essential to identifying sources of non-compliance.
- Continue improvements in information technology which provide better tools to improve compliance through early detection, better case selection, and better case management.
- Improve compliance activities that enable prevention, detection, and remedy non-compliance.
- Enhance taxpayer service to help avoid unintentional errors.
- Coordinate with partners and stakeholders to share information and compliance strategies.

Another strategy mentioned in this same section was Treasury's continued focus to determine the right mix of investment and debt instruments that will minimize risk and the cost of financing the government.

While exploring "Management and Operational Excellence," the plan outlined several new strategy directions, including implementing policies and programs where there will be necessary active, open, and productive dialogue with stakeholders whose cooperation and support is required to accomplish the department's goals on behalf of the American people.

The full plan can be found at www.treas.gov/offices/management/budget/strategic-plan/2007-2012/home.html.