



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

JUN 23 1980

B-199249

The Honorable Julian C. Dixon
Chairman, Subcommittee on the
District of Columbia
Committee on Appropriations
House of Representatives



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Dear Mr. Chairman:

Subject: Observations on Reported Deficit in
District of Columbia Government
Operations (GGD-80-85)

As you requested in your June 9, 1980, letter, we have made some inquiries into the reported and widely discussed \$284.4 million cumulative deficit in the District's general fund. The deficit, shown on the accrual basis of accounting, was included in Arthur Andersen & Co.'s audit report on the District of Columbia's financial statements as of September 30, 1979.

The deficit has been discussed at length by the Mayor and the City's financial advisor, Lazard Freres & Co. The latter's comments included criticisms of the Congress' stewardship and the District and the Federal budgeting process for the the District. As discussed later, because of certain accounting treatment, the deficit City officials face from a financial management point of view is significantly lower than the deficit reported in the statements. Mr. Philip M. Dearborn, Vice President of the Greater Washington Research Council questions whether the reported \$284.4 million reported deficit represents a real deficit, and expressed the view that the deficit is more of the magnitude of \$90 million. Also, Arthur Andersen reports that on a budget (cash) basis the fiscal year 1979 deficit is about \$41.7 million, with a \$79.7 million cumulative deficit since fiscal year 1970.

Both Arthur Andersen and Lazard Freres attribute the cause of the general fund deficit to a fiscal year 1970 change in the District's budgeting process from an obligation basis to a cash basis. They state that the practice of carrying current liabilities forward to subsequent years has contributed to an accumulated deficit on an accrual basis of \$284.4 million. Both agree that the District has not overobligated its appropriation in any of the years since fiscal year 1970.

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Arthur Andersen states that the District has financed the deficit through a series of short-term expedients which are generally no longer available. These expedients include accelerating revenues such as real estate taxes and gross earnings/gross receipts taxes and delaying certain expenditures such as paying vendor billings.

Financial statements prepared prior to fiscal year 1976 (the first year in which Arthur Andersen assisted the District in preparing the statements) were developed on a different basis than subsequent years and therefore could not be used for comparison purposes. The fiscal year 1976 financial statements show a deficit in the general fund and a cumulative deficit was reported at the end of each subsequent fiscal year with \$284.4 million reported at the end of fiscal year 1979. The details of the deficit are set forth below.

General Fund Deficit
As Of September 30, 1979

(millions)

Current Assets	<u>\$236.1</u>
Current Liabilities	
Bank overdraft financing	26.0
Due to Federal Government	
Current portion long-term	
loans/short-term advances	20.0
Interest	87.5
Accounts payable	110.3
Salaries payable	55.7
Annual leave due employees	39.6
Taxes collected, applicable	
to future months	67.7
Unexpended grant receipts	16.2
Other liabilities	<u>97.5</u>
Total liabilities	<u>\$520.5</u>
General Fund Deficit	(\$284.4) =====

The \$284.4 million deficit represents the results of operations reported in accordance with generally accepted accounting principles, but the District's financial condition is not as bleak as this amount would lead one to believe. For example, the following items contribute to the amount of the general fund deficit but do not represent a short term need for cash:

--\$39.6 million liability for leave due to employees

The accrual for annual leave may never materialize as an expense in this amount, and most of the liability is payable many years in the future. Arthur Andersen said that while they recognize that payment of this amount in the short term is highly unlikely, the accrual is required in order to show full costs of operations. The District of Columbia Auditor said that the inclusion of accrued leave as a current liability was misleading because it implies that the funds are immediately needed whereas the need to liquidate the liability may be many years in the future. Mr. Dearborn of the Greater Washington Research Council expressed the view that accrued leave should only be shown as a footnote to the financial statements since the full amount would be payable only if the District Government went out of business.

--\$67.7 million liability for taxes collected but applicable to future months

Taxes are due and payable when billed, and the classification of such taxes collected as a liability, although proper for statement purposes, causes the District's financial condition to appear worse than it is because the deficit will be reduced by the amount of the liability when the new fiscal year begins. Arthur Andersen representatives said that classifying the taxes as a liability was necessary to attribute revenues to the appropriate period. The District of Columbia Auditor expressed the view that by showing taxes collected as a liability a potential investor could be discouraged by the implication that the District had collected future taxes to pay current liabilities. Mr. Dearborn expressed the view that showing a liability for this item was not proper because the funds were not only budgeted and collected but also spent by the District during September 1979.

--\$87.5 million interest payable on long-term debt

The District pays the total annual interest, due to the Treasury on long-term debt, at the beginning of each fiscal year. The annual payment is made from appropriated funds for the year in which the interest payment is made. Because the District budget provided, and the District received, \$87.5 million in fiscal year 1980 to pay this interest, the liability that was accrued for statement purposes as of the end of fiscal year 1979 does not represent a need for cash as of that date. Arthur Andersen representatives said that the interest payment is the largest single District transaction during a year. They said inclusion of the item as a liability was proper because

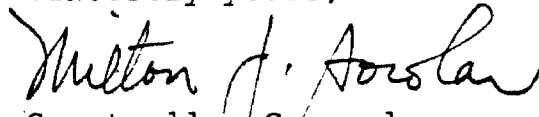
the liability had accumulated during the year. The District of Columbia Auditor also said that the interest payment is made at the beginning of the fiscal year and voiced concern that potential investors could be misled by the large interest payable liability shown on the financial statements. Mr. Dearborn said that since the interest cost was paid in fiscal year 1980 and was included in the fiscal year 1980 budget, it should be shown as a cost for 1980.

If the deficit is expected to show the District's need for funds in the short term, we believe the three items discussed above should not be considered as part of the deficit. This would reduce the deficit amount to about \$89.6 million. It is possible that some of the other items reported on the consolidated balance sheet contain amounts which affect the deficit in a manner similar to those discussed above. The analysis required to reach a firm conclusion on these other items, however, would be very time consuming because they represent the consolidation of numerous accounts involving various District agencies and operations.

As arranged with your office, we plan no further distribution of this report until June 25, 1980. At that time we will send copies to interested parties and make copies available to others upon request.

We would be pleased to discuss this matter further with you or your staff.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "Milton J. Aorolan". The signature is fluid and cursive, with a large initial "M".

Acting Comptroller General
of the United States