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DISTRICT OF COLUMBIA

Information on the District's Financial Crisis

Statement for the Record of Jeffrey C. Steinhoff
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Mr. Chairman and Members of the Subcommittee:

We are pleased to provide this statement for the record regarding the District of Columbia's financial situation as part of your consideration of H.R. 2017--the "District of Columbia Emergency Highway Relief Act." This proposed legislation would authorize an increased federal share of the costs of certain transportation projects in the District for fiscal years 1995 and 1996, with a requirement that the District repay the federal government for this increased share not later than July 31, 1997. You asked that we comment on the District's overall financial condition, which would impact on its need at this time for an increased federal share of the costs of transportation projects.

This statement for the record is based primarily on information included in our June 21, 1995, testimony[1] before the Subcommittee on the District of Columbia, House Committee on Appropriations, and represents our continuing assessment of the District's financial situation. In this continuing assessment, we have analyzed both summary and detailed data from the District's Financial Management System. We also met extensively with District officials in the Office of Financial Management and other officials in a variety of District agencies, including the Office of Personnel, the District of Columbia Public Schools, the Department of Human Services, the Department of Public Works, the Department of Corrections, Fire and Emergency Medical Services, and the Metropolitan Police Department. This assessment built on previous work, and we conducted new work from March through June 1995. We did this work in accordance with generally accepted government auditing standards. Our work, however, has not focused on the District's transportation projects or on the future prospect for repaying any increased federal share for transportation projects by the July 31, 1997, due date required by H.R. 2017. We did determine, though, that the District deposits its gasoline tax collections into its general fund and that the District projected its gasoline tax collections would be about $34.8 million this fiscal year.

THE DISTRICT OF COLUMBIA'S FINANCIAL CRISIS

As we have previously reported, the District of Columbia is insolvent--it does not have enough cash to pay all of its bills. It is spending at a rate in fiscal year 1995 that, based on its own estimates, will exceed its congressional appropriation limit by about $132 million. Millions of dollars in unpaid bills are piling up, threatening basic services provided through private contractors. Some contractors have provided services without contracts. Many District programs are under court order to address basic fundamental weaknesses. And, there is widespread belief that the District has too many employees and does not provide quality service.

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[1]District of Columbia: Improved Financial Information and Controls Are Essential to Address the Financial Crisis (GAO/T-AIMD-95-176, June 21, 1995).

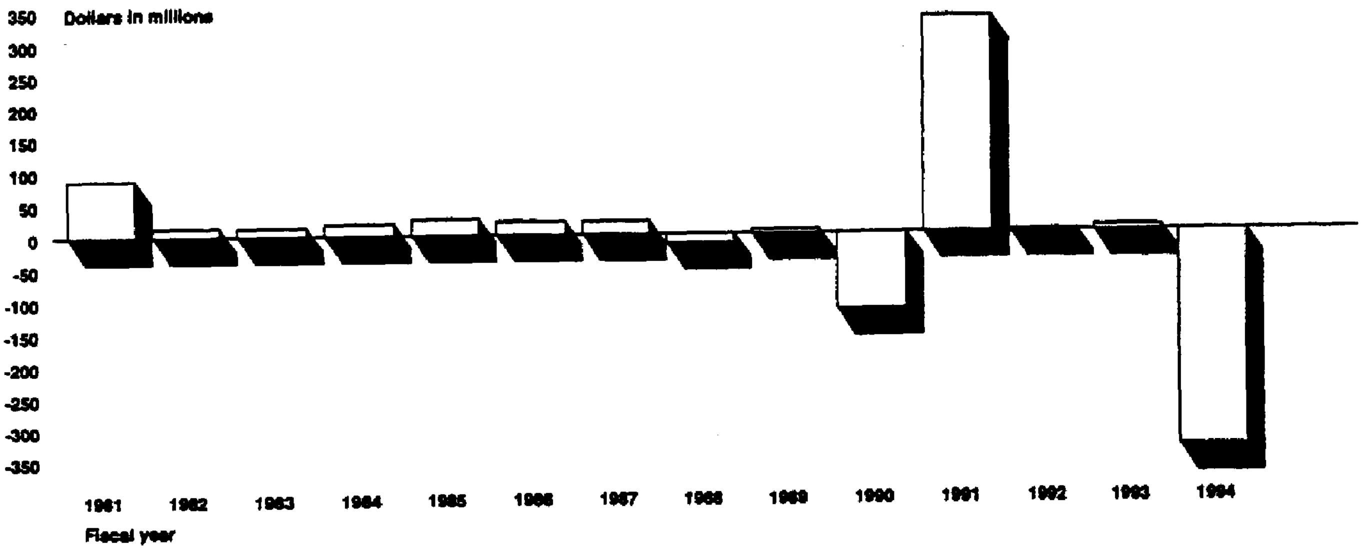
The District did not reach this crisis point overnight. Nearly 5 years ago, the Commission on Budget and Financial Priorities of the District of Columbia (commonly known as the Rivlin Commission) noted that the District "confronts an immediate fiscal crisis," and made a multitude of recommendations to the District to deal with that crisis.[2] By and large these recommendations were not followed. In most years since the Rivlin Commission report was issued, until fiscal year 1994, the District's general fund was "balanced"; however, the city's cash position was at the same time declining. This occurred despite receiving additional cash and revenues totaling nearly a billion dollars since 1991.

In June 1994, we issued a report that concluded that the District was faced with both unresolved long-term financial issues and continual short-term financial crises.[3] In that report, we discussed the District's cash and budget situation and explained how cash balances declined even though budgets were balanced. In fiscal year 1994, the District recorded a $335 million deficiency, the largest since Home Rule. Figure 1 shows the results of general fund operations since fiscal year 1981.

[2] Financing the Nation's Capital: The Report of the Commission on Budget and Financial Priorities of the District of Columbia, November 1990.

[3] Financial Status: District of Columbia Finances (GAO/AIMD/GGD-94-172BR, June 22, 1994).

Figure 1: District of Columbia General Fund Operating Results Since Fiscal Year 1981

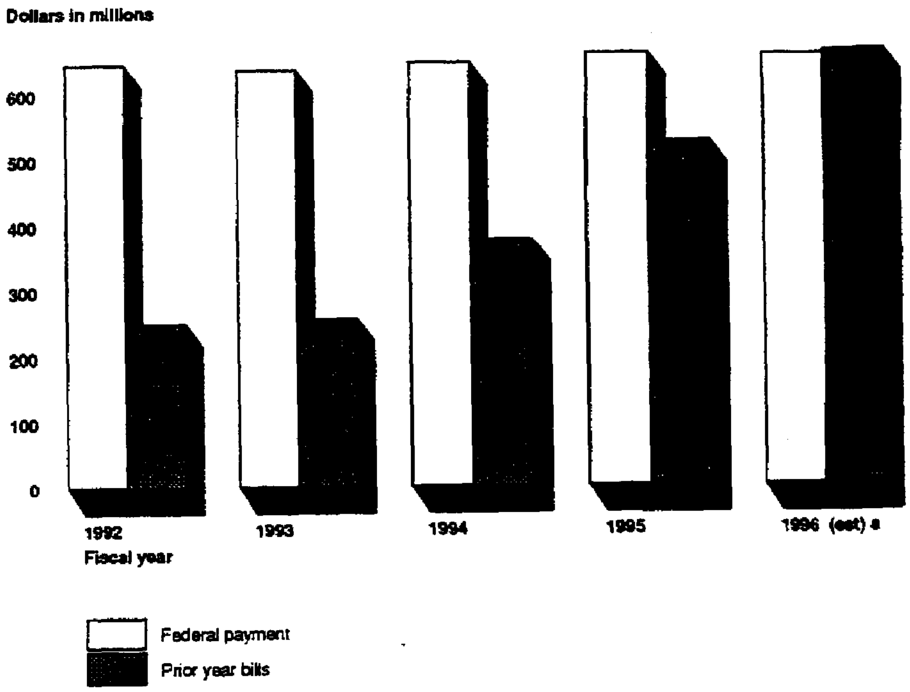


Source: District of Columbia Comprehensive Annual Financial Reports.

Although between fiscal years 1991 and 1993, the District's general fund showed small surpluses, the District's cash position steadily deteriorated. This decline in cash could have been much worse had the District made all required payments when due. Specifically, in fiscal year 1993, the District deferred nearly $100 million in payments to the pension fund and the Washington Metropolitan Transit Authority. Deferred payments also occurred in fiscal years 1991 and 1992. At the end of fiscal year 1994, deferred payments grew even more. If the District had made all payments when due, it would have run out of cash before the end of fiscal year 1994.

Another demonstration of the District's declining cash situation was that, at the end of each year, the District increasingly relied on the federal payment, which has recently been received in the first month of the fiscal year, to cover bills from the previous fiscal year. For example, in fiscal year 1991, soon after receiving the $331 million general obligation bond for the operating deficit, the previous year's bills were about 39 percent of the federal payment. At the end of fiscal year 1994, the fiscal year 1994 bills were 80 percent of the fiscal year 1995 federal payment. Current trends indicate that the situation will be worse at the end of this fiscal year. The increasing use of the federal payment for prior year bills is depicted in figure 2.

Figure 2: Portion of Federal Payment Used to Pay Prior Bills



Source: GAO analysis of District financial statements and budget.

THE DISTRICT HAS NOT REDUCED EXPENDITURES AS DIRECTED BY THE CONGRESS

Last fall, in response to the growing financial crisis, the Congress mandated $140 million in reductions to the District's planned expenditures for fiscal year 1995, thereby capping its appropriated expenditures at $3.254 billion. However, the District has not reduced spending to the congressionally approved level. As we testified on June 21, 1995, at that time, the District was projecting a negative year-end cash balance of $236 million and fiscal year 1995 spending of $3.386 billion, which is $132 million over the congressional cap. More than three-fourths of the way through fiscal year 1995, the District had not determined how to allocate the $140 million in mandated cuts to District agencies, and spending controls have largely been ineffective. District agencies were still operating on spending plans based on the original "pre-$140 million cut" budget.

To help with its projected cash shortfall, as permitted by the Financial Responsibility and Management Act of 1995, in June 1995, the District received a $146.7 million advance from Treasury, which is to be repaid by September 30, 1995, or offset against the District's federal payment for fiscal year 1996. Even with this advance, the District is projecting a year end cash shortfall unless there is additional borrowing.

MANY OF THE DISTRICT'S PLANNED EXPENDITURE CUTS HAVE NOT BEEN IMPLEMENTED

For fiscal year 1995, the District proposed a variety of cost cutting initiatives: (1) $224 million in management initiatives in the agencies, (2) $70 million in personnel savings from reductions in pay and furloughs, and (3) $70 million in interest savings resulting from refinancing the debt. Although the District has a system to periodically update the status of the initiatives, agency managers are not accountable for making sure the initiatives are effectively implemented and the savings are realized. We reviewed selected initiatives and noted that much of the savings will not be realized this year, if ever, and a significant number of initiatives have already been dropped.

First, the District has already reduced savings estimates from these initiatives by almost one-third, or $116 million. The $70 million savings from refinancing the debt was abandoned, and the projected personnel savings have been reduced by $6 million to $64 million. And finally, the District's projection of savings from agency management initiatives has been reduced by $39.6 million to $184.4 million. According to District officials, 121 of the initiatives have been completed, saving $89.6 million, and another 100 initiatives are still being implemented, with the estimated savings for these pegged at $94.8 million. However, as we testified on June 21, 1995, some of the completed and remaining initiatives may not result in the level of savings projected. For example:

-- About $5.6 million in initiatives related to the transfer of costs from one agency or program to another with no resulting District-wide savings, and another $533,000 in savings were based on eliminating positions that were already vacant.

-- The Department of Corrections plans included a $1.3 million savings that would be realized from closing a prison facility, halfway houses, and a drug counseling center. However, the prison facility cannot be closed because of a court order, and the Mayor's Office reversed its decision on closing the halfway houses and drug counseling center.

-- Contracting out food services in the Department of Corrections was expected to save $3.8 million in fiscal year 1994. As of May 1995, the action still had not been implemented and projected savings for fiscal year 1995 have been reduced to $315,000.

POOR FINANCIAL INFORMATION AND CONTROLS

The District's financial information and internal controls are poor. As a result, District managers do not have the fundamental information necessary to help control spending and costs and estimate budget and cash needs. As we testified on June 21, 1995, the District does not know the status of expenditures against budgeted amounts, does not know how many bills it owes, is allowing millions of dollars of obligations to occur without required written contracts, and does not know its cash status on a daily basis. Millions of dollars of bills are not entered into the Financial Management System until months and sometimes years after they are paid.

Numerous internal and external audits over a number of years have highlighted problems with various aspects of the District's financial and management controls procedures and practices. The Rivlin Commission Report recommended a comprehensive financial management improvement program, and both the current acting Chief Financial Officer (CFO) and previous CFO have recommended major improvements in the entire financial management system, including better procedures and improved training.

The District's Financial Management System consists of a 15-year old central system and at least 17 separate program systems. These separate program systems are not integrated with the central system. As a result, District Controller officials must input to the central system thousands of general journal entries that were originally entered into the individual systems. For example, at the Department of Human Services, benefit payments made under programs such as Medicaid, Aid to Families with Dependent Children, General Public Assistance, and Foster Care are computed by these program's own unique systems, which are not integrated with the city's Financial Management System. The benefit payment amounts for these programs and the associated obligations are then manually recorded in the Financial Management System by the D.C. Controller's Office after the payments are made. The result is delays in processing and a lack of timely, accurate information on both expenditures and cash. But while the entire financial management process is antiquated and cumbersome, the lack of effective practices and procedures by District financial officials makes any system even more ineffective.

There are numerous examples of inaccurate financial information:

-- The District's fiscal year 1995 second-quarter financial report did not include at least $80 million in Department of Human Services' expenditures that had been incurred.

-- District officials have said that the extent of unpaid bills is unknown, but it probably totals tens of millions of dollars. The District's fiscal year 1995 second-quarter financial report said that the District's accounts payable balance of $41.2 million reflects only unpaid invoices accepted into the District's Financial Management System as of March 31, 1995. Tens of millions of dollars in unknown payables also exist but are not in the Financial Management System.

-- Some expenditures at the Public Schools were not recorded and paid for months. For example, a 1993 invoice for $200,000 for food from the Defense Logistics Agency was not paid until at least May 1995.

-- Information provided by the Department of Human Services' Controller's Office shows that Medicaid payments from October 1994 through May 1995 totaled over $400 million. It was often anywhere from 2 to 12 weeks before these payments were recorded in the Financial Management System. For example, a November 1994 payment of over $6 million went unrecorded for over 12 weeks, and a March 1995 payment of almost $8 million went unrecorded for 11 weeks.

-- Aid to Families with Dependent Children payments amounting to $9.7 million and General Public Assistance payments amounting to $775,000 were made on or about January 1, 1995, but were not reflected in the Financial Management System until June 1, 1995--5 months later.

The above examples are not isolated ones. Delays in entering information in the Financial Management System are routine. Our analysis of all general journal entries for May 1995 showed that many payments were recorded months after the checks were written. In fact, over $120 million (44 percent) of the total payments recorded in the Financial Management System using general journal entries were not recorded until over 2 months after the payments occurred. Table 1 outlines the results of our review.

Table 1: Delays in Entering Payments into the Financial Management System

Delay in entering payments into FMS	Number of entries	Dollar amount of entries
0 days	87	$351,639
1-30 days	2,001	73,291,999
31-60 days	691	81,697,950
61-90 days	358	100,589,894
91-150 days	428	21,319,747
greater than 150 days	192	458,831
Total	3,757	$277,710,060

Source: GAO analysis of District of Columbia Financial Management System data.

OTHER CITIES HAD TO ADDRESS FINANCIAL MANAGEMENT WEAKNESSES

In the last 2 decades, other cities have faced financial, management, and structural problems similar to those currently facing the District of Columbia. In March 1995, we testified before the House Government Reform and Oversight Committee's Subcommittee on the District of Columbia on the work we had done on five other cities--Boston, Chicago, Cleveland, New York, and Philadelphia--which had faced financial difficulties.[4] We found that in addition to improving their financial stability, all five cities realized that if they were to avoid more financial difficulties, they also would have to improve the efficiency of city management and operations.

Some of the actions taken included: (1) hiring new financial managers and giving them authority and responsibility to strengthen the cities' accounting, budgeting, and cash management operations and (2) installing or upgrading financial management systems and improving their financial reporting. Among the points most emphasized by officials from these five cities were to establish credible information and know how to use it for making hard decisions to restore financial stability. And, once improved financial systems

[4]District of Columbia: Actions Taken in Five Cities to Improve Their Financial Health (GAO/T-GGD-95-110, March 2, 1995).

and practices are established, to use them not only to maintain credible information, but also to improve accountability and performance of government operations.

CONCLUSIONS

The District is insolvent and faces many challenges in its efforts to deal with its serious financial problems. The District does not have needed information to monitor its spending and cash, and is not holding agency managers accountable for spending in their agencies. Specifically, agency managers are not accountable to ensure that (1) spending is within prescribed budgets and allotments and (2) management initiatives are effectively implemented with commensurate savings. The problems with District financial management are long-standing, and improvements are essential to providing credible, accurate, and timely information. The new District of Columbia Financial Responsibility and Management Assistance Authority faces a difficult challenge to establish a financial baseline to monitor the District's financial condition and improve its financial management.

As part of the efforts to deal with the District's serious financial problems, improvements in the District's financial information and controls will need to be addressed. As part of our June 21, 1995, testimony, we made a variety of recommendations to the Mayor of the District of Columbia and to the District of Columbia Financial Responsibility and Management Assistance Authority directed at addressing problems with financial information, internal controls, and accountability.

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Mr. Chairman, that concludes my statement for the record.

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