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DISTRICT OF COLUMBIA

Deteriorating Financial Condition

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GAO/T-AIMD-95-89

Mr. Chairman and Members of the Subcommittee:

Today, we present our continued analysis of the District's financial situation. Earlier this week, I pointed out how the District's financial situation has continued to deteriorate to the point where the District is insolvent--it does not have enough cash to pay all its bills.

This morning, I want to expand on that testimony, particularly in four areas:

(1) the fiscal year 1994 comprehensive annual financial report and our initial analysis of the audit by Bert Smith and Company and Coopers & Lybrand,

(2) the District's information on unpaid bills,

(3) more details on the problems with the District's information on personnel and initial analysis of some of that data, and

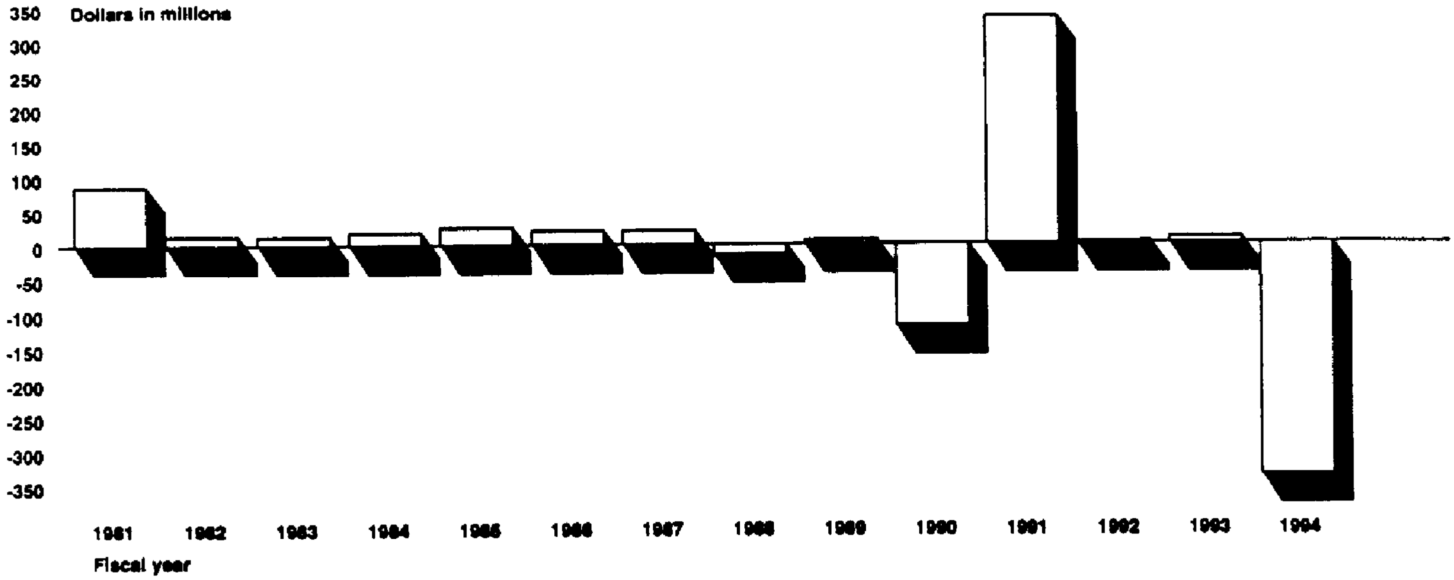
(4) the Mayor's February 1 fiscal year 1995 budget proposal and our preliminary analysis of the District's agency spending plans.

OPERATING RESULTS OF THE DISTRICT'S GENERAL FUND

The District of Columbia provides a variety of services and programs for its residents and visitors, including police and fire protection, local transportation, Medicaid, hospital care, sanitation, employment assistance, education, and housing. The District currently provides these services primarily utilizing a general fund that has a total budget of $4.4 billion. The Congress appropriates approximately $3.3 billion of this total. These appropriated revenues include a federal payment of about $650 million and $2.7 billion in locally generated income taxes, property taxes, sales taxes, and other local sources of revenue. In addition, the District receives approximately $1.1 billion in federal grants, as well as reimbursements for services that are not included in amounts annually appropriated.

Between 1981 and 1993, the District's general fund operated with revenues in excess of expenditures in 11 of the 13 years. Deficiencies of $14 million and $118 million were recorded in fiscal years 1988 and 1990, respectively. From 1991 through 1993, the District balanced its budgets. However, even though the budgets were balanced and despite receiving cash from a $331 million general obligation bond in 1991, the city's cash position declined substantially. During this period various factors helped the District balance its budget, including nearly $400 million in increased federal payments and $225 million in additional budgetary authority from measures such as changing the legal definition of the property tax year. After 3 years of positive general fund balances, the District recorded a $335 million dollar deficiency in fiscal year 1994. Figure 1 shows the excess or deficiency in the general fund since 1981.

Figure 1: General Fund Operating Results.



Source: Comprehensive Annual Financial Report (CAFR).

GENERAL FUND RECORDED LARGE DEFICIENCY IN FISCAL YEAR 1994

After 3 years of reported positive general fund balances, the District recorded a $335 million deficiency in fiscal year 1994. Of this total deficiency, $116.8 million was in appropriated funds. Deficiencies were recorded in most appropriated expenditure functions and subfunctions, including:

-- Health and Welfare (primarily Medicaid), $71 million;

-- Schools, $14 million;

-- Fire, $13 million;

-- Police, $12 million; and

-- Public Works, $21 million.

The remaining $218.6 million deficiency was in the nonappropriated funds and consisted of adjustments proposed and recorded as a result of the annual comprehensive financial audit performed by an independent public accountant and related primarily to Medicaid and D.C. General Hospital. Table 1 shows these adjustments.

Table 1: Fiscal Year 1994 Nonappropriated Fund Adjustments
(millions of dollars)

ADJUSTMENT	AMOUNT
Medicaid accrual increase	$103.5
Accounts receivable allowance increase for D.C. General Hospital	85.0
Grant disallowance	37.8
Other	(7.7)
Total	$218.6

Source: Fiscal Year 1994 Comprehensive Annual Financial Report.

In addition, accounting standards for state and local governments as established by the Governmental Accounting Standards Board may not provide for accruals of all costs associated with certain long-term liabilities.

Let me briefly explain the two largest adjustments: Medicaid and D.C. General Hospital.

Medicaid Accrual Increase.

In fiscal year 1994, Medicaid cost adjustments totalled $103.5 million. Although normal Medicaid cost adjustments that occur after the fiscal year has ended are not new, the amounts of the cost adjustments have grown in recent years. For example, in fiscal year 1993, the Medicaid cost adjustments were only $2.9 million. Table 2 outlines the $103.5 million in fiscal year 1994 adjustments.

Table 2: Costs included in Medicaid Fiscal Year 1994 Adjustment
(millions of dollars)

Medicaid Adjustments	Reported Adjustments	Amount the District owes to itself	Net amount of adjustments
Normal Medicaid cost adjustments	$ 57	$24	$33
New component of cost estimates	9	1	8
Costs representing changes from prior year estimates	37	29	8
Total Medicaid accrual increase	$103	$54	$49

Source: Coopers & Lybrand and Bert Smith and Company fiscal Year 1994 Financial Statement Audit workpapers.

Normal cost adjustments represent the differences between payments made to Medicaid providers during the year and the results of annual cost reports submitted by each hospital. In the past, the amounts the District owed to providers approximated the amounts other hospitals owed the District and only minimal adjustments were required; however, the District's fiscal year 1994 reimbursements were substantially less than the estimated payments, requiring $57 million of the adjustment. New components of the cost estimates are increases in specific payments based on first time federal audits of disproportionate share payments. In addition, the cost changes relate to changes in the state plan and Medicaid rules changes for prior years that are the components of Medicaid costs that were not available in prior years.

The Medicaid accruals also include $54 million the District pays itself. For example, a significant portion of this adjustment involves money the District owes St. Elizabeth's Hospital, a district-owned facility. While these amounts may be reflected elsewhere in the financial statements, they must be excluded from the adjustment to determine the net effect of Medicaid adjustments on the District.

D.C. General Hospital "Loans"

Since fiscal year 1990, the District has transferred $85 million of cash from the general fund directly to D.C. General Hospital to cover cash losses at the hospital. These transfers are recorded as a general fund receivable and a hospital fund payable and are in addition to annual subsidies from the District's general fund, which were $59 million in fiscal year 1993 and $47 million in fiscal year 1994. . Table 3 shows the annual "loans" to the hospital.

Table 3 "loans" to D.C. General Hospital
(dollars in millions)

Fiscal year	Annual "loan"	Total cumulative "loans"
1990	$10	$10
1991	18	28
1992	13	41
1993	17	58
1994	27	85

Source: District of Columbia Comprehensive Annual Financial Reports.

These transfers or "loans" are <u>not</u> included in the budget and therefore were <u>not</u> subject to Congressional review and approval. In our report last June, we disagreed with the District's accounting and budgeting treatment for the hospital's ever-growing loans for the operating losses. We concluded the hospital's losses should have been covered by requesting additional funds through the budget process rather than through a series of annual loans.

Coopers & Lybrand noted in both its Reports to Management for fiscal years 1992 and 1993 that operating losses had further increased the accumulated cash deficit of the hospital to $41 million and $58 million, respectively. The report covering fiscal year 1993 stated that:

> "Current levels of district appropriations and cash provided from operations are not expected to be sufficient to allow the hospital to repay these advances, however the Mayor is now required by law to develop a three-year plan to restore the financial solvency of the hospital and to provide for the orderly elimination by October 1, 1998 of the accumulated deficit as of September 30, 1993."

Coopers & Lybrand independent auditors report that same year included an unqualified opinion--the best possible outcome of an independent audit. The report included a paragraph highlighting that the financial statements included $58 million due to the District as a result of accumulated Hospital cash deficits that were funded by advances from the District. The report stated that "Unless the current level of District appropriations increase and/or there is a significant improvement in net cash provided from hospital operating results, the hospital will be unable to repay these advances." A recent draft of the fiscal year 1994 auditors report on the hospital updated the amounts to $85 million and used the same language.

For fiscal year 1993, the auditors noted that the District intended to develop a repayment plan for the $58 million for the payables owed by the hospital to the District and concluded that no adjustments were necessary, because the $58 million could be collected from the hospital. However, in fiscal year 1994, the auditors proposed, and the District agreed, to adjust the accounts receivable allowance to recognize that transfers of cash from the general fund to the hospital may be uncollectible since the hospital continues to operate at a loss. However, even after this adjustment, the District still shows the accounts receivable and the hospital still shows an accounts payable, and there has been no acknowledgement that these transactions amount to subsidies to the hospital totaling $85 million.

The Independent Auditors' Report for the Comprehensive Annual Financial Report.

The District's financial statements for the last 3 fiscal years have been audited by Coopers & Lybrand and Bert Smith and Company. Each of these years, Coopers & Lybrand and Bert Smith and Company have opined that "the general purpose financial statements... present fairly, in all material respects, the financial position of the District of Columbia ..., and the results of its operations and cash flows of its enterprise and component units for the year then ended in conformity with generally accepted accounting principles." However, in the fiscal year 1994 report, unlike the hospital's report discussed above, there was no discussion or disclosure of the District's fiscal crisis even though the District experienced a $335 million deficit in fiscal year 1994. While the deficit is relatively obvious in the financial statements, the implications of such a large deficiency are not as clear. Although a sophisticated user might be able to discern the probability of financial difficulties, most users would not have been able to identify either the severity or the extent of the financial crisis that faced the District.

The District's comprehensive annual financial reports in recent years have indicated that an unfavorable variance in the budgetary statement is a violation of the Anti-Deficiency Act. The act prohibits an officer or employee from making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation in excess the amount therein. When we asked the auditors about this interpretation, they stated that for fiscal year 1994 the District had potential violations of the act. However, to determine from the published report and financial statements that the Anti-Deficiency Act may have been violated requires the reader to make some judgements about the characteristics of the deficiency.

If we had performed the financial audit of the District in fiscal year 1994, at a minimum, our opinion letter would have highlighted (1) the deficit and a perspective on the severity of the District's budget crisis, (2) the deficit's impact on cash, (3) the District's plans to address this crisis, and (4) the serious nature of the potential violations of the Anti-Deficiency Act.

In addition, although we reported out in a November 1994 report that the District's past financial statements presented information on the "Computation of the Legal Debt Limitation" that was not consistent with the Home Rule Act, the fiscal year 1994 financial statements again showed a debt service limitation not in accordance with the Home Rule Act.[1] Specifically, the financial statements showed the legal debt service percentage to be 9.8 percent. Using the Home Rule Act methodology, this should have been 11.1 percent. As we pointed out in our November report, the financial statements inaccurate representation of the debt service percentage could mislead users of such information.

We are continuing our evaluation of the results of this audit at the request of the former Chairman of the House Appropriations Subcommittee on the District of Columbia. We are especially interested in the adjustments disclosed by the District and the decisions related to recording expenditures in either fiscal year 1994 or 1995. Because of the fiscal year 1995 spending caps and penalties contained in the 1995 Appropriation Act, decisions regarding these adjustments are critical. For example, recording an expenditure in fiscal year 1994 rather than 1995 would reduce fiscal year 1995 expenditures by a corresponding amount and, therefore, help the District address the fiscal year 1995 spending cap.

THE DISTRICT DOES NOT KNOW THE TOTAL AMOUNT OF BILLS OWED

The District does not have reliable information on the total amount of bills owed. This can be illustrated by the problems in identifying all liabilities at the end of fiscal year 1994. In addition, to recording the largest deficiency in the general fund since Home Rule, the District faced a cash crisis at the end of the fiscal year. In order to pay the $200 million in short-term notes and other critical bills by the end of the fiscal year, the District carried over into fiscal year 1995 hundreds of millions of dollars in bills that were owed but not paid. These included a $263 million pension payment, a $63 million interest payment, and $241 million in accounts payable. Because of the poor state of District financial records, not all accounts payable may have been recorded. For example, as a part of the annual financial audit, more than $20 million in unrecorded liabilities (bills held, but not paid) were "discovered" at the Department of Human Services. But the financial audit did not include a search for unrecorded liabilities in most District agencies.

The District does not know how many bills it has that are unpaid. Bills are first received by agency program managers and could be held for an inordinate length of time before being forwarded to the agency's controller. Then, the bills are recorded in the Financial Management System (FMS) and eventually paid. The only time during the year the District attempts to identify all its bills is at the end of the fiscal year. As we pointed out earlier, even at this time not all unpaid bills are discovered. The Mayor announced yesterday (February 23) that the District's cash balance was $120 million and unpaid bills totalled $40 million. This $40 million only includes the bills entered into FMS system. The District's Chief Financial Officer has stated that the total amount of unpaid bills does not include bills held by District agencies, but not yet recorded in the FMS.

[1] District of Columbia: Information on the District's Debt (GAO/AIMD-95-19, November 22, 1994).

DISTRICT DATA ON PERSONNEL ARE CONFUSING

Information on the exact number of District personnel is difficult to verify. Different sources of funding compounded by the lack of integration among the payroll, personnel, and budgeting systems makes it very difficult to establish the exact number of personnel on board. Although most of the payroll function is centralized in the District's Controller Office, personnel records are less centralized. For example, the payroll for D.C. public schools is implemented by the District controller, but the School's personnel records are maintained in the Schools own personnel office not the District's Office of Personnel. In addition, inconsistencies between personnel and payroll records were identified by Coopers & Lybrand as a part of its internal controls testing for the fiscal year 1993 financial statements.

District personnel positions are financed by both appropriated and non-appropriated funds. The District reports personnel data in a variety of ways including FTEs, the number of personnel receiving paychecks, and full-time on-board staff. An FTE is used to measure the number of equivalent positions and takes into account how many hours are actually being worked. For example, two employees working half-time would be counted as one FTE.[2]

Although the calculation of FTEs is prescribed, some District agencies are creating more FTEs than allowed in their budgets. The District's public schools, for example, allow managers to create as many FTEs as they like as long as they do not exceed their dollar personnel budget. This procedure has added nearly 200 FTEs to the D.C. Public Schools and as a result the schools FTE ceiling was exceeded by 83 positions as of January 31, 1995.

Reducing the number of District personnel has been a stated management initiative for several years. Based on information from the District, between the first quarter of fiscal year 1993 and the first quarter of fiscal year 1995, the number of actual FTEs decreased from 46,422 to 44,438. During this period appropriated positions decreased from 36,475 to 34,394 and non-appropriated positions increased from 9,947 to 10,044. More data on actual FTEs since the first quarter of fiscal year 1993 are shown in table I.1 in attachment I.

The District of Columbia Fiscal Year 1995 Appropriation Act required that the total number of FTE positions financed from appropriated funds not exceed 33,588, which is 2,000 FTEs below the 35,588 contained in the original fiscal year 1995 budget. On February 17, 1995, the District announced that it had reduced the number of FTEs by 3,058 to 32,530. This total is below the 33,588 ceiling, but the number of reductions needs further explanation. Although, the District said it cut more than 3,000 positions, some of these positions were not filled as of the end of fiscal year 1994. Specifically, as of September 1994 there were 33,675 actual FTEs on board.

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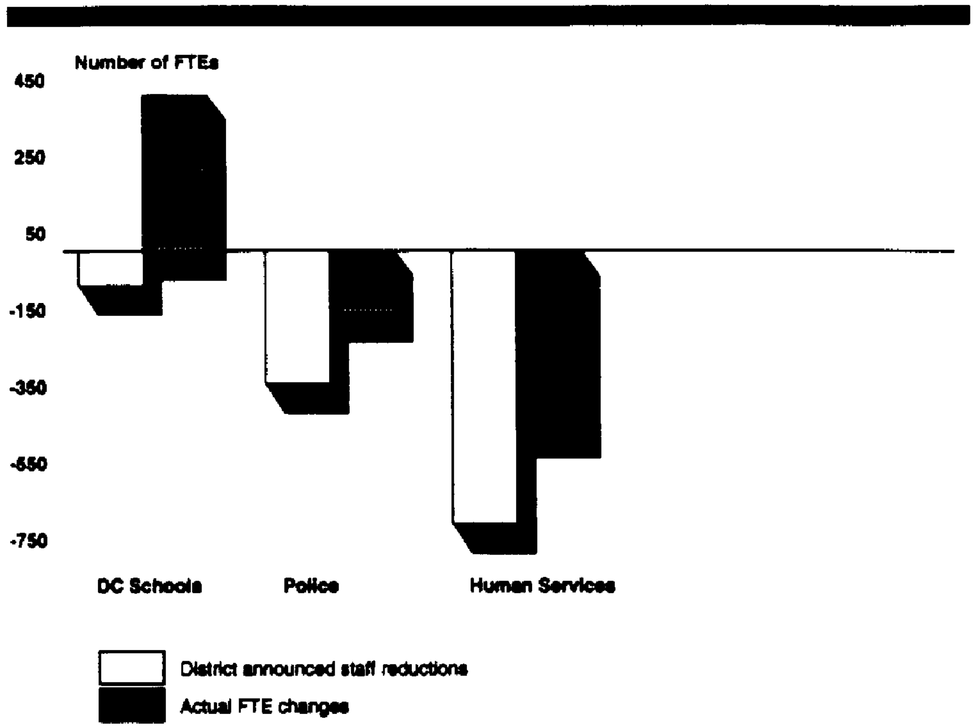
[2]OMB Circular A-11 defines FTE employment as the total number of regular hours, not including overtime and holiday hours) worked by employees divided by the number of compensable hours applicable to each fiscal year (260 days or 2,080 hours in fiscal year 1995).

Therefore, the actual reduction since the beginning of the fiscal year in actual FTEs is 1,145. In fact, because the District had 33,675 actual FTEs on-board as of September 1994, the District only needed to cut 87 positions to meet the congressionally mandated FTE limit.

In making the announcement on February 17, the District outlined the specific reductions by agency that had occurred because of incentive retirement programs and attrition. However, the number of reductions reported are significantly higher than the actual decline in FTEs. Figure 2 depicts several specific examples of these seeming inconsistencies.

Figure 2: Reported and Actual FTE Reductions as of January 31, 1995



Source: District of Columbia personnel data.

More FTE data for selected agencies are shown in table I.2 of attachment I. We are continuing to develop information on District personnel.

DC HAS NOT ADDRESSED THE SPENDING PROBLEM

As we pointed out on Wednesday, even though mandated by the Congress to cut its spending by $140 million from its fiscal year 1995 budget submitted to the Congress, the District has not reduced spending. The Congress required that total appropriated expenditures not exceed $3.25 billion in fiscal year 1995, but according to the District's own estimates, District appropriated expenditures this year could be nearly $3.9 billion. Various actions have been taken by the previous and current Mayor and the District Council to address overspending, but very little actual spending reduction has occurred. Even though the sixth month of the fiscal year begins next week, District agencies are still operating on spending plans based on the original submitted budget--before the congressionally mandated $140 million in cuts.

Of the total $631 million in overspending, District officials said they would address $224 million, but planned to ask the federal government to cover the remaining $407 million. The District's plan to reduce agency expenditures by $224 million is included in new agency spending plans. The plans have not yet been approved.

Although the District has said that $224 million in cuts are outlined in these plans, the plans contain specific initiatives that total only $190 million. The remaining $34 million in cuts are not specifically outlined in the plans. Other initiatives that are specific would generate little cash savings or simply transfer costs to other funds. For example: 25 agencies planned to generate savings by eliminating 221 vacant positions; 4 agencies were generating "savings" by transferring positions from appropriated to non-appropriated funds, and 2 agencies were transferring costs to other funds or agencies within the District.

These specific examples illustrate these types of initiatives:

-- the Department of Employment Services planned to transfer $490,000 in costs to the Department of Human Services,

-- the Department of Consumer and Regulatory Affairs planned to eliminate 7 vacant positions, and

-- the Office of Personnel planned to transfer 16 FTEs to non-appropriated positions and eliminate 8 vacant positions.

In other instances, the plans had been superseded by other events, as shown in the following examples.

-- The Department of Corrections plans included 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. These changes will result in the spending plans falling short of spending cut targets by several million dollars. In addition, the Corrections plan included the reduction-in-force (RIF) of 241 employees. Prison officials said there are currently 500 vacancies in correctional officers, 300 of which are court-ordered positions. Currently, staffing levels are maintained through the extensive use of overtime. They noted that a RIF of corrections officials would add to this overtime spending.

-- The Medicaid program initiatives were designed to save $30 million. But the Mayor told us that this $30 million would not be saved and instead is including this amount in the $267 million he is requesting from the federal government.

And finally, the D.C. public schools officials said that the $45 million amount used to indicate school overspending was overstated and that only $32 million in cuts were needed to meet their budget target. In total about $66 million of the $224 million in spending plan reductions are either not specified or would not generate actual savings.

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In summary, Mr. Chairman, as I stated on Wednesday, the District is not taking the kind of actions that are needed to reduce spending to a level that will begin to address the huge deficit. That concludes my statement and my colleagues and I will be glad to answer any questions you may have.

Table I.1: Average Number of District FTEs since Fiscal Year 1993

		Appropriated	Non-Appropriated	Total[a]
Fiscal Year 1993	1st quarter	36,475	9,947	46,422
	2nd quarter	36,686	10,042	46,728
	3rd quarter	36,160	10,149	46,309
	4th quarter[b]	30,475	9,497	39,972
Fiscal Year 1994	1st quarter	35,582	10,030	45,612
	2nd quarter	35,479	9,940	45,419
	3rd quarter	35,244	10,194	45,438
	4th quarter[b]	30,018	9,960	39,978
Fiscal Year 1995	1st quarter	34,394	10,044	44,438

[a]The data are based on the number of full-time equivalent personnel actually getting paid. If an individual is on leave without pay, for example, this individual would not be counted as an FTE. In addition, the District does not use overtime in its FTE calculations. The appropriated fund data include approximately 1,050 positions of the Water and Sewer Fund , the Lottery Board, the Retirement Board, and Office of Cable Television. The District's Office of the Budget includes these positions under appropriated funds, although it is not clear whether they should be counted towards the FTE ceiling of 33,588 mandated by the Congress. We are continuing to evaluate this and other questions regarding District personnel data.

[b]The fourth quarter average for each year is low because teachers and other educational personnel who elect to be paid over 10 months rather than 12 are not counted in the July and August FTEs. This amounts to about 6,000 personnel.

Source: GAO summary of the District's Office of the Budget FTE data.

Table I.2: Data on FTEs for Selected District Agencies:

Agency	Fiscal year 1995 budgeted FTEs[a]	FTEs as of Sept. 1994	FTEs as of end of Jan. 1995	FTE cuts (-), adds (+) from budget	District announced staff reductions[b]	Actual FTE cuts (-), adds(+)
DC Schools	10,980	10,659	11,063	+83	-90[c]	+404
Police	5,429	4,982	4,820	-609	-347	-162
Human Service	4,628	4,742	4,278	-350	-713	-464
Corrections	3,909	3,849	3,785	-124	-53	-64
Fire	1,821	1,583	1,523	-298	-85	-60
Public Works	1,366	1,251	1,051	-315	-188	-200
Superior Court	1,277	1,231	1,200	-77	-24	-31
UDC	1,130	919	760	-370	-13	-159
Consumer & Reg. Affairs	540	527	482	-58	-56	-45
Finance and Revenue	507	517	472	-35	-43	-45
Others	4,001	3,415	3,096	-905	-327	-319
Totals	35,588	33,675	32,530	-3,058	-1,939[d]	-1,145

[a]FTE data are for appropriated positions only. Budget data were reported in the fiscal year 1995 budget. FTEs as of 9/94 include the staff on the payroll as of the last pay period in fiscal year 1994. FTEs as of 1/95 include the staff on the payroll as of 1/15/95, 1/21/95, and 2/5/95. (District staff are paid on different days based on pay group.)

[b]Appropriated staff reductions announced by the District on February 17, 1995.

[c]Data for the Public Schools and Superior Court were listed as total reductions and not separated into appropriated and non-appropriated.

[d]Total does not agree to the announcement by District officials that 1,850 position reductions. We are continuing to explore this discrepancy.

Source: District of Columbia and GAO summary of the District's Office of the Budget FTE data.

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