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DISTRICT GOVERNMENT

Information on Its Fiscal Condition and the Authority's First Year of Operations

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the results of our review of the District of Columbia's financial condition and the District of Columbia Financial Responsibility and Management Assistance Authority's (Authority) efforts to resolve the financial and management problems facing the District of Columbia. As you know, our review was performed in response to your April 25, 1996, letter asking a number of questions related to the District's financial condition and the operations of the Authority during its first year. Also, as you requested, we have looked at actions taken by the control boards of New York City and Philadelphia—two cities that successfully overcame financial crises. We have organized your questions into four general topics that I will discuss today.

First, I will discuss financial and budget trends in the District's revenue flows and expense patterns, comparing and contrasting the District's historical experience through fiscal year 1995 with its enacted and proposed budgets for fiscal years 1996 and 1997, respectively. To identify the pertinent trends and patterns in the District's revenues and expenses, we performed some analysis for fiscal years 1980 through 1992 of the District's Comprehensive Annual Financial Reports (CAFR) and performed extensive comparative analysis for fiscal years 1993 through 1995. In addition, we performed analysis of the District's enacted fiscal year 1996 budget and proposed fiscal year 1997 budget and financial plan as approved by the Authority.

Where unusual trends were identified, such as when amounts changed in a way different than expected based on our knowledge of the District's operations, we met with District officials to determine the reasons for these differences. Where we deemed it necessary, we reviewed the detailed underlying supporting information and documentation to verify that the explanation provided was supported. We also reviewed reported fiscal year 1996 expenses incurred through March 31, 1996, to ensure that the trends identified in our analysis through the fiscal year ended 1995 were still appropriate. Finally, we reviewed congressional, GAO, Authority, Office of the Mayor, City Council, and consultants reports and testimonies to more fully understand the nature and history of the District's various sources of revenues and expenses.

Second, I will discuss the District's current cash position. We focused specifically on the District's cash position at the end of fiscal year 1995, as adjusted through March 31, 1996. To determine that the District's cash position as of the date of this testimony had not substantively changed from what we found in our review, we discussed the results of our analysis with the District's Chief Financial Officer. In addition, we reviewed what actions New York City (starting in June 1975) and Philadelphia (starting in June 1991) and their respective control boards took to respond to their respective cash shortages. We performed an analysis of both cities' cash and overall financial condition for the periods noted, which were the first year the respective control boards were in place, and we interviewed several key members of each city's control board and current and former government officials to understand how and why they took the actions they did. Also, we discussed with the Authority the actions it has taken and plans to take to respond to the District's current cash position and reviewed these planned actions.

Third, I will discuss the experiences of the New York City and Philadelphia control boards and the Authority. We performed extensive reviews of all the published information we could find that described the nature of each city's financial and management problems and the related actions taken by each city's control board to remedy the problems. We summarized both the problems and the actions taken by the cities and their control boards based on the purposes/objectives as set out in the enabling legislation of each city's control board. We placed particular emphasis on efforts made in each control board's first year, since the Authority has only been in place for a little over a year. (Authority officials stated that they commenced official operations on June 1, 1995.) Where practicable, we interviewed control board members and city and state officials, past and present, to further enhance our understanding of the environment in which the control boards operated and to obtain their thoughts on the prioritization and focus of their efforts in the first year and to date.

Finally, we will provide some background information and very preliminary thoughts on the District's financial management system. The feasibility study called for in the District's fiscal year 1996 appropriation act, approved on April 26, 1996, has not yet been done; thus, we were unable to evaluate it. Further, because of time constraints, we were unable to provide an in-depth analysis of the strengths and weaknesses of the current financial management system in time for this hearing.

Financial and Budget Trends and Analysis

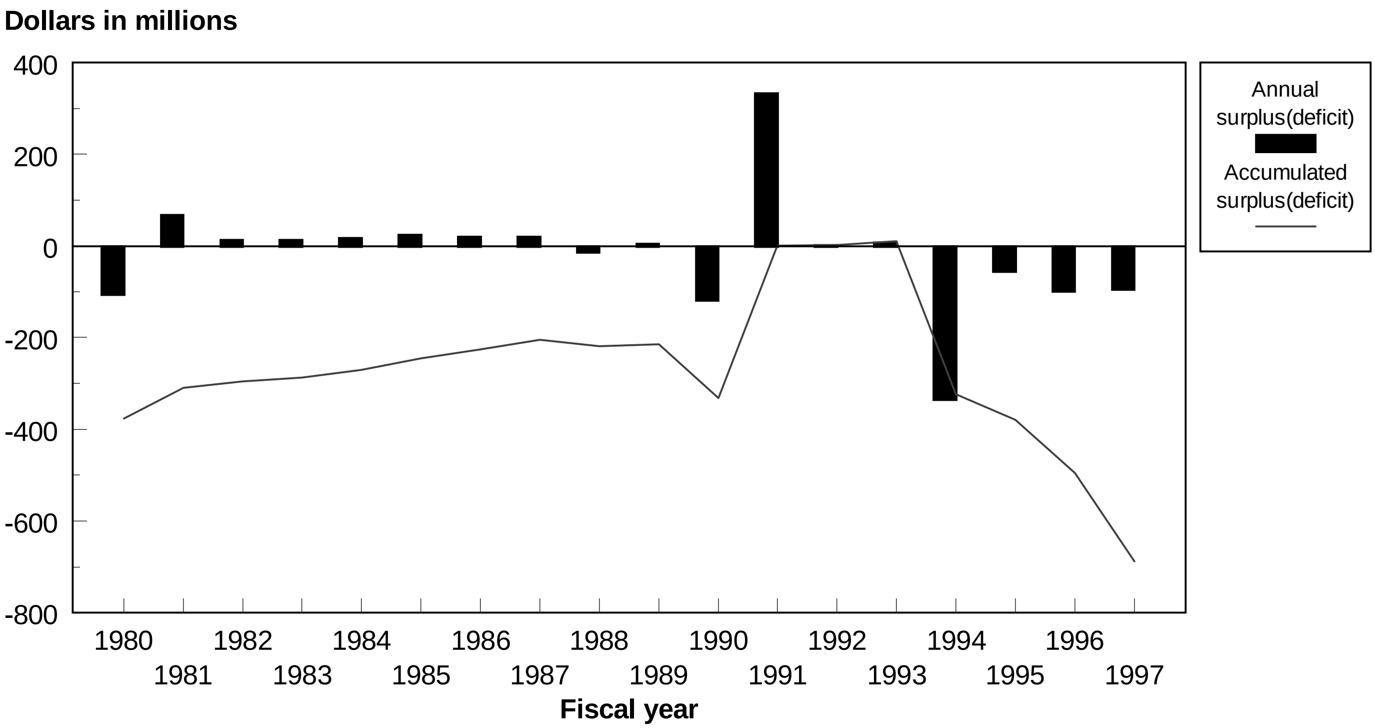
The District of Columbia Self-Government and Governmental Reorganization Act (Home Rule Act), Public Law 93-198, approved on

December 23, 1973, initiated the process by which limited autonomy was conferred on District residents, with the approval of the Home Rule charter by referendum election on May 7, 1974. In addition to the limited autonomy conferred on the District to govern local affairs, certain financial responsibilities were transferred from the federal government to the District. The most significant of these were an unaudited accumulated deficit and an unfunded pension liability relating to previously established pension plans.

Fiscal year 1979 was the first fiscal year, post-home rule, that an audited balance sheet was prepared on the District. During this audit, it was determined that the accumulated deficit was $274 million; however, in a period subsequent to fiscal year 1980, this amount was changed to $284 million—an additional deficit of $10 million. Fiscal year 1980 was the first fiscal year that a full financial statement audit was performed on the District. For fiscal year 1980, the District reported a deficit of $104 million that increased the accumulated deficit to $378 million. From fiscal years 1981 through 1990, the District incurred surpluses and deficits that resulted in an audited net surplus of $46 million and an accumulated deficit of $332 million at the end of fiscal year 1990. This deficit was fully funded in fiscal year 1991 with deficit reduction bonds, and the District had a small surplus for fiscal year 1992.

It was not until fiscal year 1993 that the District began to experience consistent annual deficits. While fiscal year 1993 had a reported surplus of $8 million, it included 15 months of property tax revenues due to a change in tax year that resulted in an additional $173 million in property tax revenue reported for that period. Thus, fiscal year 1993, adjusted downward for the extra 3 months of revenues, would have reported a deficit of $165 million. Therefore, our analysis focused on fiscal years 1993 through 1995—the period when the District's current financial difficulties began to emerge. In addition, we have included the congressionally enacted fiscal year 1996 budget and the fiscal year 1997 proposed budget that was approved by the Authority in our analysis. Figure 1 shows the reported actual budget surpluses/deficits for fiscal years 1980 through those projected for fiscal year 1997.

Figure 1: The District's General Fund Annual and Accumulated Surplus/(Deficit) **for Fiscal Years 1980 Through 1997**



Note 1: 1980 was the first year that a full set of audited financial statements was prepared.

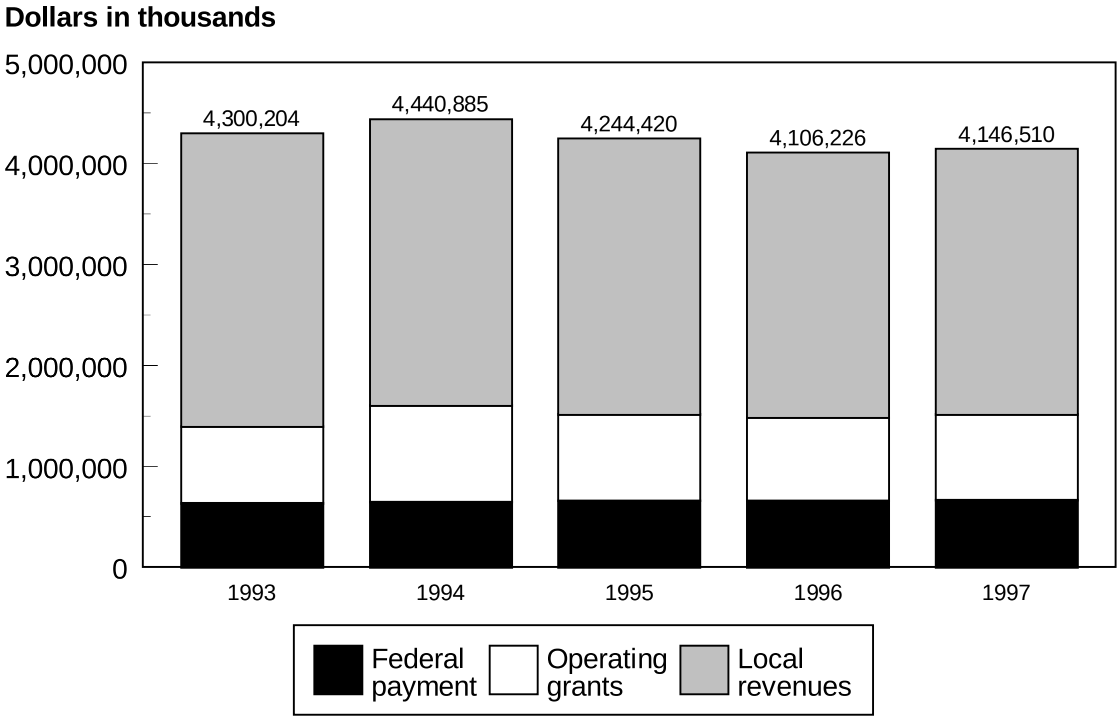
Note 2: Amounts for 1996 and 1997 are projected.

Source: Prior CAFRs and Fiscal Year 1997 Budget and Financial Plan.

General Fund Revenues

The District's revenue structure is made up of three types of revenue streams—locally generated revenues, operating grants, and the federal payment—as shown in figures 2 and 3.

Figure 2: The District's General Fund Revenues in Nominal Dollars for Fiscal Years 1993-1997



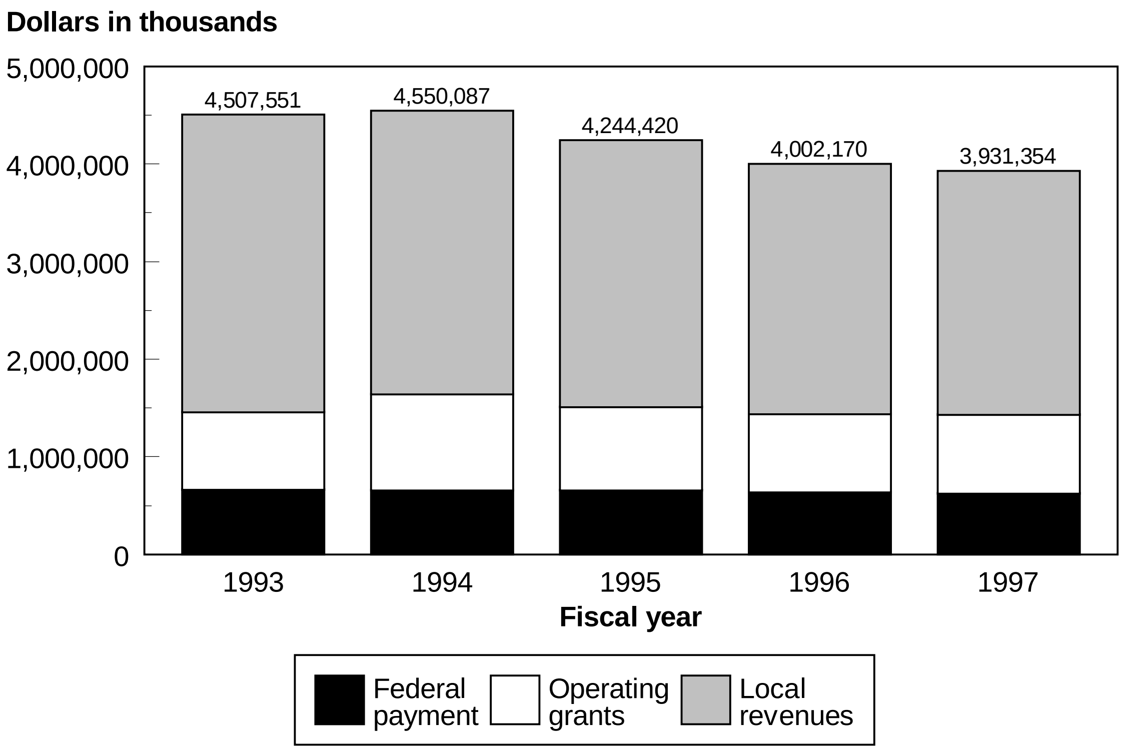
Note 1: Amounts for fiscal years 1996-1997 are projected.

Note 2: Local revenues do not include transfers from Lottery & Games.

Note 3: Nominal refers to revenues valued in actual dollars.

Source: Fiscal years 1993-1995 CAFRs and Fiscal Year 1997 Budget and Financial Plan.

Figure 3: The District's General Fund Revenues in Inflation-Adjusted Dollars for Fiscal Years 1993-1997



Note 1: Amounts are shown in fiscal year 1995 dollars. Amounts for 1996-1997 are projected.

Note 2: Indices used are from the Department of Commerce and the Bureau of Economic Analysis.

Local revenues consist primarily of levies that the District imposes, such as real property, income and business, and sales and use taxes. Operating grants consist mainly of reimbursements and grants from the federal government for the costs of social service programs, such as the federal share of Medicaid. Generally, the federal payment may be viewed as compensating the District for any unreimbursed services that the District may provide the federal government as well as revenue losses that may be attributable to (1) the large percentage of federally owned tax exempt property in the District, (2) the federally imposed limitations on the height of buildings in the District, and (3) the federally imposed limitation on the District's authority to tax the income of nonresidents.

Local Revenues

In fiscal years 1993 through 1995, local revenues declined by $175 million—from about $2.9 billion in fiscal year 1993 to about $2.7 billion in fiscal year 1995. In inflation-adjusted 1995 dollars, the decline and, thus, the loss of purchasing power, was even greater. In inflation-adjusted 1995 dollars, the District's local revenues decreased about $315 million during this period, primarily due to the decrease in real property tax revenues. However, increases in income and business taxes and sales and use taxes helped offset the real property tax decrease. For fiscal years 1996 and 1997, the District projects local revenues to remain relatively flat.

From fiscal years 1993 through 1995, reported real property tax revenues decreased by $274 million to $654 million. There are two primary reasons for this decline. The first reason relates to the previously mentioned, one-time accounting change that artificially inflated fiscal year 1993 revenues but did not affect the cash received from real property tax revenues. Specifically, the District changed its real property tax year-end, which caused an additional 3 months of revenue to be recognized for accounting purposes in fiscal year 1993. This change resulted in a small annual surplus in the District's financial statements. If the change had not occurred, as previously mentioned, the District would have recorded an annual deficit of about $165 million in fiscal year 1993. According to District officials, the tax year was changed so that the real property tax year-end would coincide with the District's September 30 fiscal year-end, which would ease reporting requirements. If fiscal year 1993 real property tax revenues had been adjusted by removing the additional 3 months of revenues, the decline between fiscal years 1993 and 1995 would not have been as great.

The second reason for the decline in real property tax revenue is a decrease in the assessed value of the District's commercial and residential property. Lower assessed property values generally equate to lower property tax revenues. From fiscal years 1993 through 1995, the assessed value of the District's taxable property declined by about 6.3 percent, with most of the decline attributable to commercial property. Consolidation of federal office space, increased competition from suburban office space, and the downward renegotiation of rents on existing space have contributed to the decline in the assessed value of commercial property. In addition, a declining population and falling employment among District residents have caused a decline in housing values and residential sales in all but a few District neighborhoods. The District forecasts real property taxes to decline slightly in fiscal years 1996 and 1997.

Operating Grants

Operating grant revenue has fluctuated in recent years. Operating grants increased from $760 million to $960 million from fiscal year 1993 through fiscal year 1994, but then decreased to $855 million in fiscal year 1995. Operating grants are primarily a function of the level of expenditures on social programs. As the level of expenditures in these programs increases or decreases, the level of revenues from operating grants increases or decreases accordingly.

In fiscal year 1995, over 75 percent, or about $653 million, of the District's operating grants were for health and welfare programs. In addition, a significant portion of the operating grant revenue is due to Medicaid expenditures—the District's largest health care expenditure. In fiscal year 1995, Medicaid expenditures for private providers of health care services totaled $744 million. The District is to receive 50 cents for each dollar spent on Medicaid from operating grants. Thus, at least $372 million, or 44 percent, of the total operating grant revenue for fiscal year 1995 represented reimbursements to the District for Medicaid expenditures.

The District forecasts operating grants to decrease from $855 million in fiscal year 1995 to $823 million in fiscal year 1996, due to an over $100 million decrease related to the housing authority being placed into receivership that was partially offset by increases to Medicaid and other grants. Further, operating grants are projected to increase from $823 million in fiscal year 1996 to $850 million in fiscal year 1997—a change of about 3 percent which is primarily due to the Medicaid program.

The Federal Payment

The District has been receiving a federal payment since the 1800s. Historically, the federal payment has fluctuated because of changes in the method and calculations used to determine its amount. Recent history shows that in fiscal year 1992, the Congress adopted a formula to set the general purpose portion amount of the payment to 24 percent of the second prior fiscal year's own-source revenues (local revenues) collected in the District. In addition to the formula, the Congress also funded certain initiatives as part of the federal payment. The general purpose portion made up about 97 percent of the total federal payment for fiscal years 1993 and 1994, and no initiatives have been included in the federal payment since then.

In fiscal years 1993 and 1994, using the aforementioned formula, the federal payments were $636 million and $648 million, respectively. In fiscal year 1995, this formula was discontinued and replaced with a federal payment of $660 million that District officials projected to remain level through the year 2000. Assuming the inflation rate of about 3.3 percent per year through 2000 that the District used in its budget projections and no adjustment to the federal payment, the District will actually lose about $116 million in purchasing power during this period.

Major studies[1] performed on the District have concluded that there are inadequacies in the federal payment. For example, it does not fully compensate the District for (1) the additional responsibilities it carries as a result of the federal government's presence or (2) the loss of revenue due to federally imposed restrictions. This structural issue affects the District's relationship with the federal government and is one of the issues the Authority is expected to focus upon.

The District's ability to significantly increase its revenue is limited by the Home Rule Act and a large federal presence. Section 602 (a)(5) of the Home Rule Act prohibits the District from taxing nonresident income. Studies performed by the Rivlin Commission, the Appleseed Foundation, and the McKinsey & Company/Urban Institute concluded that this limitation deprives the District of a substantial potential revenue. The studies reported that the District's inability to tax nonresident wages results in a loss of revenue because nearly $2 of every $3 earned in the District is earned by nonresidents. In addition, about 42 percent of the assessed value of all land and improvements in the District is tax exempt and about 23 percent of the total assessed value is federal property. Thus, the District is unable to obtain revenues from a significant portion of its land.

Many sources have estimated the impact of eliminating the restrictions that prevent the District from taxing nonresident income and federal property. The D.C. Appleseed Center for Law and Justice[2] concluded that the removal of these restrictions could have resulted in estimated

[1]These studies include those by the Rivlin Commission, McKinsey & Company/The Urban Institute, and the Fair Budget Coalition.

[2]D.C. Appleseed Center For Law and Justice, The Case for A More Fair and Predictable Federal Payment for the District.

revenues for the District of $471 million in nonresidential income tax and $694 million in additional property taxes in fiscal year 1995, which is $505 million more than the $660 million federal payment received.

District's Overall Expenditures

The general fund, at $4.2 billion, or 79 percent of the District's $5.4 billion in gross[3] expenditures/expenses for fiscal year 1995, far exceeded the expenditures and expenses of the other funds that comprise the District's budget and, thus, is the primary focus of our analysis. Overall, expenditures/expenses increased from $5.5 billion in fiscal year 1993 to $6.0 billion in fiscal year 1994 and decreased to $5.4 billion in fiscal year 1995.

The significant change from year to year was primarily due to shifts in Medicaid and employee benefits expenditures/expenses between the years. Fiscal year 1994 had particularly large human support services expenditures because Medicaid expenditures increased by almost $300 million, of which more than $200 million was due to Medicaid cost reimbursement settlements with institutional providers for fiscal years 1991 through 1993. District officials do not expect this large Medicaid increase to reoccur in future years because the District has moved away from cost settlements for in-patient hospital services and now reimburses these providers based on predetermined rates. The District projects cost settlements of $66 million and $59 million for fiscal years 1996 and 1997, respectively.

Also, for fiscal year 1995 expenditures/expenses, human support services showed a reduction of more than $200 million, primarily because of a decrease in the projected liability for disability compensation. An error in the way the amount had been computed in the past was corrected in the fiscal year 1995 financial statement audit. Previous computations of future disability compensation had failed to show recipients being deleted after the legally required time for receiving such compensation had expired and the recipient was required to retire or go off of disability. This reduction should not reoccur and, thus, for trend analysis and comparison purposes, was added back to the reported human support services costs for fiscal years 1996 and 1997 budgeted amounts.

[3]These amounts are the sum of total expenditures from the All Government Fund Types and Expendable Trust Fund's Combined Statement of Revenues, Expenditures, and Changes in Fund Balance and total operating expenses from the All Proprietary Fund Types, Pension Trust Funds, and Component Unit's Combined Statement of Revenues, Expenses, and Changes in Retained Earnings/Fund Balances.

Notwithstanding the large Medicaid increases in fiscal year 1994 and the disability compensation adjustment in fiscal year 1995, our review found that the District's proposed expenditures in its fiscal years 1996 and 1997 budgets were generally comparable to the trends in its expenditures/expenses for fiscal years 1993 through 1995, as adjusted for its proposed initiatives.

This means that the District's projected fiscal years 1996 and 1997 budgets show expenses that (1) are about the same as those reported in 1995 adjusted for the aforementioned changes and (2) have slightly decreased on an inflation-adjusted basis. This outcome is consistent with most of the proposed initiatives in the District's financial plan being management initiatives, as opposed to significant restructuring (eliminating services, for example). Also, because they are management initiatives, they may be more difficult to achieve and will require a detailed plan for implementation and close oversight. However, in an effort to control spending, the Mayor, in his Transformation Plan, has proposed reducing full-time equivalents (FTE) from 40,000 to 30,000 by the beginning of fiscal year 2000.

Our more detailed review of the District's expenditures found that two critical cost drivers of the growth in the District's expenditures are Medicaid and pension costs. In addition, much discussion in the District's budget deliberations has focused on the subsidy costs related to two aspects of the District's operations—the general hospital and university. Each of these expenditures has a significant impact on the District's financial condition.

The discussion of these four expenditures in our testimony is not intended to minimize either the impact or the need to revisit other areas of the District's operations for budget savings or revenue enhancement opportunities. Clearly, areas such as the school system (the third largest expenditure), the court system, capital project needs, and others should be more closely evaluated. However, our review showed that Medicaid costs and pension costs are the greatest risks to the District's financial viability from a cost perspective. In addition, because deliberations on the District's budget by District officials and the Congress focused on the D.C. General Hospital and the University of the District of Columbia, we also focused on these costs.

Medicaid Expenditures

Similar to the current national trend, and as we recently reported,[4] Medicaid spending is consuming an increasing share of the District's total health care expenditures. From fiscal years 1991 to 1995, the District's records showed that Medicaid expenditures for private[5] providers increased from $427 million to $744 million, or approximately 74 percent. The District projected Medicaid expenditures of $776 million and $780 million for fiscal years 1996 and 1997, respectively, and has made efforts to contain Medicaid costs, such as moving from cost reimbursements for institutional providers to reimbursements based upon diagnostically-related groups (DRG). However, based on the recent growth history of these expenditures and the poor[6] condition of the District's financial records that track and account for Medicaid costs, we are concerned that so little growth is projected in Medicaid expenses.

The District is responsible for 100 percent of the nonfederal share of all Medicaid expenditures. In other jurisdictions across the nation, states assume responsibility for this nonfederal share or require local governments, such as counties, to pay a portion of these costs. As we previously reported,[7] only three[8] states require their local governments to pay more than 25 percent of this nonfederal share for Medicaid services. Most notable is New York state's requirement for its local governments, including New York City, to pay approximately 50 percent of this nonfederal share, except for the long-term care program, for which it pays 19 percent.

As noted, New York City pays a Medicaid matching percent significantly less than the District. In addition, Philadelphia pays nothing for Medicaid. If the District would pay 50 percent of its nonfederal share of expenditures, or the equivalent of a 25 percent match of its total Medicaid expenditures comparable to New York, or pay nothing, similar to Philadelphia, the impact on the District's financial condition would be

[4] District of Columbia: Information on Health Care Costs (GAO/AIMD-96-42, April 22, 1996).

[5] GAO's health-care report figures for Medicaid included expenditures for both public—District-owned facilities, such as St. Elizabeth Hospital—and private providers. The District 1997 budget and financial plan does not provide the total Medicaid expenditures but rather only provides the amount for private providers. During fiscal years 1991 to 1995, public provider expenditures approximated between $71 and $100 million per year.

[6] GAO/AIMD-96-42, April 22, 1996.

[7] Medicaid: Local Contributions (GAO/HEHS-95-215R, July 28, 1995).

[8] New York, New Hampshire, and Arizona are the only three states that require a contribution of more than 25 percent of the nonfederal share from their local governments for Medicaid services, not administrative costs.

significant. If the fiscal year 1997 budget submission, which included total private-provider Medicaid expenditures of $780 million, was modified to show either change, the District's financial picture would shift from having a net cost of at least $390 million (100 percent of the nonfederal share or a 50-percent match) to a net cost of $195 million, when made comparable to New York City, or zero compared to Philadelphia.

While placing the District on comparable footing with New York City and Philadelphia would significantly improve its financial and cash position, longer-term solutions would have to address many other issues that would need to be considered in such a complex discussion.

The Unfunded Pension Liability

In looking at the District's financial condition, the unfunded pension liability represents one of its greatest long-term challenges. Today, the unfunded liability stands at $4.7 billion and is expected to increase to $7 billion in 2004.

The Congress created defined benefit pension plans for District police officers and fire fighters in 1916; teachers in 1920; and, judges in 1970. These funds were financed on a "pay as you go" basis. The responsibility for these payments and the related, and then undetermined, unfunded liability were transferred to the District as part of Home Rule. The District of Columbia Retirement Reform Act, Public Law 96-122, in 1979 committed the federal government to pay $52.1 million annually from 1980 to 2004 to partially finance the liability for retirement benefits incurred before January 2, 1975.[9]

In 1980,[10] the federal government provided $38 million to the District in addition to the first of 25 annual payments of $52.1 million to the pension funds authorized by the Retirement Reform Act. The then present value of these payments equalled $649 million. The present value of the pension liability at the time of the transfer equalled $2.7 billion, resulting in an unfunded liability to the District of over $2 billion.

[9]See District Pensions: Federal Options for Sharing Burden to Finance Unfunded Liability, pages 14-18 (GAO/HEHS-95-40, December 28, 1994).

[10]GAO/HEHS-95-40, December 28, 1994 and D.C. Appleseed Center, The District of Columbia's Pension Dilemma—An Immediate and Lasting Solution.

Since 1979, the District has funded[11] (that is, covered the costs of the benefits participants have earned in that year) all benefits that the pension plans' participants have earned since 1979, and paid in an additional $1.2 billion towards the unfunded liability. Table 1 shows an analysis of the unfunded pension liability since the plan was transferred to the District.

Table 1: Unfunded Pension Liability

Dollars in millions

Fiscal year	Unfunded pension liability	District contribution	If fully funded 1979 net normal cost	Excess District contribution
1980	$2,006	$108	$89	$19
1981	$2,134	$110	$93	$17
1982	$2,336	$136	$89	$47
1983	$2,874	$143	$85	$58
1984	$2,936	$174	$103	$71
1985	$3,393	$165	$110	$55
1986	$3,594	$175	$119	$56
1987	$3,458	$173	$96	$77
1988	$3,614	$179	$103	$76
1989	$3,853	$193	$106	$87
1990	$3,820	$222	$118	$104
1991	$4,005	$225	$112	$113
1992	$4,249	$254	$121	$133
1993	$4,152	$291	$135	$156
1994	$4,337	$307	$142	$165
1995	$4,526	$297	$135	$162
1996	$4,780	$337	$133	$204
1997	$4,973	$321	$126	$195

Source: D.C. Retirement Board.

Despite these efforts, the unfunded liability is now estimated at $4.7 billion,[12] and is expected to increase to $7 billion[13] in 2004 due to the

[11]D.C. Appleseed Center, The District of Columbia's Pension Dilemma—An Immediate and Lasting Solution.

[12]D.C. Appleseed Center, The District of Columbia's Pension Dilemma—An Immediate and Lasting Solution.

[13]GAO/HEHS-95-40, December 28, 1994 and D.C. Appleseed Center, The District of Columbia's Pension Dilemma—An Immediate and Lasting Solution.

accumulation of interest owed on the unfunded portion of the pension liability transferred to the District back in 1979. Similarly, the District's pension payment, which is currently approximately $300 million a year, is expected to increase to $490 million starting in 2004.

The Appleseed Foundation[14] concluded that these pension plans' unfunded liabilities should be the responsibility of the federal government since the liabilities are the results of federal actions predating the Home Rule Act. Our analysis shows that if the District did not have the responsibility for the costs of these plans related to the unfunded liability, the pension expense in its proposed fiscal year 1997 budget would be reduced by $195 million from the $321 million currently shown in the proposed budget to $126 million. This change would have a major impact on the projected budget deficit for fiscal year 1997.

Similar to the Medicaid discussion, many other factors also need to be considered longer-term in deciding the best way to address the escalating pension costs that the District will pay.

Subsidy Payments

Two other major costs for the District that have been regularly discussed in budget deliberations are the costs for D.C. General Hospital and the University of the District of Columbia. The District paid subsidies to the hospital of $59 million, $47 million, and $57 million for fiscal years 1993, 1994, and 1995, respectively. It has projected for fiscal years 1996 and 1997 that it will pay subsidies of $47 million and $52[15] million, respectively. Similarly, the District paid the university subsidies of $68 million, $66 million, and $50 million for fiscal years 1993, 1994, and 1995, respectively, and projects to pay subsidies of $43 million and $44 million for fiscal years 1996 and 1997, respectively.

Our recently issued report on health-care delivery[16] in the District pointed out several challenges that confront the hospital if it is to remain viable, including major capital improvements. In New York City's effort to turn its financial problems around, it closed a municipal hospital, had massive layoffs at others, and relied on the other hospitals in the city to absorb some of the role it had in delivering hospital care for city residents. The

[14]D.C. Appleseed Center, The District of Columbia's Pension Dilemma—An Immediate and Lasting Solution.

[15]The projected fiscal year 1997 amount includes $15 million for the public health clinics, which were transferred to the hospital.

[16]GAO/AIMD-96-42, April 22, 1996.

District has proposed creating a Public Benefit Corporation to include the hospital's operations and that would allow the hospital to operate separately from the city entirely, including the city's personnel requirements and collective bargaining agreements. However, based on the projected budget subsidies, it is unclear as yet if this initiative will save the city money or, if so, how much.

The District has not yet evaluated the financial structure of its university system to identify ways to make it less costly. However, Authority officials stated that the University of the District of Columbia had raised its tuition to offset more of its costs. At the time of its financial crisis, New York City turned its senior university system over to the state to run and operate. New York City's presence in delivering this service was scaled back dramatically and, for the most part, involved delivering higher education at the junior-college level, charging tuition for the services, and providing the services at significantly less cost.

The District's Cash Position

From the inception of its financial crisis, the District has had cash flow problems. In fact, District officials project that the District will run out of money this month. The District took several measures to address its cash flow shortage. For example, in fiscal year 1994, the District delayed pension, vendor, and Medicaid payments and borrowed internally from its capital projects fund. In fiscal year 1995, the District again deferred payments to its vendors and, as stated by the Chief Financial Officer (CFO),[17] the District began fiscal year 1996 with approximately $200 million to $300 million in delayed payments owed to vendors and Medicaid providers.

Over the last 3 fiscal years, the District also borrowed short-term from the U.S. Treasury to finance operations and capital projects. Fiscal year 1996 borrowings against the fiscal year 1997 federal payment are estimated to total $639 million of the $660 million fiscal year 1997 payment. Specific short-term borrowings for fiscal year 1996 are shown in table 2.

[17]Testimony of District CFO Anthony A. Williams before the House Subcommittee on the District of Columbia, Committee on Government Reform and Oversight, March 28, 1996.

Table 2: Short-Term Borrowings for Fiscal Year 1996

Dollars in millions

Fiscal 1996 Short-term Borrowings	
October 1995[a]	$96
January 1996 [a]	$283
Planned July 1996[b]	$260
Total	**$639**
Fiscal Year 1997 Federal Payment	$660

[a]District's Cash Flow Statements—D.C. Treasurer.

[b]Office of the Chief Financial Officer.

By borrowing against future revenue to pay for these goods and services already received, the District has not resolved its cash flow problems but has only postponed them.

During fiscal year 1995, the District's investment grade general obligation debt was down-graded to noninvestment grade. Because of this non-investment grade rating, the District's sources for obtaining short-term and long-term financing are limited and the interest cost of obtaining financing in the capital markets could be very costly. The District's financial plan discusses two borrowing options, another option was also recently added for obtaining funds from capital markets. The recently reported $220 million short-term lending offer from the capital markets to the District occurred after the completion of our work and was not part of our review.

The first option in the District's financial plan includes the District borrowing short-term from the U.S. Treasury using the subsequent year's federal payment as collateral to fund its operations and capital projects. The second option includes the District borrowing $500 million for accumulated deficit financing and $900 million (that is, $150 million in each of the next 6 years starting in fiscal year 1997) to meets its capital needs. In addition to these borrowings, the District will still need short-term borrowing for cash flow purposes.

Under the first option, the District projects that by April 1998, it will have borrowed against the entire fiscal year 1998 federal payment and will not have cash sufficient to meet its operating needs. Under current law, the District may borrow from the U.S. Treasury to meet its capital and cash flow needs, and such borrowings are payable from the subsequent fiscal year's federal payment.

There are no provisions in the current law for long-term borrowing from the U.S. Treasury or for deficit financing of the District's operating deficits. At present, the District must repay Treasury loans within 12 months. Also, section 461 of the Home Rule Act authorizes the District to enter into long-term borrowing by issuing general obligation bonds only for capital improvements or to refund outstanding indebtedness. The District of Columbia Emergency Deficit Reduction Act of 1991, Public Law 102-106, authorized the District (on a temporary basis ending on September 30, 1992) to issue general obligation bonds to finance payment of the $332 million accumulated operating deficit in the general fund at the end of fiscal year 1991. In addition, section 603 (b) of the Home Rule Act provides that the District may not issue general obligation bonds (other than to refund outstanding indebtedness) if the District's debt service in a fiscal year exceeds 14 percent of the estimated revenues during the year the bonds are issued.

By the end of fiscal year 1996, the District's debt service is forecasted to be at approximately 11.9 percent of estimated revenues. Thus, the District would need to seek additional legislative authority before plans to issue long-term bonds to fund capital improvements or to finance the District's accumulated operating deficit would become viable options.

The New York City and Philadelphia control boards, during the first year that the boards were in place, obtained long-term borrowings to finance their respective accumulated deficits. New York City, which at the time had an accumulated deficit of $6.2 billion, received about $3.6 billion as deficit financing and exchanging of notes. Philadelphia had both accumulated and projected deficits at the time its control board borrowed $475 million, as shown in table 3.

Table 3: Pennsylvania Intergovernmental Cooperation Assistance Authority Borrowing: Uses of Proceeds of Fiscal Year 1991 Serial Bonds

Dollars in millions

Funds to city for deficit reductions[a]	FY92 (cumulative)	$153.5
	FY92 (projected deficit)	$94.9
	FY93 (projected deficit)	$7.8
Subtotal		**$256.2**
Grants for capital projects		$120.0
Grants to productivity bank		$20.0
Debt service reserve fund		$47.5
Capitalized interest		$20.0
PICA expenses		$0.6
Financing costs		$10.9
Total		**$475.3**

[a]Philadelphia's actual deficit for fiscal year 1992 was $71.4 million, and it reported a surplus of $3 million in 1993. Thus, Philadelphia was only required to borrow $225 million for deficit financing.

Source: Offering Statement, June 1, 1992, p. 6.

Like New York City and Philadelphia, the District's accumulated deficit and any approved projected deficits should be fully funded through longer-term borrowings or other means, including the need for any approved capital projects funding. In addition, a funding mechanism should be established that ensures sufficient funds for its immediate short-term cash needs. Along with this funding, the District's financial plan should be modified with enough revenue enhancement efforts and/or deeper budget cuts to fund the repayment of any long-term debt incurred and current operations without incurring further budget deficits.

Actions Taken by the Three Control Boards in Their First Year

You asked us to respond to several questions relating to the three control boards[18] ranging from their organizational structure and personnel, to budget initiatives, to management initiatives implemented in the first year to resolve their respective cities' financial crises and help improve operations. In response to your specific questions, the following sections (1) provide some background on the legislative authority of the controls boards, (2) summarize the actions taken by the three respective control

[18]The three oversight boards that we reviewed are the District of Columbia Financial Responsibility and Management Assistance Authority (Authority), New York State Financial Control Board (FCB) (including the Municipal Assistance Corporation (MAC)) and the Office of the State Deputy Comptroller (OSDC), and the Pennsylvania Intergovernmental Cooperation Assistance Authority (PICA).

boards in their first year of operation, and (3) include a matrix that provides information about how the control boards are structured as well as statistical information, such as their budget and number of personnel. (See attachment).

Authority Legislation

The Authority was granted broad powers to accomplish a number of purposes, including

- eliminating the budget deficits and cash shortages of the District;
- ensuring the most efficient and effective delivery of services by the District;
- enhancing the District's timely payments of its debts and access to capital markets;
- assuring the District's long-term financial, fiscal, and economic vitality and operational efficiency;
- examining the programmatic and structural relationship between the District and the federal government;
- requiring the District to examine the programmatic and economic impact of activities before they are implemented; and
- assisting the District in achieving an appropriate relationship with the federal government and implementing the actions necessary to accomplish the purpose of the enabling legislation.

The laws creating the control boards in New York City and Philadelphia generally had purposes similar to the law for the District, except for provisions pertaining to the federal government, even though they each had comparable provisions related to their respective states.

The Authority was given extensive powers to accomplish these purposes relating to the financial management activities of the District government. The Authority's exercise of many of these powers are confined to a "control year," which, under the law, commenced in fiscal year 1996. The following are some of the more significant powers that enabling legislation confers[19] on the Authority. During a control year, the Authority has the power to:

- Annually approve the financial plan and budget of the District.
- Approve all acts and contracts of the District for consistency with its financial plan and budget.

[19]District of Columbia Financial Responsibility and Management Assistance Act of 1995, sections 201 to 205, 211 to 213, and 303.

- Approve the appointment of the District's Chief Financial Officer and Inspector General, or remove those officials for cause.
- Approve all District borrowings. In addition, at the request of the District, the Authority may borrow monies from the Treasury and the public that could be secured by dedicated revenues of the District. Also, it may control and direct the flow and use of funds from such borrowings.
- Assure that the federal payment is used under terms and conditions that the Authority deems appropriate to implement the District' s financial plan.

The Authority was given many other powers, including certain administrative and enforcement powers, to ensure that it had the necessary authority to achieve the objectives of the enabling legislation. The New York City[20] and Philadelphia[21] control boards had similar powers conferred on them, except for those pertaining to a chief financial officer and inspector general.

The District of Columbia Financial Responsibility and Management Assistance Authority

To respond to a number of your questions, we sent a letter of inquiry to the Authority on May 17, 1996. In response, the Authority provided us with written responses, reports, and testimonies it had prepared. We received substantial portions of the Authority's responses on June 25, 1996. Consequently, we cannot provide an in-depth assessment of the actions it has taken or the status of actions in the planning stages.

The following provides a summary of the Authority's response to our inquiry. In attachment I, we provide some baseline information on, for example, the Authority's and the New York and Philadelphia control boards' organization, components, number of employees and budget, which address a number of your questions. I would now like to focus on issues concerning the actions the Authority has taken or plans to take, in the form of management initiatives (financial and nonfinancial), budget initiatives, actions pertaining to the Authority itself, and legislative initiatives, to respond to the major problems facing the District.

The Authority has completed some actions in its first year and has a large number planned. In our view, the most critical challenge facing the

[20]New York State Financial Emergency Act for the City of New York, State of New York Laws of 1975, sections 5408, 4511, 5412, and Municipal Assistance Corporation Law of 1975, sections 3010, 3012, and 3013.

[21]Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class (Act of June 5, 1991, Public Law No. 6) Section 203.

Authority is to quickly alleviate the District's cash flow problems. Prospectively, the Authority needs to address the many other major issues confronting the District, such as the federal payment, Medicaid, pensions, capital improvements, school system costs, court system costs, subsidies, service delivery, and its financial management system. These issues will need to be prioritized quickly, with specific plans and objectives developed to deal with each of them. These plans need to have clearly articulated timetables, deliverables, and outcomes that are measurable if the city is going to resolve its financial problems and establish sound financial and managerial policies and procedures. The Congress then needs to provide oversight to ensure that the Authority and the District meet requirements set out in the Authority's strategic plan and the District's financial plan.

Management Initiatives

As part of its enabling legislation, the Authority was given power to help resolve the financial and operational problems facing the District, such as ensuring that proposed initiatives are in line with the District's financial plan and budget, that service delivery is efficient and effective, and that cost savings and efficiencies are received. In response to our inquiry, the Authority indicated that it had completed or planned the following management initiatives to carry out its responsibilities.

Actions Completed

The Authority advised us that, as of May 28, 1996, it had reviewed 1,562 contracts and had another 64 on-hand. Of these, 1,549 were shown as approved, 3 were rejected, 6 were withdrawn by the agency, and 4 had other dispositions. According to the Authority, the District has experienced direct savings from contracts that were rejected, withdrawn, or modified. In many other instances, the Authority stated, cost savings are not immediately quantifiable. Some examples of savings include: a pre-trial services contract that was rejected and is expected to result in savings of at least $300,000 annually; a $1 million communications equipment contract that was returned; and individual contracts for fuel oil that were withdrawn, resulting in reported savings in excess of $100,000 for the first quarter of fiscal year 1996. Other management initiatives the Authority implemented during its first year are as follows:

- Working with the City Administrator's Office, the Authority encouraged the removal of contracting authority from the Department of Human Services (DHS). The Authority said it is now working with the city to assemble contracting specialists from the federal government to clean up DHS' contracting procedures.

- The Authority engaged an independent public accounting firm to perform certain procedures regarding the District's payroll and its accounts payable. The accounts payable study began on August 28, 1995, and ended on December 14, 1995. The report on the study, issued on January 12, 1996, estimated, based on the agreed upon procedures performed, that the District's general fund accounts payable as of September 30, 1995, was between $231 million and $269 million.
- The Authority has worked with a car manufacturing company to repair the District's emergency vehicles in order to deliver services.
- The Authority stated that it privatized two functions during fiscal year 1996. Approximately 300 personal care aide jobs were replaced by a contract. D.C. Village, a nursing home, was closed and its patients transferred to private nursing homes.

Actions Planned

- The Authority said that it was developing a strategic plan and annual report. The strategic plan is to include a mission statement, measurable goals and objectives, and timetables for the expected completion of certain goals. The plan is also to include an assessment of short-term and long-term objectives and will discuss the Authority's overall priorities.
- The Authority said it planned to privatize 10 activities during fiscal year 1996, which account for approximately 1,096 FTEs and currently cost over $65 million. These initiatives include such activities as the sale/leaseback of the 800 bed Correctional Treatment Facility, food services, police and fire/medical services, transportation and motor pool services, and solid waste and transfer disposal.
- The Authority stated that it plans to perform future work to distinguish city/county/state functions that the District performs. The District provides, to a certain extent, public services that are normally provided by state and county governments, most notably extensive hospital, education, correctional, and medicaid services.
- The Authority stated that it had undertaken two relatively broad-based comparative initiatives that will be used to develop approaches to improve performance and to compare the District's performance with that of other governments. These initiatives are being undertaken in cooperation with several national organizations, including the Greater Washington Research Center, the Brookings Institution, and the International City/County Managers Association (ICMA). Brookings is examining what District activities are necessary and whether they are being delivered in the most efficient and economical way. ICMA will identify performance measures for the core services that the District performs and help determine whether

these core services are being delivered in the most efficient and economical way.

- The Authority stated that it was working with the District on a pilot performance management program at the Department of Public Works to help the District better establish benchmarks by which to measure performance.
- According to the Authority, it is working with the District to restructure programs, to enhance program delivery, and to hasten fiscal recovery. For example, the Authority plans to initiate a thorough review of how resources are used within the District of Columbia Public Schools and to identify how resources can be directed to upgrade the school system as a way of restoring and retaining the city's middle-class tax base.
- The Authority recommended that a new financial management system be implemented by the end of fiscal year 1996. The Authority stated that it reinforced this recommendation by ensuring that funds were available to perform a comprehensive needs assessment and the initial developmental stages for a new financial management system. It is the Authority's view that the District is responsible for contracting with a consultant to perform the needs assessment.

Budget Initiatives

The act requires the Authority to perform reviews of District of Columbia budgets to assist the District in its efforts to restructure its workforce for more efficient service delivery; to eliminate the District's current budget deficit; and to ensure the long-term economic, financial, and fiscal vitality of the city. In this capacity, the Authority said that it had completed or planned the following actions.

Actions Completed

In reports in February and March of this year,[22] the Authority stated that it allocated reductions in the fiscal year 1996 budget of the District to specific departments to increase the likelihood that the proposed reductions would be made. In addition, the Authority disapproved a City Council-proposed supplemental budget of $5.123 billion. The Authority concluded that the supplemental budget at this level would increase the accumulated deficit and that approving a supplemental budget with such harsh fiscal consequences would be irresponsible. Consequently, on February 23, 1996, the Authority disapproved the City Council's action and issued a list of recommendations designed to enable the City to meet the

[22] Report on Final Allocations of the District of Columbia's Fiscal Year 1996 Budget, District of Columbia Financial Responsibility and Management Assistance Authority, March 29, 1996, and Report on the District of Columbia's Fiscal Year 1996 Budget, District of Columbia Financial Responsibility and Management Assistance Authority, February 23, 1996.

$4.994 billion budget agreed upon by the Congressional Conference Committee on Appropriations for the District of Columbia.

With the Mayor and the City Council, the Authority reached consensus on the fiscal year 1997 budget and financial plan, which was submitted to the Congress for approval. This plan addresses the need for borrowing for different purposes, such as long-term borrowing for accumulated deficit and borrowing for capital investment. As I discussed earlier in this statement, the District has estimated that it will have an accumulated deficit of almost $500 million at the end of fiscal year 1996, with a deficit of $116 million for fiscal year 1996. It estimates that it will run out of cash this month.

The actions to borrow proposed in the fiscal year 1997 budget will require approval from the Congress and would require the Authority and the District to work together to establish an appropriate relationship with the Congress so that the District can achieve balanced budgets and long-term fiscal health. As I discussed earlier, the control boards in New York and Philadelphia stabilized the cities' cash position in their first year of operation through refinancing and long-term borrowing. This issue must be addressed if the District is to resolve its financial problems.

In recent congressional testimony,[23] the Authority provided its analysis of the District's fiscal year 1997 budget and its potential need for borrowing. The Authority stated that the fiscal year 1997 Budget and Financial Plan conformed with the act in that it promoted the financial stability of the District government and furthered the interests of the people of the District. The budget estimated revenues of $5.04 billion and expenditures of $5.14 billion with a resulting deficit of $98.9 million, down $17 million from the projected fiscal year 1996 deficit of $116 million. Projections for fiscal years 1998 through 2000 call for a small deficit in fiscal year 1998 and small surpluses in fiscal years 1999 and 2000.

Actions Planned

As discussed previously in this testimony, our more detailed review of the District's budgeted expenditures found that the critical areas of the District's budget that have far-reaching implications for the District financially and programmatically are Medicaid and the unfunded pension liability. Further, we noted the high level of interest by all parties in the District's budget deliberations on the subsidies paid to D.C. General Hospital and the University of the District of Columbia. These

[23]Statement of Andrew F. Brimmer, Chairman, District of Columbia Financial Responsibility and Management Assistance Authority, before the Subcommittee on the District of Columbia, House Committee on Appropriations, June 26, 1996.

expenditures individually and in the aggregate have a significant impact on the District's financial condition that must be addressed in solving its financial problems.

In a June 17, 1996, report,[24] the Authority enumerated the actions it plans to take to resolve these issues. They include the following:

- The Authority is helping the District undertake a systematic review of each health and human services program. According to the Authority, the goal of the review is to ensure that high quality services are being delivered and to require that the most efficient and accessible means of delivering the services are instituted. Service redundancies are to be identified and services prioritized within existing budget constraints. The Authority also plans to review similar operations, such as a review of the mission, operations, and ownership structure of the District-owned and operated neighborhood health clinics. The Authority committed to providing $260,000 to the District's Commission on Health Care Finance to contract for specialized consulting services to develop a detailed work plan on how the District will gain control of Medicaid expenditures. The Authority also agreed to facilitate projects previously identified by the District.
- The Authority is studying the unfunded pension liability and plans to work with District and federal officials to develop a plan to address this problem. The Authority is analyzing a District-proposed plan to create a new police, fire fighters,' and teachers' pension plan for employees hired after October 1, 1996. In May 1996, Congresswoman Norton proposed legislation to address the unfunded liability in the police, fire fighters', teachers', and judges' pension plan. The Authority is also studying this proposal.

Another area that affects the District's ability to resolve its financial problems is subsidy payments. As part of the District's efforts to turn its financial condition around in these austere times, it is imperative that the cost/benefits of these programs and any other costly aspects of the District operations be looked at for alternative ways to meet the objective(s) they were created to meet. The Authority has made some recommendations regarding D.C. General Hospital and the University of the District of Columbia.

Finally, you asked us to request a list of the Authority's recommendations for fiscal years 1995 and 1996 as submitted to the Mayor, the City Council,

[24] Report to the Congress: Issues Related to the Fiscal Year 1996 Appropriations Act, District of Columbia Financial Responsibility and Management Assistance Authority.

the President, and the Congress. These recommendations dealt with actions the District government or the federal government may take to ensure compliance by the District government with a financial plan and budget or to otherwise promote the financial stability, management responsibility, and service delivery efficiency of the District government, including recommendations relating to section 207 (a)(1) (10) of the Financial Responsibility and Management Assistance Act of 1995, Public Law 104-8. We also asked the Authority for a response from the Mayor or City Council to the Authority on whether they will adopt the recommendations and what the potential cost savings from these recommendations are. The Authority did provide a list of recommendations, which we are providing to you under separate cover today, but it did not provide any information on the Mayor's or City Council's response. It stated that it has not, in many instances, finalized the cost savings of each recommendation.

Legislative Initiatives

Under its enabling legislation and other laws, the Authority is authorized to review permanent and temporary legislation[25] for consistency with the District's financial plan and budget. Under section 203(a) of the act, the Authority has reviewed 86 acts proposed by the City Council. The Authority disapproved five of these and made recommendations to the District under section 203(a)(3)(B) of the act. The Authority has conducted informal reviews under section 203(a)(6) in consultation with City Council staff. It stated that it has not received any formal requests from the City Council to provide preliminary reviews of acts. The Authority also stated that it would continue to review proposed legislation, as required under the act.

Other Initiatives

You also asked us specific questions regarding the following:

- The Authority has contracted with the following consultants and experts:
  - an independent public accounting firm was engaged for the audit of the District' fiscal year 1995 financial statements and
  - an independent public accounting firm was engaged for the audit of the Authority's fiscal year 1995 financial statements.
- The Authority has established four accounts to handle the funds it is responsible for as follows: (1) an account for the Authority's operating purposes, (2) an escrow account for receiving the federal payment and Treasury loans for the District, (3) an escrow account for the Police Grant

[25]See Information on Emergency Legislation (GAO/AIMD-96-45R, February 21, 1996).

for the Metropolitan Police Department, and (4) account earnings on the federal payment and Treasury loan.

- The Authority stated that it had established controls on the use of these accounts. It did not provide them to us for review but expressed its willingness to discuss these controls with us directly. It also added that the Chief Financial Officer (CFO) has outlined cash management priorities, which the Authority has reviewed and approved. According to the Authority, the priorities are used to determine whether requisitions made by the CFO fit the criteria. In order for an agency to obtain funds, the terms and conditions must be met and certified to by the CFO.
- The Authority stated that it is in constant communication with District officials in both the Mayor's Office and City Council. It said that it holds meetings with these officials on a wide range of management and budget issues of mutual concern to the Authority and the District government. The Authority has not established any formal mechanism for communicating with District officials, but said that all sides remain in frequent, daily contact. The Authority has issued several public notices of public meetings and has not issued any subpoenas. The Authority has held two meetings at which the public was invited to provide views and regularly hears from the public via telephone calls and letters.

The New York City and City of Philadelphia Control Boards

At your request, we also reviewed the actions taken by the New York and Philadelphia control boards whose cities also faced serious financial problems. These were the New York State Financial Control Board (FCB) (including the Municipal Assistance Corporation (MAC)) and the Office of the State Deputy Comptroller (OSDC), and the Pennsylvania Intergovernmental Cooperation Authority (PICA).

While the catalysts for creating the New York City, Philadelphia, and District control boards were the same—financial difficulties—there are some key differences that must be considered in defining the specific problems faced by these cities and evaluating the propriety of solutions implemented and the relative performance of each control board's efforts. Some of the more significant economic and programmatic differences follow.

- New York City's financial crisis crested in 1975, Philadelphia's in 1991, and the District's in 1995, a span of 20 years and various economic times for this country that would affect available financial solutions;
- New York City and Philadelphia are large metropolitan areas of states and hold preeminent roles in their respective states. The District, on the other

hand, has no such relationship. Instead, it must compete for federal resource support with other national interests. As discussed earlier, these relationships affect such things as Medicaid.

- New York City, especially, and Philadelphia, somewhat, have larger budgets and populations and more diversified tax bases to draw revenues from and do not have the legislatively imposed restraints on their ability to control their own revenue sources that the District has.
- The demographics—for both individuals and businesses—have implications for both the problems of the three cities and potential solutions. This would include distribution of wealth of the citizenry, employment/unemployment levels, industry diversification within the city and surrounding areas, and age distribution of city residents.

While this list of key differences is not exhaustive, it does point to the critical need to consider these and other items that would potentially make the nature of the problems the cities experienced, the proposed solutions, and the actions of their respective control boards, not necessarily comparable even though the core problem—financial difficulties—was the same.

New York City ended fiscal year 1976 with an annual operating deficit of $1.2 billion and was burdened with an accumulated deficit of approximately $6.2 billion. Throughout fiscal year 1976, numerous actions were taken with the assistance of FCB and MAC to prevent the city from going bankrupt.

During their first year in operation, in order to eliminate the budget deficits and cash shortages of New York City, the following MAC and FCB recommendations were implemented: (1) the workforce was reduced by about 40,000, or 13 percent, from its June 30, 1975, level,[26] (2) remaining city employees' wages were frozen for 3 years, (3) tolls on bridges and tunnels were increased, (4) commuter and subway fares were increased, (5) municipal hospitals had massive layoffs, (6) the tuition-free policy of the City University of New York was terminated, and (7) taxes were increased by about $775 million. In addition, the FCB adopted a resolution urging the State to assume the costs of maintaining courts and correction facilities, and the State enacted legislation in that year to assume these costs. MAC helped to establish the New York Council on the Economy, which addressed, among other things: (1) relieving the stock transfer tax burden on state and city businesses, (2) developing Battery Park City,

[26]We did not receive sufficient information from New York City to quantify the savings that were realized from the FTE reductions, wage freeze, increases in transit fares, tolls, etc.

which represented a stimulus to the financial real estate market, and (3) constructing a new convention center.

A key component in New York City's plan of recovery was the comprehensive overhaul and reform of the city's accounting and budgetary practices. The objective was the installation of a new integrated financial management system (IFMS), a computerized system for accounting, budgeting, purchasing, and payroll, linking the myriad of city departments and operations for the first time into one system with a single database.

This project received the highest possible priority as fiscal year 1976 advanced. The OSDC was given oversight responsibility for this project. Professional personnel were recruited, in some cases "loaned" by leading banks or corporations, and contracts were put into place with private accounting and systems management firms for work that could not be performed in-house. The system was implemented in July 1977. In addition, a management plan was implemented that enabled the city to monitor its operations continuously. The management plan and reports identified opportunities for improved performance. To strengthen management of this program, the Mayor, who was also a member of the FCB, established an office of operations.

Despite the highest degree of commitment evidenced by New York State to avert a bankruptcy, it became apparent that federal assistance was essential. The oversight boards helped New York City gain funding from various sources, such as the state, commercial lending institutions, city and state pension funds, and the federal government. By the end of fiscal year 1976, MAC bonds and notes outstanding on behalf of the city were approximately $3.9 billion, which stabilized the City's cash position.[27] As a former congressman, and Chairman of the FCB, the State Governor worked with New York City in the first control year to attract needed federal assistance, which was key to the city receiving federal loans and loan guarantees.

According to New York City officials, the control boards made significant contributions. The governor in his elected capacity and as chairman of the FCB committed himself fully to assist the city. The FCB and its professional staff and the State Comptroller provided strong support and guidance. MAC carried out its distinctive role to finance the city and ease its debt obligations. The State Legislature and the U.S. Congress responded to New

[27]Municipal Assistance Corporation 1976 Annual Report.

York City, and the U.S. Department of the Treasury expressed its faith in the City's plans and progress.

In fiscal year 1992, Philadelphia had an operating deficit of $98.7 million and an accumulated deficit of $153.5 million; however, by the end of the fiscal year, PICA had taken actions to eliminate the operating and accumulated deficit.

In PICA's first year, it borrowed about $475 million in Special Tax Revenue Bonds on behalf of the City of Philadelphia. The bond proceeds were used to fund the cumulative deficit, current year and subsequent year deficits, and certain capital projects and productivity enhancement initiatives.[28] In addition, Philadelphia imposed a 1 percent sales tax, renegotiated labor agreements, and collected back taxes. As a result of the 1 percent sales tax, revenues increased by $52.3 million for fiscal year 1992. The renegotiation with the labor union led to a 33-month wage freeze and extensive restructuring of health benefits agreements to achieve cost savings and reductions in paid holiday and sick leave. Delinquent tax collection increased by 10 percent annually.

A PICA "authority tax" was approved by the Philadelphia city council in June 1991. This is a 1.5 percent tax on wages, salaries, commissions, and other compensation earned by residents of the city and on the net profits earned by businesses, professions, or other activities conducted by residents of the City of Philadelphia. This revenue goes into a Special Revenue Fund collected by the Commonwealth of Pennsylvania. A portion of the PICA tax is used to cover PICA debt service and other PICA expenses, with the remaining revenues going to the "City Account."[29]

In 1992, Philadelphia began the process of updating its financial and information systems to enable operating departments to obtain more detailed management information on a daily basis. It also began contracting out custodial work in all of its central facilities, saving the city an estimated $700,000 annually, in addition to improving the quality of services in city offices and transit concourse areas. Other productivity measures, which began in 1992, included a competitive contracting program and renegotiation of real estate leases resulting in savings of $1 million for fiscal year 1993.

[28]Pennsylvania Intergovernmental Cooperation Authority, Financial Statements for the Period from June 5, 1991, to June 30, 1992, and Independent Auditor's Report, September 3, 1992.

[29]"The City account" is considered a trust fund for the exclusive benefit of Philadelphia, and is used to maintain the proceeds of taxes or other revenues pledged by the Authority to secure bonds.

Finally, Philadelphia achieved a balanced budget in fiscal year 1993, 2 years after its control board was established, and has sustained it through fiscal year 1995. New York City achieved a balanced budget in the sixth year of its control board's operation and has sustained small surpluses through 1995. The FCB has been in an advisory role since fiscal year 1986, after the city had sustained 6 consecutive years of balanced budgets.

The District's Financial Management System

Your April 25, 1996, request asked that we gather information on the history, capabilities, and status of the District's Financial Management System (FMS). In our June 14, 1995,[30] testimony before this Subcommittee, we concluded that improvements in the District's financial information and controls will need to be addressed. We noted, however, that simply purchasing new hardware and software will do little to improve financial information and controls. We stated that major improvements in financial and other management information can only be realized if they are part of an overall assessment of processes, people, and equipment. We recommended that the District clean up existing data in the financial systems and place special emphasis on ensuring that basic accounting policies and procedures are followed. In addition, we recommended that the Authority study the accounting and financial management information needs of the District.

In a hearing before the House Subcommittee on the District of Columbia in June 1996,[31] the Authority's Executive Director stated that a new financial management system is needed to provide better information for monitoring such things as departmental differences between budgeted and actual spending, cash balances, and outstanding debt. The District of Columbia 1996 Appropriations Act requires the Authority to report to the District's oversight and appropriations committees of the House of Representatives and Senate on the results of a needs analysis and assessment of the District's existing financial environment, specifying deficiencies in, and recommending necessary improvements to or replacement of the District's financial management system, including a detailed explanation of each recommendation and its estimated cost.[32] The

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

[31]House of Representatives Committee on Appropriations, Subcommittee on the District of Columbia, Hearing, June 5, 1996.

[32]Public Law 104-134 has not been printed as of this date. The language of the act is set forth in the conference committee report accompanying the appropriation act (H.R. Report 104-537) reprinted as 142 Congressional Record H3842, H3862-H3883 (daily edition April 25, 1996).

Congress appropriated $2 million for the assessment and $26 million for the improvements. However, none of the $26 million may be obligated or expended until 30 days lapse after receipt of the report by the Congress.[33]

The Executive Director of the Authority advised us that the Authority views the District as having responsibility for the feasibility study. He further stated that the Chief Financial Officer of the District was requiring, as part of bid proposals for improving the existing system, that each bidder provide a systems needs assessment that identified all of the problems, the bidder's recommendation for fixing the problems, and the bidder's estimated cost to do so. The Authority's Executive Director stated that the Authority has no plans to do any other feasibility study and that the $2 million provided could go towards the cost of systems improvements. As I mentioned earlier, the Authority advised us that it included in the fiscal year 1996 budget $2 million for a feasibility study of the current system and $26 million to implement a new system. Because the study has not as yet been undertaken, and none of the bids on the system improvements had been received, and given the timing of this hearing, the information contained in the following discussion is based solely on interviews with District financial officials.

In 1976, the Congress created the Temporary Commission on Financial Oversight of the District (Commission) to develop and implement a core financial management system. In 1977, the Commission hired a contractor to design, develop, and implement the District's new system, commonly called the Financial Management System (FMS). Between April 1978 and September 1979, the contractor developed the overall system and its operating characteristics. The new system was placed in operation in October 1979. In addition to the new system, the Commission had responsibility for other initiatives, such as FMS training, developing feeder systems, and preparing for and conducting audits. Total costs for these efforts were approximately $38 million, of which the Commission spent approximately $18 million for FMS and training, and the remainder for feeder systems, audits, and operating costs. The system, as installed, was designed to perform budget and accounting functions and was considered a state-of-the-art system.

Over the years, the District made limited modifications to the system. Changes that have been implemented in FMS were primarily upgrades to tape and disk capacity and revised reports. According to District officials, the District did not improve the system to facilitate management needs

[33] See 142 Congressional Record H3863.

and, as a result, the system is not now capable of providing reliable, timely, and relevant information to manage operations and costs. District officials also told us that due to the loss of staff with FMS knowledge—through attrition, retirements, and layoffs—current FMS users are not as familiar with the system and its capabilities. In discussions with the District's CFO and various city officials, they identified several issues relevant to FMS, including:

- FMS does not currently provide complete, reliable, and useful information to assess the District's programmatic and financial activities. This hampers the District and the Congress from making informed decisions.
- FMS does not provide financial statements, such as the balance sheet and revenue, and expense statements. To prepare interim, or year-end financial statements, numerous manual entries are required to restate FMS' balances based on generally accepted accounting principles.
- FMS and the payroll system are not integrated. As a result, numerous manual tasks are required to reconcile reporting differences between the payroll system and FMS' labor distribution module, which assigns personnel hours to specific activities.
- FMS reports are not designed to meet users' needs. As a result, agencies are required to manipulate report data into formats useful to the user. For example, reports generated by FMS are summary in nature rather than detailed.
- The District does not have a cadre of skilled personnel with extensive FMS knowledge. In addition, the available, skilled staff are limited in number and some are close to retirement age. Consequently, the full capability of FMS may be underutilized.

In addition, we surveyed financial management officials at 14 key District agencies that use FMS. The results of their responses follow:

- 21 percent stated that they were satisfied with the system,
- 43 percent told us that they were partially satisfied with it, and
- 36 percent were unsatisfied.

Further, District officials stated that little or no follow-up training has been provided since the original training when FMS was implemented. District officials also told us that due to budget constraints, no formal training has been provided in approximately 4 years.

As I mentioned earlier, the Authority contracted with an independent public accounting firm to perform an accounts payable study of the

District's financial activities. In performing the study, the firm experienced difficulty due to the data structure of accounts payable which required the firm to research through several layers of source documentation to complete its work. As a result, the firm experienced numerous delays and dedicated significantly more effort than anticipated.

As part of our review, we examined steps taken by both the cities of New York and Philadelphia to improve their financial management. Both had inadequate accounting procedures and information systems. As I mentioned earlier, in 1975, the first year of its crisis, New York City began developing a new integrated financial management system to account for all revenues and expenditures in a comprehensive manner. New York City installed its Integrated Financial Management System in July 1977. Likewise, in fiscal year 1992, Philadelphia began making enhancements to its financial management system and fully converted to an upgraded system by June 1994.

Mr. Chairman, this concludes my statement. I will be happy to answer any questions that you or the other Members of the Committee may have at this time.

Information on Selected Financial Oversight Boards

Board	New York State Financial Control Board (FCB) (New York City)	Pennsylvania Intergovernmental Cooperation Authority (PICA) (City of Philadelphia)	DC Financial Responsibility & Management Assistance Authority (DCFRA)
Statutory authority	New York State Financial Emergency Act for the City of New York, State of N.Y. Laws of 1975, Chap. 868	Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class (Act of June 5, 1991, P.L.9, No.6)	DCFRA Act April 1995
Year established	1975	1991	1995
Still in operation	Yes, in advisory role only since 1986	Yes	Yes
Test for complete termination	Originally, 6 months after budget is balanced; later revised so that the board will exist until the earlier of (a) 7/1/2008, or (b) the date when all federally guaranteed loans are retired and when all bonds and notes as set out in section 5415 of act are discharged, refunded, redeemed, or otherwise defeased.	PICA exists for a term not exceeding 1 year after all its liabilities, including its bonds, have been fully paid and discharged.	Twelve months after DCFRA certifies that all its obligations, notes, bonds or borrowing have been repaid.
Appointed by	Three appointed by governor with advice and consent of the state senate.	One by governor, 1 by President pro tempore of the Senate, 1 by Minority Leader of the Senate, 1 by the Speaker of the House, and 1 by the Minority Leader of the House.	The President appoints all five members after consultation with Congress.
Number of members	7	7	5
Ex officio	4	2	0
State officials	Governor (chairman) State comptroller	Secretary of the Budget	
Local officials	Mayor City comptroller	Director of Finance	
Appointed	3 from private sector	5	5
Staff size first year	24 - New York State Financial Control Board 10 - Office of the State Deputy Comptroller 6 - Municipal Assistance Corporation	6	30

(continued)

Board	New York State Financial Control Board (FCB) (New York City)	Pennsylvania Intergovernmental Cooperation Authority (PICA) (City of Philadelphia)	DC Financial Responsibility & Management Assistance Authority (DCFRA)
Term	At discretion of governor.	At the pleasure of the appointing authority; member's term is coterminous with appointing authority.	Initially all members appointed for a 3-year period. After initial term: 1 member appointed for a term of 1 year, 2 members appointed for a term of 2 years, and 2 members appointed for a term of 3 years.
Qualifications of appointed members	Originally not specified. With revisions to law in 1978, at least 2 private members shall be city residents or have principal place of business in the city.	Experience in finance or management. Residents of the assisted city or have their primary business in such city, except for Secretary of the Budget.	Knowledge and expertise in finance, management and the organization or operations of a business or government. Either primary residence or business within the city.
Qualifications of staff	Expertise in law, political science, policy analysis, and public management.[a]	Expertise in finance, investment banking, law, public accounting, and analysis.	Expertise in accounting and financial management, procurement, international affairs, law, public administration, economics, and political science.
Expenditures year established	$6.1 million[b]	$0.7 million[c]	$0.4 million[d]

[a]MAC and OSDC staff consist of banking, finance, legal, accounting, budget analyst, economist and academicians.

[b]Fiscal year ended June 30, 1976 includes MAC and OSDC.

[c]From inception to June 30, 1992.

[d]From inception to September 30, 1995.

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