

**THE OUTLOOK FOR THE DISTRICT OF COLUMBIA  
GOVERNMENT: THE POST-CONTROL BOARD PE-  
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**JOINT HEARING**  
BEFORE THE  
SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA  
OF THE  
COMMITTEE ON GOVERNMENT REFORM  
HOUSE OF REPRESENTATIVES  
AND THE  
OVERSIGHT OF GOVERNMENT MANAGEMENT,  
RESTRUCTURING, AND THE DISTRICT OF  
COLUMBIA SUBCOMMITTEE  
OF THE  
COMMITTEE ON GOVERNMENTAL  
AFFAIRS  
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# THE OUTLOOK FOR THE DISTRICT OF COLUMBIA GOVERNMENT: THE POST-CONTROL BOARD PERIOD

FRIDAY, JUNE 8, 2001

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA, COMMITTEE ON GOVERNMENT REFORM, JOINT WITH THE U.S. SENATE, OVERSIGHT OF GOVERNMENT MANAGEMENT, RESTRUCTURING, AND THE DISTRICT OF COLUMBIA SUBCOMMITTEE, COMMITTEE ON GOVERNMENTAL AFFAIRS,

*Washington, DC.*

The subcommittees met, pursuant to notice, at 11:04 a.m., in room 2154, Rayburn House Office Building, Hon. Constance A. Morella (chairman of the Subcommittee on the District of Columbia) presiding.

Present for the District of Columbia Subcommittee: Representatives Morella, Davis, and Norton.

Present for the Oversight of Government Management, Restructuring, and the District of Columbia Subcommittee: Senator Voinovich.

Staff present for the Subcommittee on the District of Columbia: Russell Smith, staff director; Heea Vazirani-Fales, deputy staff director; Robert White, communications director; Matthew Batt, clerk; Carl Picconato, science fellow; Victoria Proctor, professional staff member, Committee on Government Reform, Subcommittee on Technology and Procurement Policy; Howie Denis, counsel, Committee on Government Reform, Subcommittee on Technology and Procurement Policy; Melissa Wojciak, staff director, Committee on Government Reform, Subcommittee on Technology and Procurement Policy; Andrea Abrams, intern with Mrs. Morella; Jean Gosa, minority clerk; and Jon Bouker, minority counsel.

Staff present for the Oversight of Government Management, Restructuring, and the District of Columbia Subcommittee: Marianne Clifford Upton, staff director and chief counsel; Kate Eltrich, professional staff member for Senator Mary Landrieu, Senate Committee on Appropriations, Subcommittee on the District of Columbia; Julie Gunlock, minority clerk; Mason Alinger, minority professional staff member; and Andrew Richardson, minority staff director.

Mrs. MORELLA. I'm going to call to order the Subcommittee of the District of Columbia of the Committee on Government Reform of the U.S. Congress.

It's been more than 6 years since the passage of legislation establishing the District of Columbia Financial Responsibility and Man-

agement Authority, and thanks to the city's turnaround, it's balanced its budget for 4 consecutive years, transformed a half-billion-dollar debt into nearly a half-billion-dollar surplus, cut the size of its work force, and begun to make improvements in government service. We've reached this point: Today we're less than 4 months from the demise of the Control Board, and even if we had a crystal ball, I doubt we would have foreseen this.

I wanted to start by publicly thanking the men and women who gave their time and considerable talents at the Control Board over the past 6 years. They are chairman—or Chairwoman Alice Rivlin, who is here to testify; former Chairman Andrew Brimmer; Constance Berry Newman; Robert Watkins; Eugene Kinlow; Stephen Harlan; Joyce Ladner; Darius Mans; and Edward Singletary. Your service to your Nation's Capital at a time of great distress will long be appreciated, and I'll be asking my colleagues to support a joint resolution recognizing your contributions.

I also want to thank all of our witnesses for being here today, including our Mayor Anthony Williams, Council chair Linda Cropp, chief financial officer Natwar Gandhi, inspector general Charles Maddox, our outside financial experts. I also want to recognize our GAO witness who is going to be testifying on the report. And in addition, I want to recognize the distinguished members of my subcommittee, the House oversight Subcommittee on the District of Columbia, Congresswoman Eleanor Holmes Norton, the District's Representative, who has been a great guide through all of this and very important to this committee; our Virginia Congressman Tom Davis, whose leadership was crucial in the creation of the Control Board, who is my immediate predecessor as Chair of this District of Columbia Subcommittee.

And I am pleased that we will be joined today in about 40 minutes or so by Senator George Voinovich of Ohio. Senator Voinovich was the mayor of Cleveland while that city was emerging from a control period, and he is the ranking member of the Senate Governmental Affairs Oversight of Government Management, Restructuring, and the District of Columbia Subcommittee. He has long been active and engaged on D.C. oversight issues, and was instrumental in organizing this joint hearing.

The purpose of our hearing today is twofold: First, to look back at the progress the District of Columbia has made over the past 6 years, to explore whether it has met all of the goals of the 1995 Control Board Act, and to gauge the success of that legislation. Second, we want to look ahead at ways to ensure D.C.'s financial and management success continues.

I am interested in hearing from our city leaders about their proposal to create an independent chief financial officer, and we expect to discuss whether other mechanisms are necessary to guard the District slipping back into a financial abyss and causing the Control Board to return. With appropriate safeguards, and strong and effective local leadership, we will avoid a return to the bad not-so-old days when the District borrowed money from the Federal Treasury just to keep the government running, and when political interference transformed the city's revenue and expenditure estimates into works of fiction.

In a larger sense the demise of the Control Board presents us with an opportunity to revisit the entire Federal-local relationship in our Nation's Capital, a chance perhaps to build upon the 1997 Revitalization Act. Under that legislation, the Federal Government is soon to control many additional State functions of the District, in addition to relieving the city of its unfunded pension liability and reducing its share of Medicare costs. But as we go forward, let's keep in mind one important fact: Congress has an explicit constitutional obligation to oversee the District of Columbia, and while Mayor Williams and other officials have done a very impressive job in turning the District around, it's impossible for those of us here on the dais to simply turn our backs on that responsibility.

One of my goals as Chair of this subcommittee is to work with Congressman Joe Knollenberg, who chairs the D.C. Appropriations Subcommittee, and our Senate colleagues to further refine the Federal-local relationship and move the District closer to full home rule.

We've been asked to reexamine some of the congressional restraints, such as a required cash reserves equal to 7 percent of the District's budget, and the 30-day review period of legislation, and both Congressman Knollenberg and I have expressed our willingness to look into these issues. The District's progress over the past 5 years is the reason we're able to at least consider these steps. Guided by the firm hand of the Control Board, the District moved from the brink of insolvency into an era of surpluses and sensible fiscal management.

A city unable to clear the streets of snow, pick up trash regularly, open schools on time, or deliver needed human services has made significant strides in almost all areas. A government that struggles to issue bonds has seen its credit ratings rise from junk bond to investment level. To be sure, there is more work to be done by the city, as our city leaders will be the first to acknowledge. The city's structural budget problems need to be addressed before a weakened economy begins to slice into revenues. We have to find a way to repair and renovate D.C. schools at a faster pace, as well as improve the quality of their instruction. And the city is still lagging behind in the implementing of its financial management, personnel and procurement systems as part of its efforts to improve the efficiency of municipal government.

And that brings us to today's hearing. Let me be very clear, I have some reservations about the city's proposal for the position of the chief financial officer [CFO], which was created along with the Control Board. I believe that the CFO must remain independent, autonomous and insulated from political pressure. I am not totally convinced that the legislation as introduced by Chairwoman Cropp and Councilman Evans goes far enough. The proposal does not require the CFO to prepare fiscal impact statements on all or even most pieces of legislation, and removes some of his powers over personnel and his own budget. I am concerned that the individual chief financial officers of the various government agencies would not be directly appointed by or report to the District's chief financial officer.

In addition, I want to pose the concern that a chief financial officer whose term runs virtually concurrent with the Mayor's is suffi-

ciently independent. I worry that the CFO could be just another political appointment, certainly in the future beholden to the chief executive and the City Council.

Well, as such, I want to explore today the possibility of having some sort of special review of the city's revenue estimate and financial audit, as the Mayor has recently suggested and some Council members publicly have supported this week, having an independent body verify the city's revenue estimate, a process that would allow for substantial public scrutiny, could help ward off any political manipulation of the members. A revenue committee or an audit committee to review the District's financial audits should not be seen in any way as an extension of the Control Board, but as bodies whose members would be appointed by and would work with local officials.

We should keep in mind that it is extremely unusual for a city to see its control period end so abruptly, as is the case here. And because the city did not borrow any Federal money to aid in its recovery, there is no provision for a gradual phaseout of the Control Board. I know that this is of some concern to those who monitor the District's finances, as you will hear in the testimony from the managing director of Moody's Investment Service. So we have called this hearing to gain an honest assessment from city leaders, an honest assessment from the Control Board and outside financial experts about the District of Columbia's financial and management health and the short and long-term challenges it faces. I am looking forward to a lively and productive discussion.

I want to reiterate this is not micromanaging, this is looking ahead, congratulating you for what's been done and looking ahead to what do we need for the future. And so it's now my pleasure to recognize the distinguished ranking member of this D.C. Subcommittee, Congresswoman Eleanor Holmes Norton.

[The prepared statement of Hon. Constance A. Morella follows:]

CONSTANCE A. MORELLA  
8TH DISTRICT, MARYLAND

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COMMITTEE ON THE DISTRICT OF COLUMBIA  
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**CHAIRWOMAN CONSTANCE A. MORELLA  
HOUSE OVERSIGHT SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA  
PREPARED STATEMENT, "THE OUTLOOK FOR THE DISTRICT OF COLUMBIA  
GOVERNMENT: THE POST-CONTROL BOARD PERIOD"**

**JUNE 8, 2001**

It has been more than six years since the passage of legislation establishing the District of Columbia Financial Responsibility and Management Authority. Thanks to the city's turnaround – it has balanced its budget for four consecutive years, transformed a half-billion dollar debt into a nearly half-billion dollar surplus, cut the size of its workforce and begun to make improvements in government service – we have reached this point: Today, we are less than four months from the demise of Control Board. Even if we had a crystal ball, I doubt we would have foreseen this.

The purpose of our hearing is two-fold: First, to look back at the progress the District of Columbia has made over the past six years, to explore whether it has met all the goals of the 1995 Control Board Act and to gauge the success of that legislation. Secondly, we want to look ahead at ways to ensure D.C.'s financial and management success continues. I am very interested to hear from city leaders about their proposal to create an independent Chief Financial Officer and expect to discuss whether other mechanisms are necessary to guard against the District slipping back into a financial abyss and causing the Control Board to return. With appropriate safeguards, and strong and effective local leadership, we will avoid a return to the bad, not-so-old days when the District borrowed money from the federal Treasury just to keep the government running and when political interference transformed the city's revenue and expenditure estimates into works of fiction.

In a larger sense, the demise of the Control Board presents us with an opportunity to revisit the entire federal-local relationship in our nation's capital -- a chance, perhaps, to build

upon the 1997 Revitalization Act. Under that legislation, the federal government assumed control of many traditional “state” functions of the District, in addition to relieving the city of its unfunded pension liability and reducing its share of Medicaid costs.

But as we go forward, let us keep in mind one important fact. Congress has an explicit Constitutional obligation to oversee the District of Columbia. While Mayor Williams and other officials have done an impressive job in turning the District around, it is impossible for those of us here on the dais to simply turn our backs on that responsibility.

One of my goals as chairwoman of this subcommittee is to work with Congressman Joe Knollenberg, chair of the D.C. Appropriations Subcommittee, and our Senate colleagues to further refine the federal-local relationship and move the District closer to full home rule. We have been asked to re-examine some of the Congressional restraints – such as a required cash reserves equal to 7 percent of the District’s budget and the 30-day review period of legislation – and both Congressman Knollenberg and I have expressed our willingness to look into those issues.

The District’s progress over the past five years is the reason we are able to at least consider these steps. Guided by the firm hand of the Control Board, the District moved from the brink of insolvency into an era of surpluses and sensible fiscal management. A city unable to clear the streets of snow, pick up trash regularly, open schools on time or deliver needed human services has made significant strides in almost all areas. A government that struggled to issue bonds has seen its credit ratings rise from junk bond to investment level.

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As such, I want to explore today the possibility of having some sort of "special review" of the city's revenue estimate and financial audit, as the Mayor recently suggested and some Council members publicly supported this week. Having an independent body verify the city's revenue estimate – a process that would allow for substantial public scrutiny – could help ward off any political manipulation of the numbers. A revenue committee or an audit committee – to review the District's financial audits -- should not be seen in any way as an extension of the Control Board, but as bodies whose members would be appointed by, and would work with, local officials.

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We have called this hearing to gain an honest assessment from city leaders, the Control Board and outside financial experts about the District of Columbia's financial and management health and the short- and long-term challenges it faces. I am looking forward to a lively and productive discussion.

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Ms. NORTON. Thank you very much, Mrs. Morella. I thank our Chair Connie Morella for convening this hearing and for her efforts as a new Chair to assist the District. I also want to thank Senator George Voinovich, who served as Chair of the Senate D.C. Subcommittee previously and as a former mayor of Cleveland and Governor of Ohio, and made a special contribution to the city.

For Congress, of course, this is another in a series of important hearings. For the District today is more like a celebration. Technically the Authority is in place until September 30th. In reality, the District is well into its post-Control Board period. That period dates from January 1999, when Congress returned the powers to a new Mayor and a new City Council that had been lost through congressional attachments in the years following the enactment of the original Control Board statute. On that same date, the current chair Alice Rivlin and the second Control Board took office and began the transition to a fully empowered D.C. government.

We are grateful for the hard work of the Authority's first chair Andrew Brimmer and of the first Control Board, who got in the trenches with the District, helped the city to dig itself out of a financial hole. We are grateful as well to Alice Rivlin and her board for their many contributions, for respecting the home rule prerogative of our elected officials and insisting that the Mayor and the City Council run the D.C. government, and for beginning the transition to normal government 3 years ago.

The District was fortunate indeed in the quality of the extraordinary residents who came forward pro bono to serve on the Financial Authority. Unlike other cities that have faced the same financial difficulties, the District was the home of two of the country's leading economists and urban financial experts, who agreed to serve the Financial Authority and offered countless hours and suffered untold grief for their hometown.

Those of us who do not work with the city's finances on a daily basis may not have a full appreciation for what the District has achieved or, for that matter, what further needs to be done. Perhaps the best way to understand the city's accomplishments is to measure them against the four goal posts that Congress itself erected. Congressional goal post No. 1: Achieve four consecutive budgets in 4 years or start all over again. The District: Four consecutive balanced budgets achieved 2 years ahead of the congressional mandate, registering surpluses all 4 years, and, despite a somewhat weakened national economy, projecting yet another surplus year. In addition, D.C. has a \$150 million budget reserve now and by fiscal year 2003 will have a full 7 percent cash reserve as well, 3 years ahead of schedule.

Goal post No. 2: Get access to short and long-term credit markets at reasonable rates. The District: Attained investment grade bond status by the 3rd year of the control period rather than in 4 years.

Congressional goal post No. 3: Repay all borrowings from the U.S. Treasury. The District: Not only repaid all borrowings, but also eliminated its accumulated deficit.

Congressional goal post No. 4: Discharge all obligations arising from obligations issued by the Financial Authority. The District: No authority obligations ever issued.

Having surpassed all congressional requirements, the testimony we have received today shows District officials imposing on themselves an innovative set of controls over and above what the Authority statute requires, including a term for the chief financial officer and enhanced powers that increase the independence of the CFO. Separately the inspector general has come forward with proposals to strengthen the oversight and independence of his role as the city's primary investigator.

With the legislation the city now proposes, the District has met every statutory mandate imposed upon the city and gone well beyond. The time has come for Congress to keep its statutory promise. There is a great deal more for Congress to do than mull over and tweak what the District is doing for itself. Six years ago Congress placed on the District the toughest Control Board law in the country. Included in that law is a sunset provision. The District has more than kept its end of the bargain. Congress has no less an obligation. If Congress in any way seeks to renege on its statutory promise or to enact its own legislation against the will of the District of Columbia, it will find in me neither an affable or a silent partner or enabler.

Despite 4 years of astonishing progress by the District, Congress has yet to respond in kind. Textbooks uniformly teach that the best way to encourage responsible behavior is to reward it. Congress may not have read these texts. In some ways that is understandable. The Congress is fully equipped with four staffed subcommittees with little to do except watch an independent jurisdiction that is doing its job. Isn't it time for Congress to reciprocate by streamlining its own processes that impose costly burdens on D.C. taxpayers?

Next week I will ask the members of the subcommittee to be original cosponsors of a bill that I believe is justified by the progress upon which every member of the subcommittee has remarked. Yet this bill is not chiefly a reward to the District for a job Congress has said has been well done. The importance of this bill lies in the contribution it would allow Congress to make to the revitalization that Congress has required of the District. At the center of the Control Board mandate has been the requirement that the District streamline layers of government redundancy and inefficiency and that the city reduce the cost of government. However, because Congress has not reformed or streamlined its own oversight procedures for the city, D.C. taxpayers incur millions of dollars in extra and unnecessary expenses and in costly delay. To correct these problems, the D.C. Budget and Legislative Autonomy Act would provide budget and legislative autonomy for the District while, I emphasize, Congress would still retain its full powers under article 1, section 8 to exercise its oversight at will.

While the reform of the District government is a work still in progress, the greatest structural barrier to reform no longer lies with the District. It is the Congress that takes the typical 6-month budget process in States and cities, and makes it into a 12 to 18-month process for the District of Columbia.

It is the Congress that guarantees that no matter how well the District does financially, it will never have the best investment

bond rating because of the uncertainty created by the congressional budget process.

It is the Congress that forces the District to engage in contortions of temporary and stopgap procedures because D.C. legislation cannot become final for 30 or 60 legislative days, which often become months because of the congressional calendar and congressional recesses.

Even during the depths of the fiscal crisis and continuing into last year, Congress has consistently added delay to its already laborious budget process by seeing to it that the District budget was virtually last to be voted, often many weeks after the end of the fiscal year. These are hardships on the people of the District that they do not deserve and that Congress should relieve.

There is another indispensable step Congress should take to assure lasting stability. Perhaps inevitably Congress has focused almost exclusively on the expenditure side of the budget and paid almost no attention to the revenue side. Yet Congress is responsible for the most important structural revenue barriers the District faces. The District cannot collect property taxes from the Federal Government, and yet gets no payment in lieu of taxes and gets no payment in lieu of taxes for having its prime land off the tax rolls. The District's major industry, the Federal Government, exempts itself from normal income taxes that, for example, the biotechnical industry pays to Montgomery County and that the dot-com industry pays to Fairfax County. Yet Congress bars the District from collecting any taxes from commuters who wreck the city streets and freely use its police, fire and other costly services.

A nonresident tax credit is necessary to relieve congressionally imposed structural financial burdens on its capital. This revenue would come from the Federal Government at no cost to commuters because most of the employees who use D.C. services free of charge are Federal employees. The fully compensated 2 percent tax credit derived from taxes commuters already pay to the Federal Government would initially raise \$400 million, a fraction of the cost of services to commuters, and would rise gradually, with the wages of commuters used as a yardstick rather than as a source of revenue. I hope that the members of the subcommittee will also become original cosponsors of the D.C. Nonresident Tax Credit Act.

I appreciate the deference to home rule that the committees of the House and Senate often have shown the District. I now ask the committees to engage in the same self-examination Congress has required of the District. Congress can speed ongoing reform if city officials know that responsible government from them will yield more self-government from Congress. Congress can assure that the financial stability the District has achieved will be lasting if Congress faces and relieves the structural financial burdens for which Congress is wholly responsible. I ask no more than that Congress give the District the same respect Congress demands for its own districts.

District of Columbia officials have responded, complied, and surpassed expectations. Congress must now be mindful that the District is not the only party to this process that has obligations. Congress now has obligations it must meet to its capital.

I welcome today's witnesses and appreciate their testimony.

Mrs. MORELLA. Thank you, Ms. Norton.

[The prepared statement of Hon. Eleanor Holmes Norton follows:]

ELEANOR HOLMES NORTON  
District of Columbia

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DISTRICT OF COLUMBIA

CIVIL SERVICE AND  
AGENCY ORGANIZATION

**Statement of Congresswoman Eleanor Holmes Norton  
District of Columbia Subcommittee Hearing  
"Outlook for the District in the Post-Control Board Period"**

**June 8, 2001**

May I thank our chair, Connie Morella, for convening this hearing and for her efforts as a new chair to assist the city. I also want to thank Senator George Voinovich, who served as chair of the Senate D.C. Subcommittee, and as a former mayor of Cleveland and governor of Ohio, made a special contribution to the city. For Congress, of course, this is another in a series of important hearings. For the District, today is more like a celebration. Technically, the Authority is in place until September 30<sup>th</sup>. In reality, the District is well into its post-control board period. That period dates from January 1999, when Congress returned the powers to a new Mayor and a new City Council, that had been lost through congressional attachments in the years following the enactment of the original control board statute. On that same date, the current chair, Alice Rivlin, and the second control board took office and began the transition to a fully empowered D.C. government. We are grateful for the hard work of the Authority's first chair, Andrew Brimmer, and of the first control board, who got in the trenches with the District helping the city to dig itself out of a financial hole. We are grateful as well to Alice Rivlin and her board for their many contributions, for respecting the home rule prerogatives of our elected officials and insisting that the Mayor and the City Council run the D.C. government, and for beginning the transition to normal government three years ago. The District was fortunate indeed in the quality of the extraordinary residents who came forward *pro bono* to serve on the Financial Authority. Unlike other cities that have faced the same financial difficulties, the District was the home of two of the country's leading economists and urban financial experts, who agreed to serve the Financial Authority and offered countless hours and suffered untold grief for their home town.

Those of us who do not work with the city's finances on a daily basis may not have a full appreciation for what the District has achieved. Perhaps the best way to understand the city's accomplishments is to measure them against the four goal posts that Congress itself erected. Congressional Goal Post Number 1: Achieve four consecutive balanced budgets in four years or start all over again. The District: Four consecutive balanced budgets achieved two years ahead of the congressional mandate, registering surpluses all four years, and despite a somewhat weakened economy, projecting yet another surplus year. In addition, D.C. has a \$150 million budget reserve now and by FY03 will have a full 7% cash reserve as well, three years ahead of

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schedule. Congressional Goal Post Number 2: Get access to short and long term credit markets at reasonable rates. The District: Attained investment grade bond status by the third year of the control period, rather than in four years. Congressional Goal Post Number 3: Repay all borrowings from the U.S. Treasury. The District: Not only repaid all borrowings, but also eliminated its accumulated deficit. Congressional Goal Post Number Four: Discharge all obligations arising from obligations issued by the Authority. The District: No Authority obligations issued.

Having surpassed all congressional requirements, the testimony we have received today shows District officials imposing on themselves an innovative set of controls over and above what the Authority statute requires, including a term for the Chief Financial Officer and enhanced powers that increase the independence of the CFO. Separately, the Inspector General has come forward with proposals to strengthen the oversight and independence of his role as the city's primary investigator. With the legislation the city now proposes, the District has met every statutory mandate imposed upon the city and gone well beyond.

The time has come for Congress to keep its statutory promise. There is a great deal more for Congress to do than mull over and tweak what the District is doing for itself. Six years ago, Congress placed on the District the toughest control board law in the country. Included in that law is a sunset provision. The District has more than kept its end of the bargain. Congress has no less an obligation. If Congress in any way seeks to renege on its statutory promise, it will not find in me an affable or silent enabler.

Despite four years of astonishing progress by the District, Congress has yet to respond in kind. Textbooks uniformly teach that the best way to encourage responsible behavior is to reward it. Congress may not have read these books. In some way this is understandable. The Congress is equipped with four, fully-staffed subcommittees with little to do except watch an independent jurisdiction that is doing its job. Isn't it time for Congress to reciprocate by streamlining its own processes that impose costly burdens on D.C. taxpayers?

Next week, I will ask the members of the subcommittee to be original cosponsors of a bill that I believe is justified by the progress upon which every member of the subcommittee has remarked. Yet this bill is not chiefly a reward to the District for a job Congress has said has been well done. The importance of this bill lies in the contribution it would allow Congress to make to the revitalization that Congress has required of the District. At the center of the control board mandate has been the requirement that the District streamline layers of government redundancy and inefficiency and that the city reduce the cost of government. However, because Congress has not reformed or streamlined its own oversight procedures for the city, D.C.'s taxpayers incur millions of dollars in extra and unnecessary expenses and in costly delay.

To correct these problems, the D.C. Budget and Legislative Autonomy Act would provide budget and legislative autonomy for the District while, I emphasize, Congress would still retain its full powers under Article I Section 8 to exercise its oversight at will. While the reform

of the District government is a work in progress, the greatest structural barrier to reform no longer lies with the District. It is the Congress that takes the typical six-month budget process in states and cities and makes it into a 12-18 month process for the District. It is the Congress that guarantees that no matter how well the District does financially, it will never have the best investment bond rating because of the uncertainty created by the congressional budget process. It is the Congress that forces the District to engage in contortions of temporary and stop gap procedures because D.C. legislation cannot become final for 30 or 60 legislative days, which often become months because of the congressional calendar and recesses. Even during the depths of the fiscal crisis and continuing into last year, Congress has consistently added delay to its own already laborious budget process by seeing to it that the District budget was virtually last to be voted, often many weeks after the end of the fiscal year. These are hardships on the people of the District that they do not deserve and that Congress should relieve.

There is another indispensable step Congress should take to assure lasting stability. Perhaps inevitably, Congress has focused almost exclusively on the expenditure side of the budget and paid almost no attention to the revenue side. Yet Congress is responsible for the most important structural revenue barriers the District faces. The District cannot collect property taxes from the federal government and yet gets no payment in lieu of taxes for having its prime land off the tax rolls. The District's major industry, the federal government, exempts itself from normal income taxes that, for example, the biotechnical industry pays to Montgomery County and that the dot-com industry pays to Fairfax County. Yet Congress bars the District from collecting any taxes from commuters who wreck the city's streets and freely use its police, fire, and other costly services.

A non-resident tax credit is necessary to relieve congressionally imposed structural financial burdens. This revenue would come from the federal government at no cost to commuters because most of the employees who use D.C. services free of charge are federal employees. The fully compensated 2% tax credit, derived from taxes commuters already pay to the federal government, would initially raise \$400 million, a fraction of the cost of services to commuters and would rise gradually, with the wages of commuters used as a yardstick rather than as a source. I hope that the members of the subcommittee will also become original cosponsors of the D.C. Non-Residents Tax Credit Act.

I appreciate the deference to home rule that the committees of the House and Senate often have shown the District. I now ask that the committees engage in the same self-examination Congress has required of the District. Congress can speed ongoing reform if city officials know that responsible government from them will yield more self government from Congress. Congress can assure that the financial stability the District has achieved will be lasting if Congress faces and relieves the structural financial burdens for which it is wholly responsible. I ask no more than that Congress give the District the same respect Congress demands for its own districts.

District of Columbia officials have responded, complied, and surpassed expectations. Congress must now be mindful that the District is not the only party to this process that has obligations. Congress now has obligations it must meet to its capital.

Mrs. MORELLA. It is now my pleasure to yield time to the gentleman who is my predecessor as Chair of this subcommittee Mr. Davis.

Mr. DAVIS. Thank you very much, Mrs. Morella. Thank you for continuing to provide outstanding leadership as Chair of this subcommittee and for holding this historic hearing. I look forward to working with you and our colleagues as we strive to maintain momentum for our Nation's Capital. I am confident we'll continue to be proactive. Working with the ranking member of this subcommittee, my good friend Delegate Holmes Norton, I'm certain we'll continue to address the city's many tough challenges in the spirit of bipartisan cooperation, respecting this city and its rights. That's the best way for us to guarantee that we can build on the progress that has been made.

You know, back in the last millennia the District of Columbia was in the midst of a crisis of epic proportions. That was just 6 years ago. But it was 10 years ago that a commission chaired by Dr. Alice Rivlin prophetically warned of an impending disaster. Dr. Rivlin called the numbers down to the decimal point on every fiscal issue. We are therefore indeed fortunate to have Dr. Rivlin serving as chair of the Control Board as it is about to enter its long-planned dormant stage.

Despite a lot of suspicion at the outset of this legislation, we always intended for the Control Board to work its way out of a job, which it has done, and the city has surpassed expectations for fiscal management earlier than I think any of us really anticipated and had some outstanding leadership get us there, and I applaud all of those who have—the Mayor and the Council who have worked together to make this historic event come about.

But I know that Dr. Rivlin and the members and the staff of the Control Board will be working until the end to perform their statutory responsibilities. Moreover, I fully expect that Dr. Rivlin will give us her expert opinion now and after the dormant stage is reached as to whether or not the city is in danger of reverting to the bad old days.

An item of great interest to us all is the status of the office of chief financial officer, which we created for the city as part of the Control Board Act. Again, we're in a unique position to get expert opinion on the future of that office not only from its outstanding current occupant Nat Gandhi, but from its first occupant Mayor Anthony Williams. Congress has worked with the city in a constructive way to strengthen and make more independent the CFO, and now that we stand at the crossroads, it's important that we reach a consensus as to any additional adjustments that may be deemed helpful.

Back in 1995, the District faced a spending problem of monumental proportions and a management failure as well. Basic service could not be delivered, and there were very real concerns that the city would run out of cash to pay its debt service or meet its payroll. So when we wrote the Control Board Act, we included seven such events, seven deadly sins, if you will, that would trigger a new control period. That provision is consistent with the other provisions for Control Board-like entities in the cities we surveyed

that had experienced similar problems, such as New York City, Philadelphia and Cleveland.

I'm aware that reference has been made to structural imbalance in the city, and some have pointed to the restriction in the Home Rule Act against the commuter tax. I have to reiterate my long-standing belief that should additional resources be necessary for the Nation's Capital, that this would be a Federal responsibility, and that would be unfair to impose an undue burden on regional commuters. This is, after all, a national responsibility, not just the responsibility of two States.

We were very careful in drafting the original statute to name the entity we created as the Financial Responsibility and Management Assistance Authority. Dr. Rivlin, I think that was your language, as we worked through that.

Ms. RIVLIN. It was sufficiently awkward that no one could ever remember it.

Mr. DAVIS. We deliberately avoided any such term as "Control Board," but nevertheless, the Authority was quickly morphed into what has ever since been called the Control Board. But that should not obscure our original intention, which is fully reflected in the various sections of the act. Congress, without a dissenting vote, backed up by a Presidential bill-signing ceremony in the Roosevelt Room of the White House, wanted to assist the city with management issues so that a higher degree of fiscal responsibility could be achieved, and that's been done.

As we look to the future with optimism, I can only reiterate what has been the D.C. Subcommittee's mantra since its creation in 1995, you can't have a healthy city—or you can't have a healthy region without a healthy city.

I thank you very much, and my congratulations to all.

[The prepared statement of Hon. Thomas M. Davis follows:]

THOMAS M. DAVIS  
11TH DISTRICT, VIRGINIA  
COMMITTEE ON GOVERNMENT REFORM  
CHAIRMAN  
SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA  
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REP. TOM DAVIS

DISTRICT OF COLUMBIA SUBCOMMITTEE

OPENING STATEMENT: JUNE 8, 2001

HEARING: D.C. POST-CONTROL BOARD

Thank you Congresswoman Connie Morella for continuing to provide such outstanding leadership as chair of the District of Columbia Subcommittee and for holding this historic hearing. I look forward to working with you and our colleagues as we strive to maintain momentum for the Nation's Capitol. I am confident that we will

continue to be proactive. Working with the Ranking Member of the Subcommittee, my friend Delegate Eleanor Holmes Norton, I'm certain we will continue to address the City's many tough challenges in a spirit of bi-partisan co-operation. That is the best way for us to guarantee that we build on the progress made.

Back in the last millennia, the District of Columbia was in the midst of a crisis of epic proportions. That was just 6 years ago. But 10 years ago, a Commission chaired by Dr. Alice Rivlin prophetically warned of an impending disaster. Dr. Rivlin called the numbers down to the decimal point on every fiscal issue. We are therefore indeed fortunate to have Dr. Rivlin serving as chair of the Control Board as it is about to enter its long-planned dormant stage. We always intended for the Control Board to work its way out of a job, which it has done. But I know that Dr. Rivlin and all members and staff of the Control Board will be working until the end to perform its statutory responsibilities. Moreover, I fully expect that Dr. Rivlin will give us her expert opinion

now and after the dormant stage is reached as to whether or not the city is in danger of reverting to the bad old days.

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Back in 1995 the District faced a spending problem of monumental proportions and a management failure as well. Basic services could not be delivered and there were very real concerns that the City would run out of cash to pay debt service or meet its payroll. So when we wrote the Control Board Act we included 7 such events--7 "deadly sins" if you

will-- that would trigger a new control period. That provision is consistent with other provisions for control board-like entities in the cities we surveyed that had experienced similar problems, such as New York City, Philadelphia, and Cleveland.

I'm aware that reference has been made to a "structural imbalance" in the city and that some have pointed to the restriction in the Home Rule Act against a commuter tax. I must reiterate my long-standing belief that should additional resources be necessary for the Nation's Capitol that this would be a federal responsibility, and that it would be unfair to impose an undue burden on regional commuters.

We were very careful in drafting the original statute to name the entity we created as the Financial Responsibility and Management Assistance Authority. We deliberately avoided any such term as "Control Board". Nevertheless, the "Authority" was quickly morphed into what has been ever since called the Control Board. But that should not obscure our original intention, which is fully reflected in the various

sections of the Act. Congress, without a dissenting vote, backed up by a Presidential bill-signing ceremony in the Roosevelt Room of the White House, wanted to ASSIST the city with management issues so that a higher degree of financial responsibility could be achieved. That was done.

As we look to the future with optimism I can only reiterate what has been D.C. Subcommittee's mantra since its creation in 1995: you can not have a healthy region without a healthy city.

Thank you.

Mrs. MORELLA. The timing is incredible of the distinguished Senator from Ohio Senator Voinovich.

Senator Voinovich, if you have time to catch your breath, I could raise you for an opening statement. We have already commented on your background as mayor of the city that was undergoing a financial Control Board. So we welcome you. I'll recognize you for any opening remarks.

Senator VOINOVICH. Thank you. I'll try to keep my statement short because of the important people that we have before us today.

It's a pleasure for me to return to this hearing room. Six years ago, I was sitting where Mayor Williams sits today at the witness table testifying on the city of Cleveland's success in recovering from a 1978 financial default that had ultimately spurred our economic recovery that continues today.

The purpose of the hearing was to learn how other cities dealt with their financial troubles in an effort to make the right choices for the District of Columbia. I was proud to sit at the witness table that day to boast of our accomplishments in Cleveland, and I hope, Mayor Williams, you feel the same way today.

As I mentioned at that hearing, I have always felt that the District should be a model for the Nation, a shining city on the hill, and in that regard I'm pleased to note that 6 years after the city was declared financially insolvent, the District is well on its way to becoming that shining city on the hill. Under the leadership of Mayor Williams, former Control Board chair Andrew Brimmer, and current Control Board chair Alice Rivlin, the District of Columbia has made great progress. Over the past 6 years the District has managed to accomplish all requirements necessary to suspend the Control Board. It has repaid all outstanding obligations to the Control Board and the U.S. Treasury, gained access to the short-term and long-term credit markets, and reported four consecutive balanced budgets.

In addition to achieving these requirements, public and private investments have sparked an economic revitalization downtown. It has had a positive impact on every aspect of the city. Residents have again begun to make an investment in the city, and home purchasing and development has soared as a result.

Yet despite these promising advancements, I do not believe the District is completely out of the woods. Based on reports from the General Accounting Office and the D.C. inspector general, as well as the status of the District's health system and education system, the majority of the District government still has a rough road in front of them. For example, GAO, in issuing its report this morning on the District's progress in adopting a performance-based government in concurrence with the subcommittee's findings at a hearing this past March, GAO concluded that District agencies were indeed moving the goal posts by holding themselves accountable to goals that were submitted in June, 9 months after the fiscal year began, rather than the goals established at the beginning of the year. GAO diplomatically explains that the late submission, "limits the use of the performance plans." And I want you to know that I share their concern.

In addition, as discussed at a House Appropriations subcommittee earlier this month, reports show that the unqualified opinions

of the District's financial statements are the result of a tremendous amount of work by a few key individuals rather than lasting institutional reforms in the financial management system. We're concerned about that. Sustaining sound financial management practices requires an investment in the human resources of the agencies that will allow the training to outlast the efforts of individual employees. The system has got to be in place. Without this type of investment in employee training, management advancements will likely rise and fall with changing administrations.

Finally, the issues facing the District education system, from the deteriorating facilities at the public elementary schools to the UDC's difficulties in collecting tuition, suggest that the District still has progress to make before it can comfortably boast financial recovery. I'll be interested in discussing these issues with the witnesses today, and I look forward to hearing their views on the future of financial oversight in the District of Columbia.

Thank you, Madam Chair.

Mrs. MORELLA. Thank you, Senator Voinovich, and thank you for joining with us in making this a joint subcommittee hearing.

[The prepared statement of Hon. George V. Voinovich follows:]

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**“The Outlook for the District of Columbia Government:  
The Post-Control Board Period”**

Opening Statement of  
Senator George V. Voinovich  
Subcommittee on Oversight of Government Management,  
Restructuring and the District of Columbia

Friday, June 8, 2001

Thank you, Madam Chairwoman. Good morning. It is with great pleasure that I return to this hearing room, six years after my initial visit in March 1995.

I was not up here on the dias at the 1995 hearing. I was sitting where Mayor Williams sits today, at the witness table, testifying on the city of Cleveland’s success in recovering from a 1978 financial default that ultimately spurred an economic recovery that continues today. The purpose of the hearing was to learn how other cities dealt with their financial troubles in an effort to make the right choices for the District of Columbia.

I was proud to sit at the witness table that day, to boast of our accomplishments in Cleveland, and I hope Mayor Williams feels the same today. As I mentioned at that hearing, I have always felt that the District should be a model for the Nation, our “shining city on the hill.”

In that regard, I am pleased to note that six years after this city was declared financially insolvent, the District is well on its way to becoming that “shining city on the hill.” Under the leadership of Mayor Anthony Williams, former Control Board Chair Andrew Brimmer and current Control Board Chair Alice Rivlin, the District of Columbia has made great progress.

Over the past six years, the District has managed to accomplish all requirements necessary to suspend the Control Board. It has repaid all outstanding obligations to the Control Board and the US Treasury, gained access to both short-term and long-term credit markets, and reported four consecutive balanced budgets.

In addition to achieving these requirements, public and private investments have sparked an economic revitalization downtown that has had a positive impact on almost every aspect of this city. Residents have again begun to make an investment in the city, and home purchasing and development have soared as a result.

Yet despite these promising advancements, I do not believe that the District is completely out of the woods. Based on reports from the General Accounting Office and the DC Inspector General, as well the status of the District's health system and education system, the Mayor and the District government still have a tough road in front of them.

For example, GAO is issuing its report this morning on the District's progress in adopting a performance based government. In concurrence with this Subcommittee's findings at a hearing this past March, GAO concluded that District agencies were indeed "moving the goalpost" by holding themselves accountable to goals that were submitted in June, nine months after the fiscal year began, rather than the goals established at the beginning of the year. GAO diplomatically explains that the late submission "limits the use" of the performance plans; I share that concern.

In addition, as discussed at a House appropriations subcommittee hearing earlier this month, reports show that the unqualified opinions of the District's financial statements are the result of a tremendous amount of work by a few key individuals rather than lasting institutional reforms in the financial management system. Sustaining sound financial management practices requires an investment in the human resources of the agencies that will allow the training to outlast the efforts of individual employees. Without this type of investment in employee training, management advancements will likely rise and fall with the changing of administrations.

Finally, issues facing the District's education system, from the deteriorating facilities at the public elementary schools to UDC's difficulties in collecting tuition, suggest that the District still has progress to make before it can comfortably boast of financial recovery.

I will be interested in discussing these issues with the witnesses today and I look forward to hearing their views on the future of financial oversight in the District of Columbia. Thank you, Madam Chairwoman.

Mrs. MORELLA. I'm going to ask the witnesses of this first panel if they would stand, and in accordance with the rules of the Government Reform Committee, we swear in all of those who are going to testify. So if you would raise your right hands.

[Witnesses sworn.]

Mrs. MORELLA. The record will indicate affirmative response by all.

Again, a procedure that we have established, not in terms of concrete, but we have established, is to allow each person testifying about 5 minutes for testimony to allow us an opportunity for questioning, and we have a subsequent panel before us, too. The testimony that you have presented to the subcommittees will be included in the record in its entirety. And so, if I could start with Dr. Rivlin.

Incidentally, I want to congratulate you on the honorary doctorate you received at Harvard yesterday. No small achievement.

Dr. Rivlin, I'll start with you, then, if you would have any comments to make.

Ms. RIVLIN. Thank you. We have joint testimony here today. We worked very hard together, the Mayor and the Council chair and myself. We worked hard at the staff level and at the principals' level to agree on a set of proposals, and so this is joint testimony, and we had agreed that the Mayor would present the testimony.

Mrs. MORELLA. All right. Splendid. We'll give you more than 5 minutes, Mr. Mayor, if you need that, since you're going to be testifying for the Control Board as well as the City Council and yourself as Mayor. You may proceed.

**STATEMENTS OF ALICE RIVLIN, CHAIR, FINANCIAL CONTROL BOARD; ANTHONY WILLIAMS, MAYOR, DISTRICT OF COLUMBIA; LINDA W. CROPP, CHAIR, COUNCIL OF THE DISTRICT OF COLUMBIA; AND J. CHRISTOPHER MIHM, DIRECTOR, STRATEGIC ISSUES, GENERAL ACCOUNTING OFFICE**

Mayor WILLIAMS. I appreciate that, Chairman Morella, and our own Congresswoman, Eleanor Holmes Norton, thank you as always for your leadership. Senator Voinovich, thank you for friendship and partnership with our city, and we value that, especially given your own leadership in Cleveland as mayor and certainly in Ohio as Governor.

As Mayor of the District, I am pleased to testify on behalf of myself, the D.C. Council chair Linda Cropp, and our D.C. Control Board chairman Alice Rivlin, as well as the citizens of the District. We're assembled here today at a very important milestone in the history of the District. Since entering a control period 6 years ago, the District has transformed itself from a struggling city on the verge of bankruptcy to a thriving community reaching reassuring levels of financial security, making rapid progress in service quality, and reaching new heights in citizen involvement.

The District achieved this turnaround by rebuilding and reenergizing the financial management structures of government. The significance of this change is really threefold: First, we restored the financial health of this city so that we can now better respond to the needs of citizens. Second, by demonstrating our capacity for financial management, we earned the return of the au-

tonomy we once knew. And third, we set in place a system that will continue improving services, continue building financial strength and continue to earn greater levels of autonomy and self-governance for the citizens of the District.

The District achieved these advancements in partnership with the Congress. In order to achieve our greater goals of prosperity and democracy, we hope to continue to work in partnership with you. To that end I'll now review these achievements for the record so that we may find common understanding upon which to build a common future.

Of all the District's accomplishment, perhaps none stands above the tremendous financial recovery achieved over the past 6 years. You consider our condition at the outset of the control period in 1995 and compare the state of affairs today. In 1995, you saw serious cash shortages because Wall Street downgraded the District's bond rating to junk bond status. Now the District's bonds rank as investment grade, and the District is building hundreds of millions of dollars in cash reserves, 7 percent in cash reserves as a percent of local operations, in excess of every other State and local government in the country, as far as I can tell.

In 1995, you saw a \$484 million accumulated deficit, which continued growing through annual budget deficits. Now the District balances its budget every year, and we have amassed a \$464 million accumulated surplus, and this surplus is still growing year after year.

Based on these achievements the Control Board has certified that the District has met the terms required for an end to the control period, but our achievements don't end there. In 1995, you saw financial systems and staff incapable of producing reports that would meet the standards of independent auditors. Obviously there are still problems, there are still challenges, but now the District closes and balances its books on a monthly basis, and we achieve clean unqualified reviews from the inspector general and our independent financial auditors every year.

And finally, in 1995, you saw major flaws in basic financial functions such as paying vendors on time, processing tax receipts and validating payroll. Now the District maintains the infrastructure to meet and in many cases exceed industry standards for financial management. And one indicator I would give you, for example, is on tax refunds where we exceed many other jurisdictions across the country and in many instances the IRS.

In achieving these advancements we did not move from poor operations to average operations and then end our efforts. We have strived and continued striving to continuously improve our operations. Many observers don't realize this, but facing a crisis can actually strengthen an organization and help it grow not only to match its peers, but to surpass them. Such is the case here in the District. To overcome financial crisis, we developed a tremendous amount of positive momentum. We have become a learning organization, and we are improving our flexibility, our use of technology, and our focus on results.

I give you just a tidbit on technology. Our Web site has gone from essentially nothing to a Web site where last month we had over 3 million visitors to the District Web site. That's a lot of visi-

tors to any Web site, let alone a government Web site, and we're proud of that.

As such our goal is not to return to the pre-Control Board days. We have set our sights on something much greater. Our goal is to meet the highest standards of financial strength and to use that strength as a foundation for building the quality of services and world-class neighborhoods that our citizens deserve.

Given that goal, our testimony today, our joint testimony, seeks to accomplish two things: First, to engage Congress in devising a rational exit strategy at the end of the control period, and, second, to look beyond the control era and set a new course for the District's continued evolution.

To take up the first task, the Council, the Financial Authority and I have jointly developed a plan to effect the transition of financial control from the Authority to elected leadership, the Mayor, yours truly, and the Council under Chairman Cropp. In order—in recognition of our restored autonomy, we propose to effect this transition through local legislation which we have drafted and the Council has introduced in anticipation of this hearing. Our intention in doing so was to provide a proposal for your review as we devise a solution in partnership.

The plan we propose incorporates the infrastructure developed in the control period into the regular operations of District government, and in so doing it ensures that the District will never deviate from the financial discipline developed during this era. To that end the District's plan is built on the following provisions: One, insulation of the CFO, achieving independence for the CFO without creating the CFO as an outpost outside of the regular affairs and operations and mission of the District government. First, it maintains the functions and operations of the chief financial officer. Under the District's plan the office of the CFO will continue to manage the treasury, accounting, tax and budget functions of the government. Rather than reporting to the Control Board, however, the CFO will now report to the Mayor.

In devising this reporting relationship, the challenge became finding a balance between, on the one hand, returning financial authority to the elected officials who must be accountable for fiscal management and, on the other hand, insulating the CFO from pressures that may compromise the execution of his duties. We address this challenge by incorporating the existing Federal provisions for appointment and removal of the CFO. For appointment this plan requires a decision of the Mayor and approval of a Council majority and allows for renewable appointments. For removal our plan requires a decision of the Mayor, which can only be for cause, and the approval of two-thirds of Council members present and voting. These provisions will allow for the CFO to serve as an integrated part of the executive branch while necessarily remaining insulated from undue political pressure from any one source.

Moreover, our plan strengthens the CFO's role by requiring him or her to complete fiscal impact statements for all local legislation and certify funding availability for all labor agreements. As an additional check and balance, this plan specifies a 4-year term for the CFO to provide for consistency in the office's leadership and to en-

sure the executive fully assumes accountability for financial operations of government.

We have made special provisions for budget formulation and revenue estimates, because, as a second provision, the District's transition plan recognizes that certain financial processes require special definition. Most important among these are budget formulation and revenue forecasting. In the budget formulation process, we will be best served by following the model used by virtually all governments at the Federal, State and local level. In this model the executive, supported by a strong budget staff, develops a budget proposal based on his or her policy direction. This proposal is then reviewed by the legislature, which is supported by a strong and separate budget staff. The creative tension between these two bodies fosters an environment of full transparency and rigorous review and accountability. This review in turn results in a process whereby only the ideas with the greatest merit and broadest support earn the taxpayers' support and, hence, dollars.

In the District's transition plan, the Office of Budget and Planning reports to the CFO as part of the executive branch. For purposes of budget formulation, however, the budget office executes the dual responsibilities of validating expenditure projections with an objective analysis and developing the proposed budget as part of the Mayor's policy agenda. This provision ensures integrity in the budget numbers and appropriate resources for the executive's responsibility for policy formulation. So the Mayor should be able to make a proposal to the Council on what we want to do with Medicaid programming and Medicaid expansion as a matter of policy, but it's up to the CFO to really take responsibility to ensure that I don't decide, or if some future Mayor decides and proposes to the Council, that we're going to save money by assuming that Medicaid will never grow. That would be an example of how that can and should work.

Like budget formulation, the revenue estimation process also requires special definition. Revenue forecasting requires a unique level of advanced and objective analysis where small changes in growth rates yield large changes in projected revenues. Given this sensitivity, these projections require the opposite treatment of the budget formulation process. Although revenue estimation must be made transparent and be thoroughly understood by policymakers, we believe this function must remain insulated from undue influence and, therefore, should continue to operate under the direct control of the CFO. The District's transition plan maintains this direct control. And needless to say, we believe it's in the revenue estimation where you get into a lot of trouble, and that's why we give this special definition to that function.

Finally, we want to talk about agency CFOs. The final provision of the District's transition plan realizes the reporting relationship of agency CFOs. At the onset of the control period, I, as CFO, identified a need to position agency-level CFOs in the largest and most troubled agencies. While this new structure greatly accelerated the financial reform of these agencies and certainly helped, needless to say, in budget control, it also created two side effects. First, and I witnessed this firsthand, it limited the ability of agency directors to integrate financial considerations in their programmatic deci-

sions as effectively as is necessary in a complex organization. And second, it made it difficult to hold agency directors directly accountable for the financial performance of their operations.

Now that we've undergone a structural reform of the financial operations across the District, we must now reintegrate financial and programmatic functions under the leadership of agency directors. The District's transition plan accomplishes this by maintaining the agency CFO positions and creating a dual reporting relationship to the agency director and District CFO. To ensure that agency CFOs maintain some independent authority, this plan requires that agency directors appoint their agency CFOs only with the approval of the District CFO. Likewise, both the agency director and the District CFO will be responsible for performance evaluations and disciplinary action, with each manager devising performance standards relevant to their scope of responsibility.

In the event of termination, however, an authority must ultimately lie with the District CFO. We find this provision necessary because the District CFO carries the greatest expertise in and the most direct responsibility for preserving the financial integrity of this government.

Taken together, these provisions for financial leadership and processes are built on the practices developed by the Mayor, Council and Financial Authority over the past 6 years. You will note that this plan institutionalizes at a local level the strong aspects of the structure established by the Congress.

Finally, a plan for performance-based autonomy. As your committees begin their deliberation in this matter, they will be well served by remaining very conscious of the previous context and future impact of these decisions. Specifically we must be aware of how these decisions will impact, affect the continued evolution of the District government and the citizens here.

On the issue of self-government, multiple people have proposed multiple solutions, but unfortunately little has changed for the more than half-million citizens in the District. I'm sure we all agree that taxation without representation is wrong, as it was two centuries ago. The question now is how to correct this problem. The District, of course, would welcome a comprehensive solution from the Congress, but in the absence of that, the end of the control period at the very least provides an opportunity to incrementally improve the level of democratic influence that Americans in the District exercise over their local affairs. Specifically, we propose that the Congress adopt a performance-based autonomy plan whereby the District gains incrementally greater autonomy based on the continuing strengthening of its management.

Five years ago Congress assumed control of the District's finances as a result of the District's performance. Now the control period is ending, again as a result of the District's performance. This experience, though a difficult one, provides a new modeling for how the Congress should exercise oversight of the District based on performance.

Accountability, though, is a two-sided coin. If the Congress were to restrict the District's autonomy when our performance lags, it should also increase our autonomy when the performance is strong. Specifically the Congress should set a new set of performance tar-

gets similar to those set to bring an end to the control period. We propose the following: Maintaining a balanced budget, maintaining an investment-grade bond rating, receiving an unqualified independent financial audit, and establishing a cash reserve equal to 7 percent of local operating expenditures, and replenishing any draws within 3 years.

After achieving these targets for 3 consecutive years, the Congress would exempt the District's budget from the Federal appropriations process. Upon achieving those targets for another 3 years, the Congress should exempt the District from the 30-day legislative review process. If any fiscal year after a measure of autonomy is earned the District fails to meet any of those criteria, the Congress could suspend budget autonomy in order to regain it. This solution allows the Congress to fulfill its constitutional charge to provide oversight, while at the same time providing the District with the budgetary autonomy needed to deliver services effectively.

Although this performance-based autonomy proposal may not be the primary consideration for these committees at this time, it represents the critical context for the sunset of the control period, and it represents a tremendous opportunity for this body to usher in a new era of greater rationality and fairness in the congressional oversight of the District of Columbia.

Likewise, by establishing this provision, the Congress will create an opportunity for Americans in the District to take a small but significant step toward achieving what every other American enjoys, and that is a full voice in electing those who govern our affairs.

With that thought in mind, and, again, on behalf of myself, Chairman Cropp, Dr. Rivlin and the citizens of the District, I conclude my testimony, and all of us are now available for any questions you may have.

Mrs. MORELLA. Thank you.

[The joint prepared statement of Mayor Williams, Ms. Rivlin and Ms. Cropp follows:]



**Joint Testimony of the Mayor, Council, and Financial Authority  
of the District of Columbia**

at the

**Joint Hearing before the**

**Committee on Government Reform  
Subcommittee on the District of Columbia**

**Committee on Governmental Affairs  
Subcommittee on Oversight of Government  
Management, Restructuring, and the  
District of Columbia**

**U.S. House of Representatives**

**U.S. Senate**

**The Honorable Constance A. Morella  
Chairwoman**

**The Honorable Richard J. Durbin  
Chairman**

**June 8, 2001**

Good morning Chairwoman Morella, Chairman Durbin, Congresswoman Norton, and members of the committee. As Mayor of the District of Columbia, I am pleased to testify on behalf of myself, D.C. Council Chairman Linda Cropp, D.C. Financial Authority Chairman Alice Rivlin, and the citizens of the District of Columbia.

We are assembled here today at a very important milestone in the history of the District of Columbia. Since entering a control period six years ago, the District has transformed itself – from a struggling city on the verge of bankruptcy to a thriving community reaching reassuring levels of financial security, making rapid progress in service quality, and reaching new heights in citizen involvement.

The District achieved this turnaround by rebuilding and reenergizing the fundamental management structures of government. The significance of this change is threefold.

- First, we restored the financial health of this city so that it can now better respond to the needs of its citizens;
- Second, by demonstrating our capacity for financial management, we earned the return of the autonomy that we once knew; and
- Third, we set in place a system that will continue improving services, continue building financial strength, and continue to earn greater levels of autonomy and self-governance for the citizens of the District.

The District achieved these advancements in partnership with the Congress. In order to achieve our greater goals of prosperity and democracy, we hope to continue to work in partnership with you. To that end, I will now review these achievements for the record so that we may find a common understanding upon which to build our common goals for the future.

#### **A Solid Fiscal Foundation**

Of all the District's accomplishments, perhaps none stands above the tremendous financial recovery achieved over the past six years. Consider our condition at the outset of the control period in 1995, and compare the state of affairs today:

- In 1995, you saw a serious cash shortage because Wall Street downgraded the District's bond rating to junk bond status. Now the District's bonds rank as investment grade, and the District is building hundreds of millions of dollars in cash reserves.
- In 1995 you saw a \$484 million accumulated deficit, which continued growing through annual budget deficits. Now the District balances its budget every year, we have amassed a \$464 million accumulated surplus – and this surplus is still growing, year after year.

Based on these achievements, the Control Board has certified that the District has met the terms required for an end to the control period. Our achievements do not end there, however.

- In 1995 you saw financial systems and staff incapable of producing reports that would meet the standards of independent auditors. Now the District closes and balances its books on a monthly basis, and we achieve clean, unqualified reviews from the inspector general and our independent financial auditors – every year.
- And finally, in 1995, you saw major flaws in basic financial functions such as paying vendors on time, processing tax receipts, and validating payroll. Now the District maintains the infrastructure to meet – and in many cases exceed – industry standards for financial management.

In achieving these advancements, we did not move from “poor” operations to “average” operations and then end our efforts. We strived – and continue striving – to continuously improve our operations.

Many observers don’t realize this, but facing a crisis can actually strengthen an organization and help it grow – not only to match its peers, but to surpass them. Such is the case for the District. To overcome financial crisis, we developed a tremendous amount of positive momentum. We have become a learning organization, and we are improving our flexibility, use of technology, and focus on results. We are striving to become the type of organization that “good government” advocates hold up as a model to the nation.

As such, our goal is not to return to the pre-control board days. We have set our sights on something much greater. Our goal is to meet the highest standards of financial strength, and to use that strength as a foundation for building the quality services and the world-class neighborhoods that our citizens deserve.

#### **Post-Control Period Structure**

Given that goal, our testimony today seeks to accomplish two things: First, to engage Congress in devising a rational exit strategy at the end of the control period; and second, to look beyond the control era, and set a new course for the District’s continued evolution.

To take up the first task, the Council, Financial Authority, and I have jointly developed a plan to affect the transition of financial control from the Authority to the elected leadership. In recognition of our restored autonomy, we propose to affect this transition through local legislation, which we have drafted, and the Council has introduced in anticipation of this hearing. Our intention in doing so was to provide a proposal for your review as we devise a solution in partnership.

The plan we propose incorporates the infrastructure developed in the control period into the regular operations of the District government. In so doing, it ensures that the District will never deviate from the fiscal discipline developed during that era. To that end, the District’s plan is built on the following provisions.

#### **Insulation of the CFO**

First, it maintains the functions and operations of the Chief Financial Officer. Under the District’s plan, the office of the CFO will continue to manage the treasury, accounting, tax, and budget functions of the government.

Rather than reporting to the Control Board, however, the CFO will now report to the Mayor. In devising this reporting relationship, the challenge became finding a balance

between, on one hand, returning financial authority to the elected officials who must be accountable for fiscal management, and on the other hand, insulating the CFO from pressures that may compromise the execution of his duties.

We addressed this challenge by incorporating the existing federal provisions for appointment and removal of the CFO. For appointment, this plan requires a decision of the mayor and approval of a Council majority, and allows for renewable appointments. For removal, our plan requires a decision of the mayor, which can only be for cause, and the approval of 2/3 of Council members present and voting. These provisions will allow the CFO to serve as an integrated part of the executive branch, while remaining insulated from undue pressure from any one source.

Moreover, our plan strengthens the CFO's role by requiring him or her to complete fiscal impact statements for all local legislation, and certify funding availability for all labor agreements. And as an additional check and balance, this plan specifies a four-year term for the CFO to provide for consistency in the office's leadership, and to ensure the executive fully assumes accountability for the financial operations of the District.

#### **Special Provisions**

As a second provision, the District's transition plan recognizes that certain financial processes require special definition. Most important among these are budget formulation and revenue forecasting. In the budget formulation process, we will be best served by following the model used by virtually all governments at the federal, state, and local level. In this model, the executive, supported by a strong budget staff, develops a budget proposal based on his or her policy direction. This proposal is then reviewed by the legislature, which is supported by a strong and separate budget staff. The creative tension between these two bodies fosters an environment of full transparency and rigorous review. This review, in turn results in a process whereby only the ideas with the greatest merit and broadest support earn the taxpayer's dollar.

In the District's transition plan, the Office of Budget and Planning reports to the CFO as part of the executive branch. For purposes of budget formulation, however, the budget office executes the dual responsibilities of validating expenditure projections with objective analysis, and developing the proposed budget as part of the mayor's policy agenda. This provision ensures integrity in all budget numbers and appropriate resources for the executive's responsibility for policy formulation.

Like budget formulation, the revenue estimation process also requires special definition. Revenue forecasting requires a unique level of advanced and objective analysis, where small changes in growth rates yield large changes in projected revenues. Given this sensitivity, these projections require the opposite treatment of the budget formulation process. Although revenue estimation must remain transparent and be thoroughly understood by policy makers, this function must remain insulated from undue influence, and therefore should continue to operate under the direct control of the CFO. The District's transition plan maintains this direct control.

### **Agency CFOs**

The final provision of the District's transition plan realigns the reporting relationship of agency CFOs. At the outset of the Control Period, I – as CFO – identified a need to position agency-level CFOs in the largest and most troubled agencies. While this new structure greatly accelerated the financial reform of these agencies, it also created two side effects. First, it limited the ability of agency directors to integrate financial considerations in their programmatic decisions as effectively as is necessary in a complex organization. Second, it made it difficult to hold agency directors directly accountable for the financial performance of their operations.

Now that we have undergone a structural reform of financial operations across the District, we must now re-integrate financial and programmatic functions under the leadership of agency directors. The District's transition plan accomplishes this by maintaining the agency CFO positions and creating a dual reporting relationship to the agency director and District CFO. To ensure that agency CFOs maintain some independent authority, this plan requires that agency directors appoint their agency CFOs only with the approval of the District CFO. Likewise, both the agency director and the District CFO will be responsible for performance evaluations and disciplinary action, with each manager devising performance standards relevant to their scope of responsibility. In the event of termination, however, authority must ultimately lie with the District CFO. We find this provision necessary because the District CFO carries the greatest expertise in, and the most direct responsibility for, preserving the financial integrity of the District.

Taken together, these provisions for the financial leadership and processes are built on the practices developed by the Mayor, Council, and Financial Authority over the past six years. You will note that this plan institutionalizes, at a local level, the strong aspects of the structure established by the Congress.

### **Performance-Based Autonomy**

But as your committees begin their deliberation on this matter, they will be well served by remaining very conscious of the previous context and future impact of your decisions. Specifically, we must be aware of how these decisions will impact the continued evolution of the District government and the citizens who live here.

On the issue of self-government, multiple people have proposed multiple solutions, but unfortunately, little has changed for the more than half million Americans in the District. I'm sure we all agree that taxation without representation is as wrong as it was two centuries ago – the question now is how to correct this problem. The District, of course, would welcome a comprehensive solution from the Congress; but in the absence of that, the end of the control period at very least provides an opportunity to incrementally improve the level of democratic influence that Americans in the District exercise over

their local affairs. Specifically, we propose that the Congress adopt a Performance-Based Autonomy plan, whereby the District gains incrementally greater autonomy based on the continued strengthening of its management.

Five years ago, Congress assumed control of the District's finances as a result of the District's performance. Now, the control period is ending, again, as a result of the District's performance. This experience, though a difficult one, provides a new model for how Congress should exercise oversight of the District – *based on performance*.

Accountability is a two-sided coin. If the Congress will restrict the District's autonomy when our performance lags, it should also increase our autonomy when our performance is strong. Specifically, the Congress should set a new set of performance targets, similar to those set to bring an end to the control period. We propose the following:

- Maintaining a balanced budget;
- Maintaining an investment grade bond rating;
- Receiving an unqualified independent financial audit; and
- Establishing a cash reserve equal to seven percent of local operating expenditures, and replenishing any draws within three years;

After achieving these targets for three consecutive years, the Congress would exempt the District's budget from the federal appropriations process. Upon achieving those targets for another three years, the Congress should exempt the District from the 30-day legislative review process.

If, in any fiscal year after a measure of autonomy is earned, the District fails to meet any of those criteria, the Congress could suspend budgetary autonomy, and the District must meet the criteria established above in order to regain it. This solution allows the Congress to fulfill its constitutional charge to provide oversight, while at the same time providing the District with the budgetary autonomy needed to deliver services effectively.

Although this Performance-Based Autonomy proposal may not be the primary consideration for these committees at this time, it represents the critical context for the sunset of the control period, and it represents a tremendous opportunity for this body to usher in a new era of greater rationality and fairness in the Congressional oversight of the District of Columbia.

Likewise, by establishing this provision, the Congress will create an opportunity for Americans in the District to take a small but significant step toward achieving what every other American enjoys – a full voice in electing those who govern.

With that thought, and on behalf of myself, Chairman Cropp, Dr. Rivlin, and the citizens of the District, I conclude this testimony. We will now gladly respond to any questions or comments that you may have.

Mrs. MORELLA. Ms. Cropp, would you like to make any opening statement, or do you—

Ms. CROPP. I'll wait for questioning. The Mayor spoke for the Council.

Mrs. MORELLA. We'll have order in this hearing room.

It's now my pleasure to recognize J. Christopher Mihm, who is the Director of Strategic Issues of the General Accounting Office. Your testimony, sir.

Mr. MIHM. Thank you, Madam Chairwoman, Congresswoman Norton and Senator Voinovich. I am honored and pleased to be here today to discuss the outlook for the District of Columbia in a post-Authority period.

I'll briefly cover three topics this morning. First, I will note the central elements in the District's financial recovery since 1995 and the continuing long-term challenges it faces. Second, I'll discuss some of the new reporting requirements that Congress has put in place since 1995 to assist it in oversight and decisionmaking. And finally, as requested, I'll identify some additional mechanisms that Congress may wish to consider to ensure that it and the District have the information needed to help the District maintain its financial viability.

First, in regards to the city's financial recovery, as has been widely noted this morning, since 1995, aided by a strong local economy and through the combined and cooperative efforts of the Authority, the District government, Congress and the citizens of the District, the District has experienced a remarkable turnaround in its financial condition. All of the Members' opening statements, and as Mayor Williams detailed, the District has made outstanding progress in dealing with its deficits and paying down its debts, obtaining access to the bond markets and obtaining clean financial audit opinions.

It in no way minimizes this remarkable achievement to note, however, that the District, similar to many other cities, continues to face a series of substantial long-term challenges to its financial status. Addressing these challenges requires continued dedicated and inspired leadership to make the hard decisions and often painful tradeoffs among equally compelling needs and priorities. Sound financial and program costs and performance information is and will be critical to making these decisions in an economical, efficient and effective manner.

This then gets to the second point I wish to cover this morning. Since 1995, Congress has put in place a number of reporting requirements to help provide the financial planning and performance information that it needs to conduct effective oversight and make decisions. One of the potentially more valuable requirements that Congress has put in place for the District is similar to the requirements Federal agencies have under the Government Performance and Results Act to produce annual performance plans and subsequent reports. In that regard we are—as Senator Voinovich noted, we are releasing today our assessment of the District's fiscal year 2000 performance report.

My point here is that we should keep these new reporting requirements in mind as any additional ones are considered and debated.

Third and finally, Congress may wish to consider additional mechanisms to ensure that it and the District have the information needed to help the District maintain its financial viability and address its current and emerging challenges. Such mechanisms must be considered and implemented within a context that seeks to balance two sets of values, the overriding importance of home rule and respect for the District's democratic institutions on the one hand, and Congress's oversight decisionmaking—oversight decision-making responsibilities for the Nation's Capital on the other.

My written statement details a number of options that have been widely discussed, including assuring the independence of the CFO, which was, of course, discussed by the Mayor and the subject of the District's legislative initiative earlier this week, maintaining the independence of the inspector general, and the possibility of forming an audit committee or similar arrangement. One option that Congress may wish to specifically consider is requiring the District to notify it if certain predefined reportable events occur that require the prompt attention of the District and Congress.

Under the law, an Authority or Control Board could be reestablished if any number of a specific set of major events occur, such as the default on the District's borrowing or failure to meet payroll. The major events that do lead to this reestablishment are clearly to be avoided at nearly all cost, but to do so, the District and Congress need information in time to act before a crisis occurs that would lead to the return of an Authority. A reportable event notification system could be designed to provide just such information. Such a system would be generally consistent with the approaches that have been taken from other jurisdictions, and my written statement details some principles that Congress may wish to keep in mind if it considers such an arrangement.

In summary, the District and its citizens, the Authority and Congress have jointly achieved an enormous accomplishment in restoring the District to financial viability. Nevertheless, the District and Congress must have reliable, accurate and timely financial and program cost information if they are to respond to pressures and warning signs that could indicate that future difficulties lie ahead; in short, if they are to deal with problems before they become full-blown crises.

Madam Chairwoman, this concludes my prepared statement. I would be pleased to respond to any questions you or other members of the subcommittees may have.

Mrs. MORELLA. I thank you for your statement and want you to know that your entire statement as submitted will be included in the record.

[The prepared statement of Mr. Mihm follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on the District of Columbia,  
Committee on Government Reform, House of  
Representatives and Subcommittee on Oversight of  
Government Management, Restructuring and the  
District of Columbia, Committee on Governmental  
Affairs, U.S. Senate

For Release on Delivery  
Expected at 11:00 a.m. EDT  
Friday June 8, 2001

DISTRICT OF COLUMBIA

Oversight in the Post-  
Control Board Period

Statement of J. Christopher Mihm  
Director, Strategic Issues



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Madam Chairwoman, Mr. Chairman, and Members of the Subcommittees:

I am pleased to be here today to discuss issues relating to the suspension of the activities of the District of Columbia Financial Responsibility and Management Assistance Authority (Authority). As agreed with the Subcommittees, my comments this morning will cover three topics. First, I will highlight the central elements in the District's financial recovery since 1995 and the continuing long-term challenges it faces. Second, I will discuss some of the new reporting requirements that Congress has put in place since 1995 to assist it in oversight and decision-making regarding the District. Finally, as requested, I'll identify some additional mechanisms that Congress may wish to consider to ensure that it and the District have the information needed to help the District maintain its financial viability.

In response to the District's severe financial crisis, Congress passed the District of Columbia Financial Responsibility and Management Assistance Act (commonly known as the Financial Responsibility Act) in April 1995.<sup>1</sup> The Financial Responsibility Act established the Authority to assist the District in restoring financial solvency and improving management effectiveness during a "control period." The Financial Responsibility Act also established an independent Office of the Chief Financial Officer (CFO) within the District government. The CFO was given responsibility for all financial offices of the District (budget, controller, treasurer, finance, and revenue). During a control period, the CFO is nominated by the Mayor and appointed by the Authority. The act also revised the Office of the Inspector General's (OIG) powers and responsibilities and provided that the Inspector General (IG) be appointed to a 6-year term by the Mayor and approved by the Authority, during a control period. In 1997, Congress passed the National Capital Revitalization and Self-Government Improvement Act (Revitalization Act), which provided key structural changes to the District's finances, including the federal government's assumption of the District's unfunded pension liabilities and a larger share of the District's Medicaid expenditures.

As you know, the Authority has certified that the relevant provisions of the law have been met and, on September 30, 2001, the "control period" will end and the Authority will suspend its activities. The relevant provisions include the following: all borrowings by and on behalf of the District of Columbia from the U.S. Treasury have been repaid; the District has

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<sup>1</sup>Public Law No. 104-8, 109 Stat. 97 (April 17, 1995).

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obtained access to both short-term and long-term credit markets at reasonable rates to meet its borrowing needs; and the District has balanced its budget for 4 consecutive fiscal years in accordance with generally accepted accounting principles (GAAP) based on the Comprehensive Annual Financial Report (CAFR) for the District.<sup>2</sup>

The District's outstanding return to financial health is the direct product of the combined, cooperative efforts of the District and its elected and appointed leadership, the Authority, and Congress. It in no way minimizes this remarkable achievement to note, however, that the District, similar to many other cities, continues to face a series of substantial, long-term challenges to its financial viability. Addressing these challenges requires continued dedicated and inspired leadership to make the hard decisions and often painful trade-offs among equally compelling needs and priorities. Sound financial and program cost and performance information is and will be critical to making these decisions in an economical, efficient, and effective manner.

Toward that end, the District must ensure that its new financial management system is effectively implemented and provides decisionmakers with reliable and timely data. In addition, since 1995 Congress has put in place a number reporting requirements to help provide the financial, planning, and performance information that it needs to conduct effective oversight and make decisions. Congress may wish to consider additional mechanisms to ensure that it and the District have the information needed to help the District maintain its financial viability and address its current and emerging challenges. Such mechanisms must be considered and implemented within a context that seeks to balance two sets of values: the overriding importance of Home Rule and respect for the District's democratic institutions on the one hand and Congress' oversight and decision-making responsibilities for the nation's capital on the other.

My comments today are based on our reviews of the District's Comprehensive Annual Financial Reports for fiscal years 1990 through 2000 and related financial management reports and documents issued by the District CFO, the IG, and the Authority; our recent work on the District's financial management system and performance planning and

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<sup>2</sup>A fourth provision, that all obligations arising from the Authority's issuance of bonds, notes, or other obligations be discharged, was not relevant since the Authority never had to issue its own bonds, notes, or other obligations; thus, there were no such obligations to discharge.

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reporting efforts;<sup>3</sup> and our discussions with the Deputy Mayor/City Administrator, the D.C. Council Budget Director and other representatives of the District Council, the CFO and other officials in the Office of the CFO, the IG and other officials in the OIG, and officials from other states and cities that have experienced local government fiscal crises and recoveries, including officials from the Miami Financial Emergency Oversight Board and Florida Auditor General's Office, the Office of the New York State Comptroller, and the Ohio State Auditor.

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### The District's Financial Recovery and Continuing Challenges

In 1995, the District of Columbia faced the worst financial crisis in its history. Unable to pay its employees or its contractors, the District was running a significant operating deficit, carrying a large accumulated deficit, and relying on the U.S. Treasury for help in funding its operations. The District's ordinary services, such as motor vehicle inspections and building permits, were difficult to obtain, and the District could not sell its bonds at market rates. In short, as we testified in February 1995, the District was without the cash to pay its bills.

Since then, aided by a strong local economy and through the combined and cooperative efforts of the Authority, the District government, Congress, and the citizens of the District, the District has experienced a remarkable turnaround in its financial condition. For example, in fiscal year 1996, the District ended the year with a \$33 million operating deficit and a \$518 million accumulated deficit. In contrast, for fiscal years 1997, 1998, 1999, and 2000, the District generated operating surpluses. The District has eliminated its accumulated deficit and at the end of fiscal year 2000 had a positive fund balance of over \$465 million—a turnaround of almost a billion dollars from its accumulated deficit in September 1996.

As shown in figure 1, in looking at the trends in the District's general fund balance from 1990 through 2000, its financial situation has improved remarkably since fiscal year 1997. Prior to fiscal year 1997, the District had experienced operating deficits in 4 out of 7 years, and the surplus in 1991 reflected a one-time sale of \$331 million of "deficit reduction bonds" that were designed to eliminate the District's accumulated deficit at the time. In addition, the surplus it showed in 1993 included a "windfall" of \$173

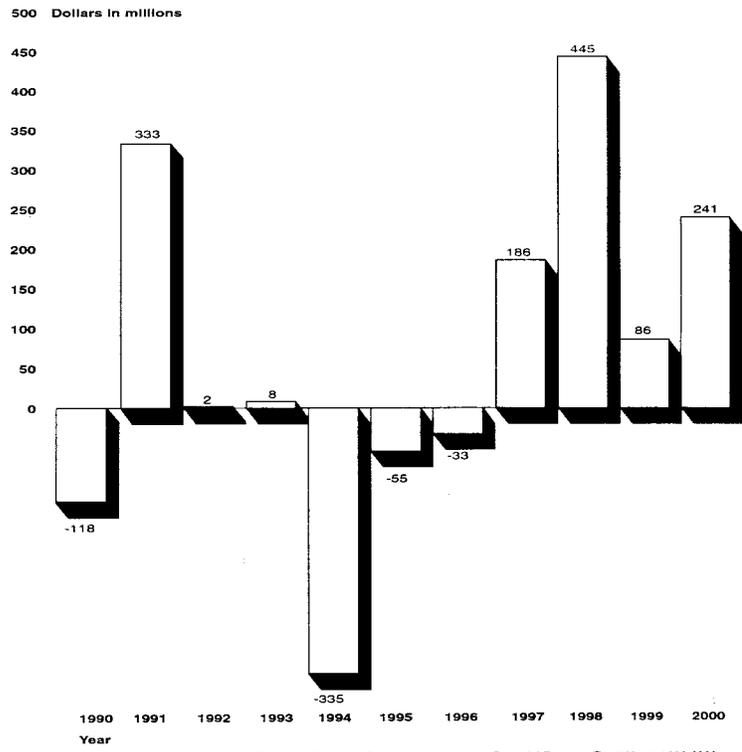
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<sup>3</sup> *District of Columbia: Weaknesses in Financial Management System Implementation* (GAO-01-489, April 30, 2001), and *District of Columbia: Observations on Management Issues* (GAO-01-743T, May 16, 2001).

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million in real estate taxes due to a change in the tax year—recognizing 15 months' worth of taxes in a 12-month period. These transactions masked the financial crisis that was brewing in the District. In 1994, the District's financial crisis became apparent, and the District experienced 3 consecutive years of significant operating deficits. Once the District's financial situation began to turn around in 1997, the District reported an operating surplus of \$186 million. Currently, the District has achieved its fourth consecutive balanced budget, showing a \$241 million surplus for fiscal year 2000—a major achievement for a city that had been struggling to recover from financial difficulties for years. The District expects this trend to continue through 2001 with a projected surplus of \$65 million.

Figure 1: The District's General Fund Annual and Accumulated Surplus (Deficit) for Fiscal Years 1990 Through 2000.



Source: District of Columbia Comprehensive Annual Financial Reports, Fiscal Years 1990-2000.

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**Bond Ratings**

During 1995, the District's general obligation (GO) bond ratings were lowered by Standard and Poor's Corporation, Moody's Investors Service, and Fitch IBCA to levels that were considered to be below investment grade. The bond ratings were lowered because of the District's financial deterioration and its lack of a short- or long-term plan for resolving its budget problems. In 1998, after the District's financial situation had turned around, all three rating agencies began to increase the rating on the District's GO bonds, a trend that has continued through the most recent bond ratings. In February 2001, Standard and Poor's upgraded the District's bond rating from BBB to BBB+, citing the District's improved financial operations due to substantial operating surpluses and its enhanced debt position. In March of this year, Moody's also upgraded the District's bond rating from Baa3 to Baa1, citing, among other things, the District's fourth consecutive budget surplus in fiscal year 2000. Also in March 2001, Fitch IBCA upgraded the District's bond rating from BBB to BBB+ because of the District's positive financial performance and strengthening economic indicators.

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**Audit Opinions**

The District was unable to achieve unqualified, or "clean," opinions on its fiscal years 1995 and 1996 financial statements and received qualified opinions.<sup>4</sup> The reasons for the qualified opinions included the District's inability to provide evidence to support business tax receivables and credit balances in the tens of millions of dollars and the related impact on revenues, expenditures, and fund balances as a result of business system inadequacies. The auditors also cautioned that the District experienced increases in its accumulated deficit and declines in its pooled cash. Then, in fiscal year 1997, the District began to turn its financial reporting around and was able to receive a clean opinion on its financial statements. The District continued its recovery and, most recently, in fiscal year 2000, also received a clean opinion on its financial statements.

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**Continuing Challenges**

While the District has made significant progress over the last 6 years, it still faces short- and long-term challenges to its financial situation. For example, the District's current projection for its fiscal year 2001 surplus is approximately \$65 million. This represents a fairly tight financial margin

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<sup>4</sup>A qualified opinion means that the financial statements are presented in conformity with generally accepted accounting principles, with the exception of any issues(s) identified in the opinion.

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for a budget of approximately \$4.9 billion. In order to ensure that the District does not experience unexpected deficits, constant monitoring of actual revenues and expenditures is needed throughout the year. As budget pressures are identified, the District needs to take quick, decisive actions in order to address the budget pressures and avoid running deficits. Over the longer term, as Authority Chair Rivlin noted in her February 14, 2001, statement,<sup>5</sup> significant challenges still facing the District are securing its financial future for the longer run and addressing the structural imbalance of a jurisdiction caught between the need for greatly improving services and a narrow tax base. Moreover, the bond rating companies also have issued cautions about future factors that could affect the District. For instance, Moody's cautions that the District could be vulnerable in two areas: (1) potential costs and obstacles to improving the quality and efficiency of public services and (2) whether elected officials will have the ability and will to produce results to continue to build stakeholder confidence. Standards and Poor's cautions that financial pressures will come from the District's limited revenue flexibility, significant amount of capital needs, and risks associated with the District's unique economic profile. Fitch cautions that the District still faces challenges including a high debt load, funding of health care, and deferred capital and operating needs, in addition to the possibility of an economic downturn, which is beginning to be felt in other parts of the country.

A sound financial management system is critical in helping the District address the continuing pressures that it faces. As we noted in our April 30, 2001 report<sup>6</sup> and our May 16, 2001, testimony,<sup>7</sup> the District continues to face significant challenges in its efforts to put in place a financial management framework that ensures timely and reliable financial data on the cost of the District's operations. Almost 4 years after the District's acquisition of its core financial management system, that system and related elements are in various stages of implementation. The current mix of components involves duplication of effort and, in some cases, requires cumbersome manual processing. As a result, the system does not produce certain types of financial information on a timely and reliable basis, such as the cost of services at the program level. In our report, we made several

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<sup>5</sup>Statement of Alice M. Rivlin, Chair, Authority, February 14, 2001.

<sup>6</sup>*District of Columbia: Weaknesses in Financial Management System Implementation* (GAO-01-488, April 30, 2001).

<sup>7</sup>*District of Columbia: Observations on Management Issues* (GAO-01-743T, May 16, 2001).

recommendations related to the District's completion of its financial management system implementation and the District's need to ensure that the system effectively and efficiently meets the District's information requirements. We are pleased that the CFO and other District leaders are already taking action on some of our recommendations and plan to implement the recommendations remaining from our prior reports.

It is also important to note that the District has internal control weaknesses that were identified by its independent auditor during the course of its annual financial statement audits. The weaknesses reported by the District's independent auditor as a result of its 2000 audit include issues related to reconciliation of bank accounts and cash management, accounting for payroll transactions, transaction processing for the Public Benefit Corporation and the University of the District of Columbia, lack of timely entry of transactions into the District's core general ledger System of Accounting and Reporting (SOAR), failure to monitor expenditures against open procurements, accounting and reporting for intra-District transactions, and timely reporting of budgetary revisions. Similar to its response to our report, the District has shown a commitment to addressing these problems and is taking action accordingly.

### Congress Has Established Requirements for Financial and Performance Reporting to Aid Its Oversight and Decision-making

At the time of the District's financial crisis, concerns were raised that Congress did not have the oversight mechanisms in place and the information it needed to identify the nature and scope of the District's problems before they became a full-blown crisis and to help the District respond effectively to those problems. Since then, Congress has added new reporting requirements that, if effectively implemented, could provide Congress with critical financial and performance information to help Congress in its oversight and decision-making. We believe that two of the requirements in place may be especially helpful in providing information and perspective that Congress needs to make decisions.

- Since 1997, the CFO has been required to submit a quarterly report to Congress on the District's financial and budgetary status. This quarterly financial report, which must be submitted no later than 15 days after the end of each calendar quarter, is to contain a comparison between the actual and forecasted cash receipts and disbursements for each month of the quarter. Within the report, the CFO is required to explain any differences between the actual and forecasted cash amounts, any changes that would need to be made to the remaining months' cash forecasts, any impact these changes would have on the budget or supplemental budget request, or if these changes would necessitate any reduction in any

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agency's expenditures. Provided that this financial information is timely, reliable, and objective, this quarterly financial report could be useful to Congress and others in monitoring the District's financial condition.

- Since 1998, the Mayor has been required to develop and submit to Congress a performance accountability plan for each fiscal year, including a statement of measurable, objective performance goals for all of the District's significant activities. After each fiscal year, the Mayor is to develop and submit a performance report that includes (1) the level of performance achieved in relation to each of the goals in the performance plan, (2) the title of the management employee most directly responsible for achieving each goal and the title of the employee's immediate supervisor or superior, and (3) the status of any applicable court orders and the steps taken to comply with such orders. This law's general approach of establishing performance goals and reporting on performance is similar to the requirements for executive branch federal agencies under the Government Performance and Results Act of 1993.

In reviewing the District's fiscal year 2000 performance report, we found that performance management remains very much a work in progress for the District, and the performance report reflects that fact. The District's goals and measures were in a state of flux during fiscal year 2000, changing as the District introduced new plans, goals, and measures into its performance management process. These changes were part of its ongoing efforts to further develop and improve the performance management process. Nevertheless, these significant and continuing revisions to the District's performance goals limit the usefulness of the performance report for oversight, transparency, accountability, and decision-making. District officials recognize that much work remains in its goal setting, performance measurement, and accountability efforts, and they have important initiatives under way. For example, the Deputy Mayor/City Administrator recently outlined the District's performance-based budgeting initiative that, if effectively implemented, should help improve the transparency and accountability of District agencies by clearly showing the relationship among dollars spent and activities undertaken and services provided.

In addition to these two requirements, there are other permanent and temporary reporting requirements that are intended to provide Congress with specific information regarding the state of the District's finances.<sup>7</sup>

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<sup>7</sup>Public Law No. 106-522, 114 Stat. 2440 (November 22, 2000).

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(See appendix I for a sample of these reporting requirements, most of which were included in the 2001 D.C. Appropriations Act.)

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### Options for Additional Mechanisms to Ensure That Congress and the District Have Needed Information

While the reporting requirements enacted since 1995 are to provide Congress with important information and perspective on the financial condition, plans, and program performance of the District—information that was sorely lacking in the past—Congress may wish to consider the need for additional mechanisms to help it and the District ensure that they have the information needed to help the District maintain its financial viability. One option that Congress may wish to consider is requiring the District to notify it if certain predefined “reportable events” occur that require the prompt attention of Congress and the District to ensure that financial viability is maintained. Under the Financial Responsibility Act, an Authority could be reestablished if any number of a specific set of major events occur, such as the District’s default on any loans, bonds, notes, or other forms of borrowing or the District’s failure to meet its payroll for any pay period. The major events that could lead to the reestablishment of the Authority are clearly to be avoided at nearly all costs. But to do so, Congress and the District need pertinent information in time to act before a crisis occurs that would necessitate the return of the Authority. A reportable event notification system could be designed to provide just such information and include some or all of the following types of information:

- cash flow pressures that show—
  - projected difficulties in meeting any of the District’s financial responsibilities, including debt service, payroll, pension payments, payments under interstate agreements, or any other financial obligations of the District;
  - projected difficulties in meeting any of the District’s operational, program, and service obligations to its citizens;
  - a need for increased short-term borrowings to cover the District’s operations;
- budget gap pressures that could indicate—
  - tight operating margins or potential future operating deficits;
  - that certain major programs or services within the District are experiencing difficulties in meeting their missions within their current structures and levels of resources;
- pressures or questions from the bond rating organizations regarding the District’s credit ratings; and
- cash projections that indicate a future need for Treasury borrowings.

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A reportable events notification system for the District would be generally consistent with the approaches that have been taken in other local jurisdictions that have had experiences similar to the District's. For example, the Office of the New York State Comptroller has an ongoing program to assess cities and townships that experience trouble generating sufficient revenues on a continuing basis while maintaining adequate service levels. The assessment program uses nine financial indicators, such as the jurisdiction's fund balance, the liquidity of its cash and investments, and its current liabilities as a percent of net operating revenues. These factors are used as ratios to facilitate comparisons with comparable local jurisdictions. The program also uses nonfinancial indicators, such as the locality's reliance on intergovernmental revenues, the jurisdiction's management ability (measured by the timeliness of annual reports and stability of key management positions), and economic activity measures (for example, the per capita income and number of building permits issued). After determining the causes for the local jurisdiction's financial distress, the State Comptroller offers a wide range of services to address the problem.

Similarly, the Ohio Auditor of State uses various financial indicators that could result in a "fiscal watch" of local governments under financial stress. To determine if a local government qualifies for a fiscal watch, the Auditor of State conducts an initial review of the jurisdiction's accounts payable, deficits, cash, and marketable investments. While under a fiscal watch, local governments can receive technical assistance ranging from advice on budget formulation to developing performance audits. A key element of Ohio's fiscal intervention system is providing local officials the opportunity to respond to a fiscal crisis prior to the establishment of an oversight commission.

Another notable example is the ongoing transition to local control from the Miami Financial Emergency Oversight Board to the City of Miami, during which a set of financial integrity principles and policies have been developed and codified into city ordinances. Among the 10 financial integrity principles is a provision for financial oversight and reporting, which includes monthly financial reports issued to city departments, the Mayor, and the city commission on any potentially adverse fiscal trends or conditions including comparing the city's budgeted revenues and expenditures.

The experiences of these governments, our work at the District, and our related work on reportable events notification systems, suggest that such a

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system would be most useful to Congress and the District if, in crafting the system, the following considerations are kept in mind.

- The District and Congress should seek to reach broad agreement on the reportable events that would warrant notification to Congress. Such an agreement would help to ensure that the notification system serves the common needs of the District and Congress in ensuring that the District maintains its financial viability.
- The reportable events should focus squarely on those current financial pressures that have the potential of developing into a triggering event requiring the re-establishment of the Authority if not promptly and adequately corrected.
- The reportable events should be selected so that, in the event they occur, enough time is available for Congress and the District to take any needed remedial action to address the matter before it leads to a crisis or triggers the return of the Authority.
- The reportable events should be clearly defined and transparent so as to limit the possibility of unproductive debate about whether or not a reportable event has actually occurred.
- The reportable events should be well documented; that is, the notification of a reportable event should include discussion of what happened and why, an assessment of the risk to the District's financial situation, and a discussion of needed actions, if any, to address the reportable event.
- Such a system should include a "vital few" set of reportable events. Reportable events are not intended to be a substitute for more comprehensive periodic reporting of financial and program performance, but rather are to draw attention to specific events needing immediate attention.
- The system should seek, as much as possible, to build on financial information already collected, monitored, and used by the District. This would help to minimize the reporting burden and, more importantly, help to ensure that reportable events are valid and reliable indicators of fiscal performance. In that regard, much of the financial information needed to support a reportable events notification system likely is already processed and monitored by the District's CFO. For example, the CFO produces quarterly *Financial Status Reports*, which provide consolidated summaries of the District's financial status and describe the current status of revenues and expenditures, as well as any developing budget gaps and pressures. The reports also provide updated information about projected revenues and expenditures for the remainder of the fiscal year.

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At the request of Congress, we would be pleased to work with the District and Congress to develop a reportable events notification system that meets the common needs of the District and Congress.

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#### Role of the CFO

As I noted at the outset of my statement, in crafting the Financial Responsibility Act, Congress established an independent Office of the Chief Financial Officer within the District government with full authority over all financial offices of the District. Congress recognized that it was critical for timely, reliable, and objective financial information to be available to the District and Congress. Congress also recognized that the CFO's independence and authority is vital to its effectiveness. It is important to note, however, that certain powers and functions granted to the OCFO by the Financial Responsibility Act during a control period will change under current law, as the District moves into a noncontrol period. For example:

- In a control period, all budgeting, accounting, and financial management personnel of the executive branch of the District government (including the independent agencies) are appointed by, serve at the pleasure of, and act under the direction and control of the CFO. This authority will cease during a noncontrol period.
- In a control period, the CFO employs its own legal counsel. The CFO's legal counsel is independent of the District's Office of the Corporation Counsel, which mainly serves the Mayor, and is under the direct administrative control of the Mayor. Current law does not provide the OCFO with authority to employ its own legal counsel during a noncontrol period.
- In a control period, the CFO is appointed and removed with the approval of the Authority. However, in a noncontrol period, the CFO can be removed by the Mayor for cause, with the approval of two-thirds of the Council. The law does not define "cause."
- In a control period, the CFO has the authority to contract for services. This authority will revert to the District's central procurement process during a noncontrol period.
- During a control period, the CFO's budget request is not subject to revision but is subject to comment by the Mayor and Council as part of the District's annual appropriation request. During a noncontrol period, the CFO's budget would be included in the District's regular budget process.

As the District and Congress consider options for ensuring the independence and authority of the CFO, they may wish to consider whether the requirement that the CFO certify the availability of funds for

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contract should be amended to expressly include leases and collective bargaining agreements, which can involve significant expenditures but are not currently subject to the CFO's certification. Currently, these items are not expressly included in the CFO's legal responsibility for certification, thereby leaving the certification of funds process subject to disagreement. In addition, Congress and the District may want to consider whether the CFO's budget, once it is appropriated by Congress, should be exempt from being reduced by the Mayor. A similar exemption is currently in place for the City Council.

Earlier this week, the Chair of the District City Council submitted a legislative proposal to the City Council to specifically address issues related to the CFO's independence and the scope of the CFO's duties. While we have not had a chance to analyze the proposal in detail, we support efforts by the District to continue or strengthen the independence and authority of the District's CFO in a post-Authority environment. Our *Executive Guide: Creating Value Through World-class Financial Management*,<sup>9</sup> notes that one of the essential elements of a successful finance organization is clear, strong executive leadership. Once the Authority suspends its activities, it is important to consider whether the CFO will be able to continue to operate and perform its ongoing fiscal and financial activities in an independent manner, without encroachment by others, especially if the District faces difficult choices caused by financial downturn.

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#### Role of the IG

The IG is now appointed to a 6-year term and may be removed by the Mayor only with Authority approval during a control period. In 1995, around the time of the passage of the Financial Responsibility Act, the OIG had seven authorized full-time equivalents (FTE).<sup>10</sup> Since 1995, the OIG has substantially built its operations, staffing, and audit capabilities. Currently, the OIG has authorized staffing of 105 FTEs. The current responsibilities of the IG include the following:

- conducting independent fiscal and management audits of District government operations;

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<sup>9</sup>GAO/AIMD-00-134, April 2000.

<sup>10</sup>FTEs are used to measure federal civilian employment. One FTE is equal to 1 work year of 2,080 hours.

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- contracting and overseeing the contract with an outside auditor to perform the annual audit of the District's CAFR;
  - conducting other special audits, assignments, and investigations;
  - annually conducting an operational audit of procurement activities of the District government;
  - forwarding to the appropriate authorities evidence of criminal wrongdoing that is discovered during the course of its audits, inspections, or investigations; and
  - submitting to the appropriate congressional committees and subcommittees an annual report summarizing its activities from the preceding fiscal year.

Each year, the IG establishes an audit plan, in consultation with the Mayor, City Council, and Authority (during a control period) 30 days prior to the beginning of the fiscal year. The IG's criteria for selecting audit areas to be included in the plan include the following: (1) materiality of the programs, (2) activities and functions considered for audit, (3) vulnerability of operations to fraud, waste, and mismanagement, and (4) whether there is a legislative or regulatory audit requirement.

As with the CFO, the key is to ensure the IG's independence and authority, which are vital to its effectiveness. During a control period, the IG is appointed and removed with the approval of the Authority. During a noncontrol period, the IG can be removed by the Mayor for "cause," although the law does not define "cause." In addition, Congress and the District may want to examine whether the IG has personnel authorities needed to maintain and assure independence. Finally, as with the CFO, Congress and the District may want to consider whether the IG's budget, once it is appropriated by Congress, should be exempt from being reduced by the Mayor.

One of the IG's key responsibilities is identifying and reporting to the Mayor, the District Council, and District department and agency heads any problems in the administration of District programs and operations and the need for corrective action. The IG's role in a post-Authority environment is critical because of its mandate to audit and report on the economy, efficiency, and effectiveness of District programs and operations. As such, Congress, the Mayor, and the District Council should consider how to best use the IG's financial and performance-related audits and reporting in order to provide critical oversight and early warnings of any potential problems.

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**Audit Committee**

Audit committees have long been recognized as a key component of the corporate governance system for private sector companies. Generally, audit committees play an important role in corporate governance by providing an independent view of management's financial reporting and by facilitating communication between management and its internal and external auditors. Typical responsibilities of audit committees include assessing the processes related to the company's risks and control environment, overseeing financial reporting, and evaluating the internal and independent audit processes.

The importance of audit committees has also come to be recognized as increasingly important in the public sector. In 1997, the Government Finance Officers Association (GFOA) recommended that every government establish an audit committee or its equivalent. The GFOA also stated that each audit committee should be formally established by charter and that the members of the audit committee should collectively possess the expertise and experience in accounting, auditing, and financial reporting needed to understand and resolve issues raised by the independent audit of the financial statements. The GFOA stated that the primary responsibility of the audit committee should be to oversee the independent audit of the government financial statements from the selection of the independent auditor to the resolution of audit findings. The GFOA also stated that the audit committee should have access to internal audit reports and plans. Finally, the GFOA recommended that the audit committee present annually to the governing board and management a written report on how it has discharged its duties.

The District's IG has established a CAFR Oversight Committee, which oversees the progress on the annual financial audit. While not an audit committee, the CAFR Oversight Committee provides an excellent opportunity for District financial management staff, OIG staff, and representatives from the Mayor's office, the D.C. Council, and the Authority to be updated on the status of the audit and any issues being encountered by the auditors. Consequently, issues affecting the audit could be addressed in an effective and timely manner so the auditor's progress towards timely completion of the CAFR would not be impeded. This process has been key in assuring that the District was able to compensate for current issues and avoid many of the past problems that resulted in the late issuance of the fiscal year 1999 CAFR. The CAFR Oversight Committee, however, does not have the full scope of roles and responsibilities typical of an audit committee, nor does it follow the organizational requirements of a traditional audit committee. Congress and the District may want to consider forming an audit committee or

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variation of an audit committee based on the objectives of audit committees described above, and/or strengthening and further defining the current CAFR Oversight Committee already in place.

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In summary, the District and its citizens, the Authority, and Congress have jointly achieved an enormous accomplishment in restoring the District to financial viability. At the same time, many of the challenges the District faced in the past continue, requiring difficult decisions now and in the future. The District and Congress must have reliable, accurate, and timely financial, program cost, and performance information if they are to confidently make these hard decisions. Specifically, the District and Congress need current, reliable information about the District's financial condition and developing trends in order to promptly respond to any pressures or warning signs that could indicate that future difficulties lie ahead. District officials and Congress could thereby take an active and prospective role in dealing with issues, rather than finding themselves in a position of reacting to a crisis. Such information and oversight will also be helpful to the District in providing confidence that the District is well managed, providing needed services to its citizens, and maintaining its financial solvency. We have a very constructive relationship with the District and we look forward to continuing to work with Congress, your Subcommittees, and District officials as the District government continues to strive to provide the services that its residents expect and deserve.

Madam Chairwoman and Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions you or other members of the Subcommittees may have.

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### Contacts and Acknowledgments

For further information, please contact Jeanette Franzel, Acting Director, Financial Management and Assurance, at (202) 512-9406 or J. Christopher Mihm, Director, Strategic Issues, at (202) 512-6806. Major contributors to this testimony included Richard Cambosos, Sharon Caudle, Doug Delacruz, Molly Gleeson, Steven Lozano, Meg Mills, Susan Ragland, and Norma Samuel.

## Appendix I: District Reporting Requirements

Since the financial crisis precipitating establishment of the Authority, Congress has enacted a number of reporting requirements for various entities within the District of Columbia government. Some of the reports are required by permanent law while others are temporary. A sample of the permanent reporting requirements is listed in table 1.

**Table 1: Reporting Requirements Enacted as Permanent Law and Codified in D.C. Code**

<b>Permanent Laws</b>			
<b>Report and statute*</b>	<b>Description</b>	<b>Prepared by</b>	<b>Prepared for</b>
Annual Performance Accountability Plan D.C. Code 47-231	A performance accountability plan for all departments, agencies, and programs of the D.C. government for the subsequent fiscal year to be submitted not later than March 1 of each year	Mayor	Senate and House Committees on Appropriations, Senate Committee on Governmental Affairs, House Committee on Government Reform and Oversight, and the Comptroller General
Annual Performance Accountability Report DC Code 47-232	A performance accountability report on activities of the D.C. government during the fiscal year ending on the previous September 30, to be submitted not later than March 1 of each year	Mayor	Senate and House Committees on Appropriations, Senate Committee on Governmental Affairs, House Committee on Government Reform and Oversight, and the Comptroller General
Financial Accountability Plan and Report D.C. Code 47-233	A 5-year financial plan for the D.C. government that contains a description of the steps the government will take to eliminate any differences between expenditures from and revenues attributable to, each fund of the District of Columbia during the first 5 fiscal years beginning after the submission of the plan, to be submitted not later than March 1 of each year	Chief Financial Officer (CFO)	Senate and House Committees on Appropriations, Senate Committee on Governmental Affairs, House Committee on Government Reform and Oversight and the Comptroller General
Quarterly Financial Report D.C. Code 47-234	A report on the financial and budgetary status of the D.C. government for the previous quarter to be submitted not later than 15 days after the end of every calendar quarter.	CFO	Subcommittees on the District of Columbia of the House and Senate Committees on Appropriations, Senate Committee on Governmental Affairs, and House Committee on Government Reform and Oversight

<b>Permanent Laws</b>			
<b>Report and statute*</b>	<b>Description</b>	<b>Prepared by</b>	<b>Prepared for</b>
Emergency Reserve Fund Use P.L. 106-522 Sec. 450A, 114 Stat. 2480	Notification to Congress of the use of the emergency reserve fund to be issued not more than 30 days after the expenditure of funds	Mayor and D.C. Council (and the Authority during a control year)	Senate and House Committees on Appropriations
Quarterly Report on Emergency Reserve Funds P.L. 106-522 Sec. 450A, 114 Stat. 2481	A quarterly report that includes a monthly statement on the balance and activities of the contingency and emergency reserve funds	CFO	Mayor, D.C. Council, the Authority, and Senate and House Committees on Appropriations
Report on Federal, Private, and Other Grants P.L. 106-522 Sec. 126, 114 Stat 2465	Quarterly report providing detailed information on federal, private, and other grants, to be submitted not later than 15 days after the end of the quarter	CFO	D.C. Council and Senate and House Committees on Appropriations
Inspector General Audit P.L. 106-522 Sec. 135, 114 Stat. 2468	Annual audit of the financial statements of the D.C. Highway Trust Fund, to be submitted not later than February 1, 2001, and each February 1 thereafter	Inspector General	Congress
Annual Review P.L. 106-522 Sec. 450B, 114 Stat. 2475	A review of the comprehensive financial management policy to be issued at the end of each fiscal year	CFO	Senate and House Committees on Appropriations, Senate Committee on Governmental Affairs, and House Committee on Government Reform

\*District of Columbia Appropriations Act, 2001, P.L. 106-522, 114 Stat. 2440 (November 22, 2000).

The table below lists a sample of temporary reporting requirements that were included in the 2001 D.C. Appropriations Act.

**Table 2: Temporary Reporting Requirements from the 2001 D.C. Appropriations Act.**

<b>Temporary Laws</b>			
<b>Report and statute*</b>	<b>Description</b>	<b>Prepared by</b>	<b>Prepared for</b>
Quality of Life Indicators P.L. 106-522 Sec. 424, 114 Stat. 2477	Quarterly report on the issues of crime, access to drug abuse treatment, management of parolees, education and special education access, improvement in rat control and abatement, application and management of federal grants, and indicators of child well-being	Mayor	Senate and House Committees on Appropriations, Senate Committee on Governmental Affairs, and House Committee on Government Reform
Capital Outlay Borrowings Report P.L. 106-522 Sec. 110, 114 Stat. 2459	An annual plan, by quarter and by project, for capital outlay borrowing	Mayor	DC Council and Congress
Management of Real Property Assets P.L. 106-522 Sec 139, 114 Stat. 2470	A comprehensive plan for management of the District of Columbia's real property assets	Mayor and D.C. Council	Senate and House Committee on Appropriations, Senate Committee on Governmental Affairs, and House Committee on Government Reform
Reports on Current Leases P.L. 106-522 Sec 138, 114 Stat. 2469	Quarterly reports on location of property involved, the extent to which the property is or is not occupied by the D.C. government, and a plan for occupying and utilizing the property	Mayor and D.C. Council	Senate and House Committees on Appropriations

\*District of Columbia Appropriations Act, 2001, P.L. 106-522 Stat. 2440 (November 22, 2000).

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Mrs. MORELLA. I'll start off with the questioning, and each of us will have several rounds as necessary, maybe 5 minutes for each of us to pose questions. I'm going to start off with Dr. Rivlin.

Two of the purposes of the Control Board were to eliminate budget deficits and cash shortages of the District of Columbia through visionary financial planning, sound budgeting, accurate revenue forecasts and careful spending, and to ensure the long-term financial, fiscal and economic vitality and operational efficiency of the District of Columbia. Dr. Rivlin, have these two purposes of the Control Board Act been met?

Ms. RIVLIN. Well, certainly the specific criteria for the end of the Control Board have been met. The purposes that you just enunciated are ongoing challenges. The District has, as you know, a very narrow tax base, and there's certainly a very strong case, in my opinion, for the Congress looking at the structural imbalance of the District and deciding what to do about it in the long run. Even if the District is extremely well managed and does, as we all hope, improve its economic situation through economic development, more population, I believe that the narrowness of the tax base caused by the fact that the Federal Government is its principal industry is a serious problem and should be corrected, and there are options on the table, the principal one being Congresswoman Norton's bill for a wage tax with a credit against the Federal tax, which would meet Congressman Davis' criteria that it not be an undue burden on the States of Maryland and Virginia. So that's a possibility. So are payments in lieu of taxes.

The other even more challenging problem, I think, is to improve the services of the District, and that is a continuing effort that the Mayor and the Council, with the oversight of the Congress, with the help of the Congress, have to pay attention to.

But I think that the District is in good shape to take over that responsibility itself.

Mrs. MORELLA. Both you and the chief financial officer have suggested, and you just mentioned, that the District government has a structural budget imbalance. What are the revenue and expenditure components of this structural imbalance? And then I would say—I mean, what is the revenue and expenditure growth going forward?

Ms. RIVLIN. Well, the District does have a 5-year plan now which projected balanced budgets for the next 5 years, but that is based on very careful expenditure control and actually very small amount of growth in revenues anticipated over the next several years.

The source of the imbalance is basically that the property sales and income tax base is so drastically narrowed both by the fact that the Federal Government is the city's principal industry and by the actions of the Congress to prohibit taxation of nonresident income.

Mrs. MORELLA. We will—this subcommittee will be looking at the kind of long range. We have that on our agenda to look at.

But let me ask you directly. In my opening statement, I made some statement about the possibility of some special review of the city's revenue estimate and financial audit, as the Mayor had suggested and some members of the Council had supported publicly. I mean, is there some kind of an audit committee that would be—

I don't want the Congress involved in it if you think there is a place for it—where the Council, the Mayor would appoint people to kind of do an audit review or be available? I mean, how do you feel about that?

I have said to everybody—I am going to ask all of you that. And if my time elapses before I get back to everybody, but I will get back to you later, but I want for the record to know how you feel about that.

Ms. RIVLIN. Should I start?

Mrs. MORELLA. Whatever.

Ms. RIVLIN. I have mixed feelings about it. We all talked about this, and when I first thought about it, I thought that the idea of having a validation group of experts for the chief financial officer is a very valuable one. And I still think so. But I believed that the chief financial officer can appoint such a group. In fact, the current chief financial officer has such a group to assist in—a group to bounce off the projections.

The trouble with putting such a group into law and having it appointed by the elected officials is, I think, the risk of what do you do if such a group then differs with the chief financial officer? Then you have a problem. And it is possible, though one would hope not likely, that a group appointed by an elected official might in some future years become a political group itself; and that I think would be unfortunate.

Mrs. MORELLA. Maybe there would be a different group of a different composition or whatever.

I know my time has elapsed. I will get back to all of you to answer that specific question so I know how you really feel things should be done.

Now I am pleased to defer and recognize the ranking member of this subcommittee, Ms. Norton.

Ms. NORTON. Thank you, Mrs. Morella.

I would just like to clear up a difference between Mrs. Morella's statement and the Mayor's statement, just so that I can have the record clarify and have the city officials clarify.

Her statement says—this is her statement. Her statement says that the proposal does not require the CFO to prepare fiscal impact statements on all or even most pieces of legislation. Now the Mayor testified our plan strengthens the CFO's role by requiring him or her to complete fiscal impact statements for all local legislation. Which is the case, please? I mean, does the CFO have to prepare fiscal impact statements or not?

Ms. CROPP. Well, I think it is two parts. The fiscal impact statements on legislation that are submitted by the Mayor, the CFO would provide fiscal impact statements. The legislation that is provided by the Council, as the legislation is currently written, it would not have the fiscal impact statements. That would be the Budget Office from the Council that would have to supply the fiscal impact statements.

However, Council legislation requires that all legislation that is passed must be accompanied with a fiscal impact statement. And I have been extremely vigilant during my tenure, and that is part of our Council role. So all legislation will have fiscal impact statements accompanied with them.

Ms. NORTON. So essentially what the city does is to leave in place, is to take onto itself the function that is now performed by the Control Board, which, as I understand, looks at the fiscal impact statements?

Ms. CROPP. Yes. And our Budget Office also works usually in conjunction with the CFO's office.

Ms. NORTON. Just let me give some sense of context here. As long as there is going to be a local government anywhere—I address this specifically to the gentleman from the GAO. As long as there is a government anywhere, especially a city government, there will never be a time when there will not be many problems to put on the table, especially today when cities have been—are bereft of the many people who used to live there who now moved to the suburbs. So it is a truism that if what you are doing is looking for problems, you will always find them in this government and any other government. Can I have your agreement to that?

Mr. MIHM. Yes, ma'am. I mean, well, there are certainly issues that we have seen in the D.C. government, Federal Government and the GAO, we have management challenges that we deal with. The key is, do you have—are you identifying them? Do you have an action plan in order to address them and is the organization moving forward? And that is—

Ms. NORTON. Answer those three questions with respect to the District of Columbia.

Mr. MIHM. With the District, we have been very pleased with the types of relationships we have had with them with their understandings of the challenges that we faced. We work very closely with the Mayor's office and in particular the Deputy Mayor's office and his staff on the issues that concern us. They clearly understand some of the substantial challenges that they face and financial management and performance management, have taken the hard recommendations and are taking actions to address those.

Ms. NORTON. Do you see any operational problems that the District government has now that a competent and committed government cannot or will not deal with on its own?

Mr. MIHM. Operational problems?

Ms. NORTON. Yes.

Mr. MIHM. No, ma'am. Our concern is—is that as we look at the—as has been discussed, some of the longer term fiscal challenges that the District faces, in order to address those challenges the District and Congress need to have good performance and financial information in place in order to address those.

Our concerns have been when we have looked at the financial management system that is still a work in progress. They are working real hard at it, but it is a work in progress.

The performance information is still a work in progress, again working very hard at it. The concern we have is making sure that we continue to make progress in getting this good information in place so that the District leadership and others can make the decisions that need to be made.

Ms. NORTON. You are quick to point out what you, yourself, say the District is already doing. And I appreciate the balance in your testimony. But you say nothing about structural imbalances that the District can do nothing about.

Suppose the District were to do everything it is supposed to do. Would there be structural imbalances in its tax structure imposed on it by the Federal Government that it could do nothing about and that threatens the future viability of the city?

Mr. MIHM. I understand your question, ma'am, and I understand the importance of that question. But the work that we would need to do in order to answer that question has been—was beyond the scope of the work that we do.

Ms. NORTON. It is not beyond the scope of common sense, if I may say so. I put it on the table because the District has come here as good soldiers, and I appreciate it, saying this is what we have done and, please, Congress, let us continue to do what we are doing on our own, and has had little to say about its own structural revenue challenges.

I would like to invite the District to speak further about its structural revenue challenges. Because if those challenges are to be met, it will put this Member of Congress in the position of having to prepare the Congress, perhaps in too short a time, to understand that if the District itself does not give the same early warning to the Congress that the GAO keeps telling us we need from you—in other words, somehow we need you to warn us that you are in trouble.

Who is to warn the Congress if structural revenue problems are, in fact, overtaking all that the District can do? What is in place now to keep another financial crisis from coming to the District based on pressures outside of the control of the District imposed on it by the requirements that the Congress has put upon the city?

Mrs. MORELLA. Actually, the gentlewoman's time has expired. If you can all remember that when we get back to you for the next round, I would appreciate that.

Senator.

Senator VOINOVICH. Thank you very much.

First of all, I would like to congratulate Dr. Rivlin and the Mayor and the chairwoman for coming together and joining in your testimony. I am very interested in the proposal that you have put together for continued solvency and recovery of the District in terms of the CFO and its relationship to the Council and to the Mayor and so forth.

I would like very much for Mr. Mihm to look at the proposal that the city has put together, to opine, from the GAO's opinion as to whether or not it does the kind of thing that is being presented here in terms of continued fiscal responsibility and financial management on the part of the city.

Mr. MIHM. Yes, sir.

Senator VOINOVICH. Mr. Mihm has also raised some issues today in terms of the District's plans, and I would ask you, Mayor, to sit down and look at some of his suggestions and to come back to see what you think of them and how, perhaps, you could incorporate some of his concerns into what you are doing.

We are very interested in just seeing progress and doing something that is very realistic, and as far as I am concerned you are the ones that are closest to the problem and most responsible, and we want to cooperate with you.

Mayor, you were interviewed in “the Hill” a Capitol Hill newspaper and said, “it makes sense to have strength in oversight controls, that we ought to have special review of our revenue estimate in the city and a special review of our audit,” and I strongly support that.

You didn’t specifically mention that in your testimony. And when you did talk about this independent, unbiased review of the District’s financial numbers, is the plan that you submitted or discussed today what you were considering when you made that statement in the newspaper?

Mayor WILLIAMS. Yes, it is, Senator. I believe that having the CFO have direct support for the revenue estimate accomplishes an important goal of sequestering or segregating the revenue estimate from political influence. I believe that is where we get into trouble.

And I believe that, if I can kind of partner questions, if our 5-year plan, based on an objective revenue estimate of the CFO, and right now the outstanding forecasting of Julia Freedman, who does an outstanding job as our chief economist, shows that we are in trouble, it is going to be reflected in the 5-year plan.

And, believe me, everybody will hear the chorus of voices complaining about us elected officials not doing A, B or C, because we don’t have the money, because we are operating under legitimate revenue constraints.

As to the audit function, I believe that we have a very strong inspector general. We support continuing the independence of the inspector general and the special autonomy that he or she has; and we believe that the inspector general, with the responsibility for the audit, presenting it to the Mayor, the Council Chair, and the Chair of the Finance and Revenue Committee of the Council, can form that audit committee function in a transparent way.

Senator VOINOVICH. What is your response to Mr. Mihm’s testimony that the GAO noted that last year’s unqualified opinion was largely the result of the extraordinary efforts of a few key individuals, despite serious weaknesses in the District’s financial system? What’s your response to that?

That basically says you have some really good people that busted their back to put together and get it done, but the financial management system itself is not yet in place to have this occur on a regular basis without extraordinary work on the part of special individuals.

Mayor WILLIAMS. I believe that when we look at systems, our city administrator, Deputy Mayor, John Koskinen and Nat Gandhi, when we look at a system, we look always at not just hardware and software but organization processes and, very importantly, people.

John Koskinen and the Chair of the Finance and Revenue Committee, Jack Evans, serve on a committee called the SOAR, which is an intergovernmental committee, with everybody involved responsible for seeing that this system gets implemented, working, with managers taking responsibility for the implementation of a system. And we are confident that we are going to be—continue to make advances in the area of reorganizing our operations and procedures so this system can work.

To give you an example, in our labor negotiations, we are working in cooperation with labor to reduce dramatically the number of

bargaining units in the city. Why is that important? Because the more bargaining units you have, permutations, combinations and more pay tables you have, if you have the infinite number of pay tables we have, there's no way that any payroll system is going to pay reliably because you have so much complication.

We are trying to reengineer our processes down to an off-the-shelf system as opposed to vice versa that we have been doing in the past.

Senator VOINOVICH. Now, you agree that the financial management system isn't yet in place?

Mayor WILLIAMS. It isn't yet in place, but I believe we are putting the systematic—have put in and are putting in the systematic tactics and strategies in place to see that it gets implemented right. And we get full advantage of this system, particularly in the area of cost accounting, which is critical, as you know, to linking performance information and budget information.

Mrs. MORELLA. The gentleman's time is expired.

I want to pick up—and I know that, Mayor Williams, you seem to have been answering in response to the Senator's questioning that you do not think that any separate audit committee appointed by the Council or whatever would be necessary for revenue estimates.

Mayor WILLIAMS. Chairman Cropp and Dr. Rivlin can speak for themselves, but in my approach or our joint approach to this has been to look at what is the function we are trying to serve and how can we reach agreement on serving that important function.

To achieve authenticity, validity, credibility in your audit, there are a number of different ways to do that. Certainly in a lot of organizations, an audit committee does that. We believe, given our circumstances and given where we are, having again an indispensable, independent Inspector General with overall responsibility for the audit, working with an outside accounting firm, reporting to the elected officials in committee can serve that function of transparency and accountability.

We have one of the strongest IGs in the country now, and we want to keep it that way.

Mrs. MORELLA. I am impressed with the IG, with whom I met and who will be on the next panel, too.

Councilwoman Cropp, let's hear from you about that specific item.

Ms. CROPP. Congresswoman, the issue of the revenue commission was one that we probably had the largest amount of debate. If I was sitting here 2 months ago, I probably would have been more supportive and gung ho and said, yes, we must have that revenue commission.

There has been another bill that was introduced to the Council to form a revenue commission; and at the time that we have the hearing on our CFO legislation we are going to also have it on this revenue commission bill that was introduced by Councilmember Patterson. Our hearing is scheduled for June 19th at 2 p.m., because we want to move quickly.

That is an issue that I think we worked very diligently on in our joint presentation to you, that we agreed that we wanted to leave that issue open a little more and get some more information and

testimony. So I hope that we will come to a resolution on that issue after that June 19th hearing.

We did have great concern, however, that as we have this revenue commission, that it could become extremely political in the final analysis. If that estimate is quite different from the estimate of the CFO who has some independence, then what? Then we create a whole new set of political problems; and we may, in fact, be shooting ourselves in the foot with that.

That was one of the greatest concerns that we had. We have been extremely fortunate in the District of Columbia to have CFOs to give revenue estimates under Julia Freedman, and I am going to tell you sometimes we have not been happy with them. But the conservative estimates that have come, I think, have bode well for the District of Columbia, and I think it will continue in that mechanism.

Mrs. MORELLA. OK. I am pleased to hear about the hearing. You will have to, of course, apprise us of the results of it.

It is really important that I hear from GAO, Mr. Mihm, your response to the possibility of the audit committee of some sort.

Mr. MIHM. I think there's two things here, Madam Chairwoman. One is, as Dr. Rivlin pointed out, we are all in agreement that revenue estimates are strengthened by a level of external revenue. And, indeed, we are very pleased to see that the CFO is reaching out to professionals to help them in that regard, both in terms of looking at the assumptions—the particular assumption and then in the broader methodology.

Revenue—doing revenue estimates is very difficult and technical, but it is something that is done frequently around the country, so there is certainly best practice that can be learned from that.

The second point I would make, though, and the challenge is not just in making an initial estimate that is accurate. The challenge is also in making sure that you routinely have the information that you can check on. How is that revenue estimate going? What sort of adjustments do we need to make? And that is where we get back into the questions about—or the importance of the District carrying through on the implementation of its financial management system.

In terms of an audit committee, they typically have a separate set of functions and are not typically involved in revenue estimates. Rather, they are typically responsible for overseeing the independent financial audit, that is, the selection of the auditor and making sure that they carry out the audit correctly and that there is resolution of the auditor's findings.

And there's a wide range of how this model is actually implemented across the country. Most typically, they are a function or—rather, they are part of, in this case, what would be the City Council, and do the financial—rather oversee the financial audit of what would be the executive branch.

Mrs. MORELLA. I note accurately my time has just expired. So I will be back for the next round.

Now I am pleased to recognize Congresswoman Norton. I hope you remember her question. I won't count the time if she repeats it.

Ms. NORTON. No, frankly, because you didn't get to answer it, rather than to go back over that, I think I will save that question on the structural revenue problems that may be flowing to the District that you did not speak in detail to, to the chief financial officer, whose job it is to look at the outyears. The GAO tells me that is not even a part of what Congress, what it's to look at. So perhaps no one can authoritatively speak to that at the table.

Ms. Cropp, you speak—on this question about a revenue commission—which the Mayor kind of threw out off the top of his head. Watch out what you ask for, Mayor, you may get it, if we 1 day are speaking out loud—was something I was completely open to.

May I compliment you on the way that you are looking at it? By listening to you, I have learned the pros and cons. And when you talk about how political it could be, that strikes a real note in this Member who has watched the District through her entire life.

I also am concerned—again, I am completely neutral on it until I hear your discussion. I am concerned. But what I think you have been fortunate in is not only that you had very good financial officers but that the financial officer has been independent and had nothing to fear but fear itself.

I don't know what it is that would keep somebody appointed by the Mayor or, for that matter, or somebody on the City Council, people on the City Council, what would make them independent.

I don't understand why they would feel the same independence the CFO feels or why somebody from the private sector would necessarily—or, for that matter, some parts of the public sector—would necessarily bring to the table anything but an adversarial and redundancy process for somebody to figure out.

Again, you would be asking the Congress to figure it out if there were a difference here. So I think for every provision we have to do a costs benefit and find out, weigh both sides and find out where we come.

I would like to ask Mr. Mihm. Your testimony calls for, again, this notion of an early warning so that Congress and presumably the District will know that financial problems are coming up. But isn't that the job of the CFO? I mean, why would you need anything more than an independent CFO with a term, they can't be fired, who is competent to do that?

I mean, sometimes I think we don't have anything to do but think of things for people to do. One of the things we are supposed to be doing is streamlining the government, not thinking of revenue commissions on top of things just to have them, but thinking, do we need this? Is there somebody who does this? Every time we put in a bill, someone asks us, are you putting in a new bureaucracy? Are you putting in a new structure for the Congress to pay for?

Well, I am asking you, what in the world is the job of the CFO if it is not to give the District years out, early warnings? And I will ask you further, if not—whether or not the CFO has, indeed, been doing that.

It is my recollection that, just by reading the newspaper, that as the fiscal year began, even though there was plenty of time to alert people much later in the year, the fiscal year just began, and he alerted the whole city to the fact that there was some agency

spending beyond their budget. And, of course, everyone apparently took care of it, because I haven't heard another thing. So I want to know why you think, in addition to an independent CFO now who would have a term, you would need some other mechanism to give an early warning.

Mr. MIHM. I think—ma'am, I would agree with certainly the first part of your statement in that—about the importance of an independent and qualified CFO. In fact, an early warning system, the success of that is predicated, absolutely, on the existence of that CFO.

And as we note in the statement, presumably much of the information that would be in an early warning system is already tracked and monitored and examined by the CFO; and, I would agree with you that much of that information is certainly there.

The idea here would be for Congress and the District to try and work together and say are there a select few, and we would call them in the statement the "vital few," types of indicators that we could all agree to focus on, that if this type of event occurs it will lead—if we don't deal with it, 6, 8, 10 months, a year down the road, it could lead to a turning event.

Ms. NORTON. I don't understand why the CFO's job would not be to do just that. If you are looking for work for us to do, let us know, but I don't know why that is not the CFO's job.

I don't disagree with you at all. I am just trying to find out whether you need another mechanism, whether somebody needs to spell out because the CFO hasn't been doing its job, or you think there should have been some things spelled out that have not been spelled out.

Mr. MIHM. No. This is not based in any way on a belief that the CFO has not been doing its job. What it is based on is a belief that there are—or a hope that there is a way that Congress and the District could agree to focus on some vital few indicators.

Ms. NORTON. Give me an example of a vital few indicators.

Mr. MIHM. We identify some potential ones, and this is one of the things that our first principle is that Congress and—hopefully, Congress and the District could come together and agree on some.

But I am flipping to page 10 of our statement. We provide some of those cash-flow pressures that show projected difficulties in meeting any of the District's financial responsibilities, projected difficulties in meeting any of the District's operational programs, service obligations to citizens.

The idea would be to take the seven deadly sins, I think as referred to earlier, that lead to the imposition of a new authority, move back off of those and say what are the types of things that would warn us about that in the future, agree that those—get Congress and the District to agree, OK, these are the ones that we are going to focus on.

And I should add what that allows then, at least the potential, is the opportunity to then reach agreement, OK, we are not going to focus on other things. We will not necessarily need congressional notification on other things.

Ms. NORTON. I will save my questions for the CFO, because I think that the real issue now becomes what does the CFO do with respect to the indicators you have named.

Thank you, Madam Chair.

Mrs. MORELLA. Senator Voinovich.

Senator VOINOVICH. Ms. Rivlin, you have done an outstanding job with your responsibilities as the Chair of the District of Columbia Financial Responsibility and Management Authority; and you joined in the testimony here this morning.

You can well imagine that, as a Member of Congress, I am concerned that, at least during my watch, that the District doesn't fall back into a situation where the supervisory commission would have to be reinstated. Are you satisfied that the things that the Mayor talked about today will provide the safeguards and the warnings that are necessary so that doesn't occur?

Ms. RIVLIN. I am, Senator. But let me add a couple of strengthening points.

I think that the early warning indicators idea is a good one and that most of those things would be normally coming out of the CFO's office, but I think agreement that these would be regularly transmitted to Congress seems to me perfectly good reinforcement.

The important thing about the CFO, it seems to me, is not just the independence but that the CFO be able to build a strong, continuing professional staff that is respected by everybody and known to do a good job. Without that, it won't work. And the protection of the CFO is partly to protect the ability of the CFO to build such a strong professional staff over time.

I also think that the Council needs to have a strong professional staff. And if you are thinking about how the revenue estimates should be reviewed, one model I think that the District ought to think about is, similar to what the Congress does with the Joint Committee on Taxation, staff a good, strong staff on the legislative side to review the revenue estimates.

There's nothing like having both the executive branch and the legislative branch have good professional staffs to ensure that you get adequate warning and nonpolitical estimates on both revenues and expenditures.

Senator VOINOVICH. In putting together your recommendations, Mayor, on some of the things that you do in relationship to the CFO, have you discussed this at all with any of the rating agencies?

What I found many times you have had your bond rating increased, but one of things I've always tried to do is try and make sure that the rating agencies are happy with what I am doing, because they are real important, and I'm sure you would like to see your rating increased. Have you got any response back from them in terms of what they think you ought to do?

Mayor WILLIAMS. No. Our conversations with our rating agencies, staff of the Control Board, Chairman Cropp and I, we assure the rating agencies that we all are steadfast in our support for a strong, independent CFO and for a strong, independent CFO relationship with the agencies. But we didn't get into the detail of exactly how evaluations were done and terminations would be done, but we definitely share with them our commitment to strong, autonomous CFO function.

Senator VOINOVICH. One of the things when I was Governor, we had a strong Office of Management and Budget; and the legislature

also had some very strong people that worked for them. But we did meet twice a year with economic experts that represented a cross-section of businesses in our State to get their feel on terms of where we were going as far as our estimates and what was happening to the economy. We just thought that was an additional help for us.

And it seems to me that you might give some consideration to having something like that in place. Though Dr. Gandhi said he had some folks, that do meet with him, but that might be something that you might give some thought to.

Chairwoman Cropp, I was pleased to see that the Council held hearings earlier this year on the implementation of the Mayor's performance management system. It has been a focus of my subcommittee, and I applaud Council's focusing in on that.

What do you think are of the most significant problems that the Mayor faces in implementing an effective performance management system and how do you intend to help him get it done?

Ms. CROPP. Our hearing process, I think, has been very helpful to try to focus on what the concerns are. I think the new approach that you will see in our 2002 budget process will be one that will help us considerably.

We will look at the budget and actually—we are budgeting now based on activity-based budgeting. And as we do an activity-based budget we can very clearly see, for example, if the Mayor is stating in his performance objective that I will now cut 10 lawns, the new budgeting process that was developed by the office in conjunction with the Mayor and part of our hearing process on the legislative side, we will now be able to look and see whether or not this activity was actually achieved.

The Council is committed to continue to hold these performance-based hearings outside of the budget, but you see whether or not the government is really doing what we said that we were going to do. And in this 2002 budget you will see additional staff and programs being developed for us to do this type of activity-based budgeting that will help us in looking at our performance of the government.

Senator VOINOVICH. In other words, you are in sync with what the new performance goals that have been put together by Mr. Koskinen and others are?

Ms. CROPP. Very much in support, and we have been working together in trying to help to develop it.

Our whole budget process this year was extremely smooth. There has been much better dialog between the executive and the legislative branch as we all try to work to try to make sure that whatever activities the government is stating that it is going to achieve that we all work together to help it get completed.

Senator VOINOVICH. Thank you.

Ms. CROPP. We are learning, and we have a long way to go with it, but we are learning. And I think we are moving in the right direction.

Senator VOINOVICH. It is really important that you agree to the performance goals that the administration is talking about, because that is the only way that—our problem is that we have changed the goalposts several times, and it has been difficult for our sub-

committee that is doing the oversight to find out whether or not things are really being achieved.

I think it is time that you agree and the city agree, the administrative branch, so that we are using the same numbers and the same standards in terms of evaluation.

Ms. CROPP. Senator, if I could add, the Council for the past 2 years has developed—4 years actually—developed a legislative agenda. And this year, as we develop the budget, the executive branch also looked at the legislative agenda of the Council, and you will see there is great agreement as to what the goals are, and the budget reflects that.

Now, whether or not we agree on 100 percent of the—I've been married 31 years, and I don't agree with my husband 100 percent, but, for most of it, we are on the same wavelength.

Senator VOINOVICH. Thank you.

Mrs. MORELLA. And this subcommittee, obviously, would agree with the Senator's comments and your response to it, so do keep us posted.

I wanted to ask—in my opening statement, first of all, we all have recognized and everybody I think has mentioned about the fact that the current CFO has done an admirable job of recognizing and publicizing the early warning signs and the importance of good staffing.

Under the legislation that you have submitted, which I find very interesting and would concur with a lot of it, just having read your draft, the CFO's term would run concurrently with the term of the Mayor. And I just wonder, is there a possibility that a CFO in the future could be beholden to a mayor and to a council and not have that kind of independence we have talked about throughout this hearing?

The IG, the inspector general, has a 6-year term. Would it not be advisable to make that term for the CFO also 6 years?

Ms. CROPP. Let me assure you that the intent of all of us was to try to have the independence of the CFO. We were not trying to negate that by putting the term concurrent with the Mayor. In fact, at that point all data that we received seemed somewhat—showed that would be supportive.

During this hearing process, I think we are open to looking at that issue to see whether or not that approach would be much better, because all of us sitting at this table certainly supported the idea for there to be independence with the CFO.

So we can certainly look at that issue, and we hope that our whole hearing process will give us information so that the final piece of legislation that comes out will be even stronger and more comprehensive than the one that we introduced.

I do want to also just add that another important component of the legislation is that it requires the CFO to develop standards by which the deputy CFOs and the agencies would be able to live by, and that has been something that I think has been lacking in the past.

It also enables the CFO to develop a pool of potential CFOs for the agencies, and then the agency heads would be able to select from that pool. And, once again, I think it will solve a couple of the issues that we have faced with the city in the past.

Mrs. MORELLA. I also mentioned in my opening comments, too, with regard to that, that the CFOs of the various government agencies would not be appointed by or report to the District's CFO. Yes, there would be a list that would be submitted but would not be directly appointed by or reported. Would you like to comment on that?

Ms. CROPP. That was a very important issue that we looked at, because we were looking at approaches where we needed to have an integrated government. Even though we want the independence of the CFO, the CFO still has the function to function within the government.

So we are trying to figure out approaches that would make sure that we had financial stability. And by having the CFO, the directors chose from—select from a pool that was developed by the CFO, it would ensure that those agency-level CFOs met the standards, met the qualifications. But it would also allow input from the agency heads.

That was, Madam Chair, extremely important as we looked at some of the potential problems. But it will also enable the CFO to terminate that deputy CFO if, in fact, the deputy CFO did not meet the standards; and that termination would be in consultation with the Mayor and with the Council.

So I think that addresses the concerns that you raised, while, at the same time, addressing very legitimate concerns that agencies have in that the CFO needs to be able to also work well with the agency director.

And, on the term piece, the legislation allows for the term of the CFO to start July 1st, so not immediately after the Mayor would take office. The existing CFO would continue in office if a Mayor comes in in January until July, and then July 1st the new one would come in.

Mrs. MORELLA. Mayor Williams.

Mayor WILLIAMS. If I could just—from my own personal experience, having been the CFO and been a CFO in different levels of government and now an executive, I think that there really are two extremes that we are trying to avoid.

We are trying to avoid one extreme, and this is obvious. The CFO is a model—the CFO is dormant, basically whatever you want. The CFO gives you drive-up service. We don't want that.

But, on the other hand, I don't think we want a situation where the CFO is reigning king or queen and everybody else is subservient to the CFO, and the CFO feels no responsibility for helping the government meet legitimate performance goals on which this government is selected and which the government has got to serve.

An example would be, let's say the CFO is too removed and too sequestered. We are trying to get an economic development project done. And let's say the CFO doesn't like TIF or does like TIF for this kind of project versus this kind of project, clearly into a policy area.

Or let's say that the CFO decides that the Police Department has got a budget problem, but it is very, very relaxed and very, very processional and less than aggressive about helping the Police Department solve that problem.

Somehow or another we have—we are trying to find out a way jointly where the CFO has the necessary level of independence without being completely independent of legitimate performance goals of the government. And I think that we have struck that balance here.

So, for example, if you are the agency, we don't want a situation where the agency head can say, well, I don't know what my budget was, because the CFO didn't tell me. Because the CFO is completely independent. They don't report to me, and they don't care whether I know about the budget or the financial system. Well, I don't care what happens with the financial system. That is the CFO's problem.

Well, it is everybody's problem, getting a financial system done.

Mrs. MORELLA. It is like the whole world is a balancing act in some way. I understand what you are saying. It just seems the 6-year term might be good, and, also, from what you say, it also sounds like some kind of an audit advisory group would kind of take it out of any political situation. But this is all a work in progress. And my time has expired.

Congresswoman Norton.

Ms. NORTON. Thank you, Mrs. Morella.

Mayor Williams, you testified before the Appropriations Subcommittee that the District should have budget autonomy, that it would simplify the process and reduce the costs, and you have so testified here today.

When you say there should be—after you met these targets for 3 consecutive years, I assume that you are counting the 4 years you have already met them and that the 3 consecutive years is included within that period?

Mayor WILLIAMS. Yes, I would include them.

Ms. NORTON. When it comes to the 30-day legislative process, as cumbersome as that is, that is a process for which you almost already have complete freedom.

To the credit of Chairman Tom Davis, not once did he agree to use the 30-day period in order to override a provision of District law; and in more than almost 25 years of home rule, there have not been a half a dozen laws that have been overturned. The way in which laws have been overturned has been misuse of the budget process, not the 30-day layover process.

Therefore, I can't understand—since you are almost free of it anyway and all you are left with is the most tortious process I have ever seen, where law gets delayed, people refuse to come on board because they are not sure whether or not in the—it may take 4, 5 months, somebody will jump up, for the life of me I can't understand why you put a more stringent requirement on the 30-day layover period, which you almost already have, than on the budget period.

And I want to know whether you think the District—I want to know whether you all think that the District needs—what purpose the 30-day layover period now serves, on the one hand, and what burdens it adds to the District of Columbia, on the other.

First of all, Mr. Mihm, let me ask you, since you are the one that put this thing in your testimony.

Mayor. WILLIAMS. No. Since you're upset, this is joint testimony.

Ms. NORTON. If you all want to—if the Council Chair wants to take responsibility for that, I would like to hear it. All I've heard are complaints from the District about this process.

Ms. CROPP. Let me join with you in saying that if we can eliminate the layover period it would be most welcome. You know, from the Council's viewpoint, constantly one of the things that we have been criticized about is so much of our legislation.

I would like to present to you a lot of our congressional review legislation and just give you the numbers of how much legislation we have to keep passing over and over again as emergency legislation because we are just waiting for the congressional review time period to come by.

We have to pass emergency legislation because sometimes the government just doesn't say you can't function in 60 days, we have to make some decisions immediately. And in order to be able to make the immediate decisions we have had to pass emergency legislation, because that is the only way we could get something done right away.

I would applaud any effort and support any effort that would eliminate that need. I think there are enough safeguards that if there's something that the District is doing that article 1 section 8 would come up, that they are there without us having to have the 30-day layover or 60-day layover.

Ms. NORTON. We all understand this to be a holdover period. It puts the District on hold. The District—the Congress can get up right now and say that a law you passed 20 years ago is null and void. So the only question before us is, is it worth the wait, again, given the notion of weighing the benefits against the costs to a local jurisdiction, not to mention the paternalism?

Let me ask, Mr. Mihm, you have testified that the District has, indeed—you put in your appendix many reported requirements. You lay them out, the many committees that require them. What burden in financial terms, perhaps diversion of resources, do these requirements place on the District? Can you think of any way to streamline these multiple requirements on the District of Columbia?

Mr. MIHM. In terms of the first part of your question, we haven't looked and worked with the District about the financial burden that it places on them. We have done similar work, though, on multiple reporting requirements placed on Federal agencies and can tell you that it sometimes can be quite expensive to report on these things.

One—not to reopen an issue, ma'am, but one of the things that reportable events could help do is, if it is done as part of a sorting-through of the cumulative burden that is placed on the District for reporting, it could offer an opportunity to say, OK, these are the things that we are agreeing on and, as part of that, here's the things that we are going to eliminate.

There is—for example, there's a report—there's a requirement for the emergency reserve fund use that Congress be notified within 30 days. I call that a reportable event. I would assume that—you know, pending agreement between Congress and the District, that is exactly the type of thing that would be rolled into a reportable event system.

So the cumulative effect, I mean, can be burdensome; and the idea of a reportable event would be to try and just let's all focus on the vital few so that we really know we are focusing on what is important and not just everything.

Ms. NORTON. Well, I very much appreciate that, Mr. Mihm. And since you have been working with the District on an ongoing basis and have laid these out and have indicated that there should be these early warnings, perhaps you can work with the District to sort out which of these might be eliminated or rolled into others as a part of the Congress' contribution to the streamlining of the District government.

Mr. MIHM. We would be pleased to work with your office on that, yes, ma'am.

Mrs. MORELLA. I am not going to hold you up, if it is OK with Congresswoman Norton. We will be submitting questions to you for your response.

I must say, in reading the legislation that you submitted to us, the draft, I was pleased to note that your 3-year period for then allowing the District of Columbia to spend its own money is as it deems appropriate was very sound, very accurate.

I also question why we have to wait 6 years in order to get rid of the 30-day holdover. So, again, if something can be worked out, I think that 30-day period for 6 years is pretty lengthy. Maybe that could be in some way accommodated.

I want to thank you very much for being so patient, being here.

I know, Councilwoman Cropp, you wanted to make a comment.

Ms. CROPP. Madam Chair, if you could just indulge me for 1 further second.

Mrs. MORELLA. Yes, ma'am.

Ms. CROPP. When you asked about structural problems that the District has, I don't think I can leave this table without also talking about the issue of rollover funds.

In other business, if you have excess dollars at the end of your fiscal year, you have the ability to roll them over into your next year. We don't have that. It creates—it encourages bad behavior. It encourages you to try to spend absolutely every penny so that you won't have anything left over.

I implore the committee to support the idea of the District having the ability to roll over excess funds so that we will be able to utilize them in the appropriate programs and do it in a reasoned and comprehensive approach to it.

Mrs. MORELLA. I appreciate your mentioning that. You and I in our discussions have commented on it; and I know that Congressman Knollenberg is also interested in pursuing that, as is Congresswoman Norton. That will be an area we will be looking at.

Again, I want to thank the panel. You have been terrific. Thank you for the work that you have done through the years to bring us to this point where we really are celebrating and planning ahead.

Dr. Rivlin, thank you. Mayor Williams, thank you. Councilwoman Cropp, thank you. I want to thank you, Mr. GAO Director Mihm. Thank you. Thank you all.

Now the second panel. We should have been serving boxed lunches, but, unfortunately, the budget didn't provide that. The second panel will come forward.

Our second panel consists of Dr. Natwar Gandhi, the chief financial officer of the District of Columbia, about whom we have heard so much with regard to responsibility in the future, as well as past achievements. Charles Maddox, who is the inspector general of the District of Columbia. He comes with a great deal of experience. Joshua Wyner, the executive director of the DC Appleseed Center, thank you for being here. Renee Boicourt, the managing director, Moody's Investors Service. We are very pleased to have you and to have Parry Young, the director of public finance, Standard & Poors.

Again, as we did with the first panel, if you would rise and raise your right hands for swearing in.

[Witness sworn.]

Mrs. MORELLA. The record will reflect an affirmative response.

Again, we will try to stick with our 5-minute rule and get to our questions quickly. Thank you.

Dr. Gandhi, do you feel overwhelmed with the fact that you have been in our discussion so much, so predominantly?

**STATEMENTS OF NATWAR M. GANDHI, CHIEF FINANCIAL OFFICER, DISTRICT OF COLUMBIA; CHARLES C. MADDOX, INSPECTOR GENERAL, DISTRICT OF COLUMBIA; JOSHUA S. WYNER, EXECUTIVE DIRECTOR, DC APPLESEED CENTER; RENEE BOICOURT, MANAGING DIRECTOR, MOODY'S INVESTORS SERVICE; AND PARRY YOUNG, DIRECTOR, PUBLIC FINANCE DEPARTMENT, STANDARD & POOR'S**

Mr. GANDHI. Thank you, Madam Chair.

Madam Chair, Ms. Norton, members of the committee, I am Natwar M. Gandhi, chief financial officer for the District of Columbia. I appreciate the opportunity to appear before you today to testify about the outlook for the District's post-control period.

I will summarize my prepared statement here and request that it will be made a part of the record in its entirety.

Mrs. MORELLA. Without objection, it is so ordered.

Mr. GANDHI. In my summary, I want to focus on the key contributing factors in the financial turnaround of the District of Columbia that we have seen over the last 5 years. I will speak in terms of "factors" rather than any particular organizational arrangement for two reasons. First, I believe, these factors are essential, and, if they are present, a number of organizational arrangements could be effective; and, second, the organization of the District government in the post-control period is properly a matter for the elected leaders of the District and the Congress.

Having said that, I will also tell you that it is my opinion that the District would best be served by an independent CFO who is still an integral part of the District government, consistent with home rule. What factors make any CFO independent? I mean that the CFO as well as the CFO cluster and its work in all aspects of financial review and analysis are separate and insulated from the every day political environment. In this regard I believe I'm in agreement with the Mayor, the Council and the Authority. They have expressed similar opinions about the need for the CFO to render financial judgments and share information without prior approval of the other District officials. Among others, the District's

business community and the New York financial markets are sensitive to these issues as well.

This kind of independence can be implemented by making the CFO a scorekeeper, so to speak, for financial purposes rather than a gatekeeper, a role that is currently played by the Authority. The CFO would be the transparent developer and certifier of financial data, such as revenue estimates, fiscal or contractual impact statements and the budget costing and budget monitoring. The CFO, in part, would become a city version of the Congressional Budget Office with respect to assessing revenues and reviewing the costs of legislation. This would allow elected leaders to focus on the direction of the government knowing that the financial picture was portrayed by a nonpartisan, independent entity with no vested interest in the policy outcomes.

It is also important to remember what independence is not. I believe the CFO should not be independent from the District government in the same sense that the Authority is currently independent. After all, it is one government under home rule. With that in mind, we have already begun the process of reintegrating the CFO cluster into District government.

For example, we are working with the chief technology officer on information technology decisions; we participate directly in executive meetings, and in almost all cases, we act in parallel with other components of the District government on issues like pay and personnel policy. We are also working very closely with the City administrator on restructuring the District's system of accounts and the introduction of performance-based budgeting.

Overall, the CFO is a resource for both the executive and legislative branches of the city government, the Congress, and other stakeholders, such as bond investors. We work with everyone as an equal opportunity sharer of information and analysis, and I believe this positive role can best be maintained by the sort of independence that I have described here today. But retaining that independence requires a positive action by the Congress and the District by the end of the control period, because with that event, the prior law will come back into effect.

I would be pleased to answer any questions you and Ms. Norton may have. Thank you.

[The prepared statement of Mr. Gandhi follows:]

**THE OUTLOOK FOR THE  
DISTRICT OF COLUMBIA GOVERNMENT:  
THE POST-CONTROL BOARD PERIOD**

Joint Hearing before the

Subcommittee on the District of Columbia  
Committee on Government Reform  
U.S. House of Representatives

Subcommittee on Oversight of Government  
Management, Restructuring and the  
District of Columbia  
&  
Committee on Governmental Affairs  
U.S. Senate

The Honorable Constance A. Morella, Chairwoman

The Honorable Richard J. Durbin, Chairman

June 8, 2001  
2154 Rayburn House Office Building  
11:00 a.m.

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Testimony of  
Natwar M. Gandhi  
Chief Financial Officer  
Government of the District of Columbia

Good morning, Madam Chairwoman, Mr. Chairman and Members of the House and Senate Oversight Subcommittees on the District of Columbia. I am Natwar M. Gandhi, Chief Financial Officer for the District of Columbia.

We are now less than four months away from the end of a congressionally mandated control period that began in April 1995 with the enactment of the District of Columbia Financial Responsibility and Management Assistance Act. Since that time, with the assistance of the Congress, the work of the Financial Responsibility and Management Assistance Authority (“Authority”), and the efforts of elected and appointed officials in the District of Columbia government, we have all witnessed a true turn-around in the management of the District of Columbia on both the program and financial level. It is accurate to say that what Congress intended when it passed the Authority Act has come to pass in just six years.

While much remains to be done, what has been accomplished is remarkable. The District has moved from an end-of-year operating cash deficit in FY 1996 of \$201 million to a positive \$538 million in FY 2000 – a turnaround of \$739 million. Over the same period, total local source tax collections have increased by 28%, from \$2.40 billion to \$3.08 billion, partly as a result of a vibrant economy but also in substantial measure because of rejuvenated tax administration. Also over the same period, government local source expenditures actually declined from \$3.4 billion to \$3.1 billion, as did the total number of employees on the District government’s payroll.

Today, I would like to discuss with you the following questions. First, what is the current budget outlook for the District of Columbia? Second, what are the key components needed to keep the District financially viable in the future? Third, what role should be played by the Office of the Chief Financial Officer (OCFO) in ensuring this viability?

#### **The FY 2002 Budget Outlook**

The District's FY 2002 budget proposal submitted to the Congress on June 4 reflects the District's projected net operating margin through FY 2005. This presentation shows an average annual local source surplus of receipts over expenditures of approximately \$80 million. On the surface this appears to present a very positive financial picture, and is based on a revenue forecast that was built using realistic economic and demographic assumptions generally accepted by the forecasting community and used by the federal government. In this regard, I believe it is safe to say that these estimates are neither unduly conservative nor optimistic, but represent a professional consensus view.

However, a closer examination of the budget proposal suggests the District is operating on a much tighter financial margin. First, in building the District's FY 2002 local source budget, we utilized all the data available to include all known costs for maintaining the current services of existing programs. We then built in the costs of the operating initiatives approved by the Mayor and the Council. This process, in which we worked closely with the Mayor and the Council, should go a long way toward eliminating the types of spending pressures that occurred early this fiscal year. We also

built into out-year projections a cost of living index to serve as a proxy for the on-going costs of current programs at current levels. However, no allowance was made for possible new initiatives in FY 2003 and beyond.

Second, current law requires that the District have a set-aside budgeted reserve of \$150 million. In our FY 2002 through FY 2004 projections, we have assumed that this reserve is funded annually from that year's local source revenues and that roughly one-third of the reserve is expended, thereby contributing to each year's overall positive operating margin.

Based on experience, I believe we can keep the costs of maintaining current services within the amounts projected. However, it is unlikely that the District will operate over the next several years without program initiatives. Should this occur, the District would be operating on a narrower positive margin indeed. All this suggests that the District needs to maintain and improve its financial diligence in managing its resources and look for ways to improve services through business process improvement rather than additional program spending. It also suggests that, despite current positive trends, there may be a long-term structural imbalance in the District's financial situation that ultimately will have to be remedied. I will return to this issue later.

#### **Key Components of Financial Viability**

The District needs to maintain its financial viability at three distinct levels.

*Financial Viability.* First, on a week-to-week, month-to-month basis, the District needs to understand costs and their sources, revenue flow from

various sources, and meet payroll and other operating costs just like a business. The District has not always done this. Speaking as a financial manager, one key benefit of the control period was that it gave the District both the requirement and incentives to greatly improve its capabilities in this arena.

During the control period, the District made improvements in consolidating and standardizing budget and accounting controls. Information on its cash position improved greatly. We no longer “call the bank” to find out how much money we have, but are able to reconcile our cash balances on a monthly basis. Revenue accounting improved immensely and will soon approach best practice levels once the Integrated Tax System is fully implemented in FY 2002. Internal controls over financial transactions need substantial improvements, but are still light years better than when the control period began in 1995.

Borrowing practices have similarly improved. With the securitization of tobacco settlement payments and other debt retirement actions, the District reduced its overall debt load from \$3.21 billion to \$2.76 billion between September 30, 1999, and the present, and on a per capita basis from \$6,177 to \$4,819.

We still have much to do in building the type of information systems infrastructure and procedures needed to move quickly to respond to changing programmatic or financial conditions. I have testified before the Council of the District of Columbia that we must work to interface the procurement and personnel systems with the financial system, if we are to

have the type of real-time information needed in today's environment to manage an enterprise the size and complexity of the District government. Also, now that we have implemented our new System of Accounting and Reporting (SOAR) and worked out the operational details, we need to build out its full capabilities of fixed asset accounting and performance budgeting. Both efforts are underway. We also need to use the budget monitoring capabilities of SOAR to drill down into the organization to isolate organizational and program costs so that performance standards and spending expectations can be matched with available revenues.

*Fiscal Viability.* The second level of financial viability is at the year-to-year level. Starting this year, the District is building a rainy day fund in the form of two cash reserves provided for in the FY 2001 D.C. Appropriations Act. When fully funded, an event projected for FY 2003, the District will have a cash fund equivalent to 7% of local annual expenditures (nearly \$260 million) to deal with emergencies and unforeseen economic downturns similar to that of many other jurisdictions. It will also have a fund balance well over a half-billion dollars that will rise to well over three-quarters of a billion dollars by FY 2005.

The Council of the District of Columbia has directed that it receive a tax expenditure budget from the OCFO. This budget will identify the cost of tax preferences so that, in establishing spending programs and making tax decisions, it can weigh the costs of its current tax expenditures against other competing needs.

Despite these positive steps, we have much work to do. Budget modeling remains an area in need of major improvement despite the steps that have been taken over the past few years. The City Administrator's office and the OCFO have undertaken a joint project to build out the capabilities of SOAR to track costs in great program detail and to tie this cost tracking to specific program or work plan expectations at a comparable level. This Account Structure/Performance Budgeting Project will provide for the first time the kind of detailed financial information necessary to see what the District is getting for what it spends. With this information, agency and unit work plans will be tied to a corresponding financial plan. We will be able to hold managers accountable for both their program and financial performance just as in a private business.

However, much of what is needed to drive good budget modeling requires a link between the District's personnel systems and the financial system. Personnel costs account for about one-third of the District's gross operating costs, and we know little about what drives them – promotions within grades, attrition, vacancies. The first task that must be undertaken before this can be accomplished is to rationalize the District's personnel system, which over the years has devolved into a series of independent systems with multiple pay tables, work rules and other distinctions.

Grants management is also an area in need of close monitoring. The District needs to ensure that it is taking advantage of opportunities to avail itself of federal funds while closely tracking and accounting for the expenditure of those funds once received.

Finally, I believe the District needs to work with the Congress to address the degree of financial flexibility it has permitted the District. For example, the District is on a path to build a 7% cash reserve – above average for jurisdictions that have such reserves. But at the same time, it is still required to have an additional \$150 million in reserves that are budgeted each year. Also, while the District has built a substantial fund balance from its annual surpluses, and will continue to do so under current law, it does not have the capability common in other jurisdictions to draw on these balances for its budget. The District also has no way of certifying and allocating additional revenues that may be estimated, either one-time or recurring, once its budget has been submitted to the Congress – except through the time-consuming supplemental appropriations process. This area particularly needs to be addressed as we move to the post-control era.

*Economic Viability.* The third level of financial viability is long-term. I foresee a time within the next few years when the District will have effective controls over all operating spending. We will be able to describe costs down to the first or second line in the organization and be able to relate those costs to program outputs. Budgets will be built using effective standards and cost models. Production of financial statements on a monthly and annual basis will be a routine matter. We will have reduced the number of District bank accounts from 1,500 to approximately 300 by the end of FY 2002, and will

be able to forecast our cash flow with great accuracy. Despite having reached this high plateau of performance, there will remain, unless otherwise addressed, a structural imbalance that may cause District expenditures to exceed revenues.

This imbalance has been well documented. For example:

- tax exemptions of federal commercial activity – such as the commercial property tax exemptions on federal office buildings – reduce District revenue by as much as \$193 million;
- the District provides as much as \$339 million in public services to support federal property, which comprises over 40% of District property by area;
- lacking a state or state-like support from the federal government, the District spends as much as \$588 million per year on state-like functions, such as the University of the District of Columbia; and,
- the District can tax only 34% of income earned in the District.

The federal assumption of certain pension liabilities and court and prison functions was an important step in correcting this imbalance, but only a step. Most financial analysts would conclude that the District government is a going concern in a good economy, but will face major problems in any serious or sustained economic downturn. As important as good government and financial prudence are, they cannot by themselves overcome the fundamental imbalance the District now faces.

The long-term solutions to this imbalance are matters to be addressed by District and congressional policy-makers. Federal tax incentives may be

part of the answer. Adjusting restrictions on the District's local taxing capabilities to reflect the structure of today's economic and residential patterns might be another. Delegate Norton in the past has sponsored legislation to enact a nonresident wage tax with a corresponding federal tax credit, and may do so again. Further addressing the federal/local partnership for providing city services is yet a third path that could be explored.

At the same time, there are steps the District can take to improve its economic posture on its own. Both the Tax Parity Act and the Tax Clarity Act were first steps in this direction, but the D.C. Code can be made more business friendly. The District's tax expenditures might be reviewed and streamlined. Also, consideration should be given to creating the District equivalent of the federal Budget Enforcement Act, under which pay-as-you-go rules would apply whenever proposed legislation has not been scored and incorporated in the District's approved, multi-year financial plan.

**The Office of the Chief Financial Officer in the Post-Control Period**

For the past five years, my predecessors as Chief Financial Officer and I have been engaged in facilitating a fundamental change in the financial management of the District. It takes some time for a culture of fiscal and financial discipline to be created. Making significant change takes time, commitment and perseverance. The provisions of the Authority Act, and related subsequent legislation, provided the framework for effecting such change. It is my view that the body of law that has been established to improve District financial management should be carefully reviewed, so that those portions or factors that have facilitated the financial turn-around can be retained in organic statute. In this respect, positive action on the part of

elected District and congressional policymakers will be required. Otherwise, with the dormancy of certain provisions of P.L.104-8, the provisions of prior law, either federal or District, will take effect by default.

I agree with the Mayor, the Council, and the Authority that it is important for the OCFO to be able to make financial judgments and share information without prior restraints or approval. The District's business community and the financial markets in New York are particularly sensitive to these issues. For the post-control period, I believe that changes made to the Home Rule Act in the FY 2001 D.C. Appropriations Act have gone a long way toward creating the environment necessary for this independence in the post-control era.

At the same time, I believe the OCFO can discharge its financial management responsibilities without being independent from the District of Columbia government in the same sense that the Authority is independent. We have already begun the process of reintegrating OCFO processes into the broader management systems of the District. For example, we are working with the Chief Technology Officer on information technology decisions, we participate directly in the overall executive department governance meetings, and in most cases we act in parallel with other components of the District government on such issues as pay and personnel policy. We are also working closely with the City Administrator on restructuring the District's system of accounts and the introduction of performance budgeting.

We are an "equal opportunity" sharer of information and analysis, working with both the Office of the Mayor and the Council. The OCFO is a resource

for both the executive and legislative branches as well as outside stakeholders such as bondholders and the Congress. Because of this, and in light of the past financial history of the District, my opinion is that the District would be served best by an independent CFO.

This needs to be done in congruence with the District's cherished Home Rule and in a manner where the OCFO is the scorekeeper, so to speak, of the financial process rather than the gatekeeper, a role played by the Authority. To me, the way to accomplish this is to place the CFO in the role of transparent developer and certifier of financial numbers – revenue estimates, fiscal or contractual impact statements, budget formulation cost estimates, and budget execution monitoring. With this type of system in place, the OCFO can play a role similar to that of the Congressional Budget Office with respect to assessing revenues and reviewing the costs of legislation. Policy officials can focus on the direction of government knowing the financial constraints within which they must operate and that these constraints have been established by a non-partisan body without a stake in policy outcomes. Prior to the control period, financial constraints were too often tailored to fit the desired policy outcome rather than the reverse.

Financial management in the District of Columbia is clearly a work in progress. The recently published GAO report on Weaknesses in Financial Management Systems Implementation points to many of the matters we must address, and we are doing so, as I testified last month before Congress. In the context of today's hearing, we must remember that financial improvements do not exist in a vacuum. In many instances, a necessary

precondition for making significant improvement in financial systems is a complementing business process improvement elsewhere in the District government. To effectively interface procurement actions with SOAR, procurement controls need to be automated. To acquire a new payroll system at reasonable cost, the personnel system needs to be streamlined. To implement performance budgeting, program managers must institute a work planning process that identifies cost centers and related measures. These are all areas the District is addressing. This is another reason that continuity of operations in the financial governance structure is important.

Madam Chairwoman, Mr. Chairman, this concludes my testimony. I would be pleased to answer any questions you may have.

Mrs. MORELLA. Thank you, Dr. Gandhi.

And I'm pleased now to recognize our inspector general for the District of Columbia, Director Maddox.

Mr. MADDOX. Good afternoon, Chairwoman Morella, Chairman Voinovich and councilwoman—Committee woman Norton.

I appreciate the opportunity to share my views on the position of the Office of the Inspector General [OIG], in its respective role in the District once the Control Board is suspended on September 30, 2001. My testimony today will point out that the D.C. Office of the Inspector General has become a key component of the District governance for two primary reasons.

First, during the Control Board period we have been provided with the critical resources necessary to address a wide range of fiscal and managerial deficiencies that affect the city.

Second, we strive to be an independent organization that is guided by strict adherence to principles of objectivity as clearly established by generally accepted auditing inspections and investigative standards.

The recommendations that I will urge this committee and others to consider today relate directly to these two imperatives. I will share with you my perspective about what I think our organizational long-term strategic vision should be for helping to mitigate risk in critical areas. A description of actions already under way to mitigate risk is included in the longer version of this testimony for the record. I also will suggest legislative changes that I believe will enhance and clarify our authority and independence.

As the Office of Inspector General evolves, my vision for helping to foster accountability and the integrity of the District government rests on a commitment to strategically focus our limited resources. Accordingly, I believe strongly that the Office of Inspector General's oversight of District affairs does not and should not include the policymaking authority and managerial role that has been exercised by the Control Board. Instead, I believe the effectiveness of the OIG is tied to our ability to be perceived as and utilized as a source of independent, objective analysis that can be considered by all stakeholders. Therefore, I would like to share several ideas which comport with the unique and specific functions of our office as we move forward.

In the area of procurement, the OIG should develop a long-range plan to cover procurement and contract administration. Specifically, we should conduct audits which accomplish the following: identify systemic problems and the potential for monetary and management benefits, focus on single audits and determine whether the cost of contracts is being properly estimated and negotiated. We plan to create a pilot program for the establishment of an Office of Inspector General resident audit sites at various agencies. Our resident auditors will provide an independent audit function to ensure that appropriated funds are properly controlled and accounted for and provide continual feedback on efficiency and effectiveness.

Based on our early analysis by choosing five or six of the agencies with the largest budgets and most complex operations, the OIG could cover approximately 50 percent of the District's operating budget. We plan to intensify our inspections of selected agencies in

accordance with the standards for eternal control recently promulgated by the General Accounting Office for Federal agencies. Again, we will concentrate on agencies which deliver key services to the city and which have the greatest fiscal impact on their budget.

We believe that it is necessary to create a contractor integrity group comprised of representatives from the Office of the Inspector General, the Office of Contracting and Procurement, the FBI, U.S. Attorney's Office and the Office of Corporation Counsel, which would conduct background and prequalification checks of contractors seeking to do business with the District.

It is important to note today that the Federal legislation that created the Control Board also had a significant impact on the role of the Inspector General's Office to enable the IG to assist the Control Board in addressing budget deficits and management deficiencies in the District government.

Section 303 of Public Law 104-8, the D.C. Financial Responsibility and Management Assistance Act of 1995 provided the IG with duties crucial to determining the District's fiscal stability. Among those duties are contracting authority, to audit the complete financial statement of the District's government each year and development of an annual plan for audits by the IG to be conducted in consultation with the Authority, the Mayor and the Council.

These two responsibilities provided us with a unique perspective of the District's fiscal health. For this reason, section 209 of Public Law 104-8 places a duty on the IG to provide warnings concerning the emergence of certain fiscal weaknesses, such as the failure to make timely payroll or pension payments that could trigger the initiation of a control period. I can assure this body that my office will remain watchful of these conditions which are set forth in Federal law very specifically and report on them accordingly.

I also would like to note that the City Council has amended the IG statute several times since the Federal legislation was passed in 1995. On each occasion these amendments have strengthened our authorities and clarified our mission.

Again, I would like to commend—recommend a number of additional legislative changes that I believe will assist my office in addressing risk to the District in the post-Control Board years. These recommendations are summarized in attachment A and are set forth in detail in the longer version of my statement.

With the exception of two proposals regarding the Federal Ethics in Government Act and the Federal false statement statute, all of my legislative proposals can be addressed by making changes in the DC Code. I have had preliminary discussions with the Mayor and with Chairwoman Cropp, and I am pleased to say that I believe they are supportive of these recommendations. In the coming weeks, I plan to submit these proposals directly to the Mayor and to Chairwoman Cropp for their review and legislative action.

Again, thank you for the opportunity to share my views today. I look forward to working with the committee and with others as

we do all we can to ensure the fiscal health of the District in years to come. I will be pleased to respond to any of your questions at this time.

Mrs. MORELLA. Thank you very much, Mr. Maddox.  
[The prepared statement of Mr. Maddox follows:]

## TESTIMONY BY INSPECTOR GENERAL CHARLES C. MADDOX

Before the House Subcommittee on the District of Columbia, Committee on Government Reform, and the Senate Subcommittee on Oversight of Government Management, Restructuring and the District of Columbia, Committee on Governmental Affairs

June 8, 2001

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Chairman Voinovich, Chairwoman Morella, and other members of the House and Senate Committees, I appreciate the opportunity to share my views on the mission of the Office of the Inspector General (OIG) and its prospective role in the District once the Control Board is suspended on September 30, 2001. As you know, Inspectors General enjoy a unique perspective about management because we address the concerns of government from several vantage points. More than 15 years of federal IG experience, and now two full years as the DC IG, has allowed me the benefit of having observed the challenges and the opportunities faced by governments, and by the IG's themselves, who must audit, inspect, and investigate a wide range of matters that impact the lives of many people. I hope that the ideas and proposals you have asked me to share at this hearing prove to be beneficial to all of the District stakeholders, including Congress, the Control Board, the Mayor, the City Council, District agencies, and the residents of this great city.

My testimony today will point out that the OIG has become a key component of District governance for two primary reasons: First, during the control period, we have been provided with the critical resources necessary to address a wide range of fiscal and managerial deficiencies that affect the city. It may surprise you to know that, just six years ago, this Office had a complement of only seven employees. Today, with the support of the Control Board, Congress, Mayor, and the City Council, we have 105 employees. As a result of receiving additional resources, the audit division was augmented by an investigations division formed to focus on procurement fraud and other employee misconduct, both criminal and administrative. In 1999, I created an Inspections and Evaluations division to evaluate the programs and management of

District agencies. On March 1, 2000, our application to the US Department of Health and Human Services for a \$1.2 million grant to establish a Medicaid Fraud Control Unit (MFCU). This Unit, the first in the District since 1983 investigates allegations of abuse against Medicaid recipients and will seek to recover Medicaid funds lost due to fraud and mismanagement.

Second, we strive to be an independent organization that is guided by strict adherence to principles of objectivity as established in generally accepted auditing, inspection and investigative standards. Based on my experience within the last two years as IG, I believe our work has been requested and acted upon extensively by all stakeholders because our findings and recommendations have been objective and realistic, based on straightforward interactions with the parties we have reviewed.

All of our employees are engaged vigorously in activities which I believe will enable us to continue addressing, in a unique way, many of the functions that have been executed by the Control Board. I am particularly optimistic that we will be able to continue our important work to mitigate the risks that could possibly cause the Control Board to be reactivated.

The suggestions I will urge this Committee and others to consider today relate very directly to these two imperatives. First, I will provide examples of actions we have been taking that are specifically aimed at mitigating risks to the District government. Second, I will share with you my perspective about what I think our organization's long term strategic vision should be for helping to mitigate risks in critical areas. Third, I will suggest legislative changes, which would enhance and clarify our authority and independence.

#### MITIGATING RISKS

In almost every agency we have investigated, audited, or inspected, we have found material internal control breakdowns and noncompliance with District and Federal

Government regulations. As a result, management is faced with risk related to strategic initiatives proposed by the Mayor. The risks relate to problems associated with weak infrastructure, inadequate controls, and inadequate use of state of the art technology. In response, we are engineering most aspects of our operations to directly or indirectly address the risks that naturally flow from these deficiencies. For example:

- In addition to penalizing those who commit healthcare fraud and patient abuse, the other major goal of the MFCU is to train and coordinate efforts with the Department of Health, Metropolitan Police Department, and Fire Department to prevent and deter patient abuse and financial waste that can occur in an \$800 million Medicaid program.
- We have designed our reporting system to include issuance of Management Alert Reports (MAR) and Management Implication Reports (MIR), which are quick reaction reports that go to management when it is necessary to advise managers that time sensitive action is needed. We issued such a report with regard to a practice in which several District agencies were not following federal requirements that single audits be completed on the use of millions of dollars in federal grants.
- In our oversight of the Comprehensive Annual Financial Report (CAFR), we are formalizing the oversight committee process to ensure that any impediments to timely completion of the CAFR are recognized and addressed promptly. This process has proven especially useful as Committee members, including the General Accounting Office, City Council, Mayor's Office, and Office of the Chief Financial Officer, we are able to be informed of developments as they arise. In addition, with the issuance of the management letters associated with the CAFR, we are highlighting for stakeholders the key areas of concern, which we believe should be focus points. (Our alert regarding the control weaknesses and repeated deficiencies at University of the District of Columbia and the Public Benefit Corporation are just two examples.)

- We conducted an audit to assess the accuracy and reliability of performance measurements associated with the Mayor's "Scorecard" and FY 2000 performance contracts between the Mayor and agency heads.
- We conducted an audit, which disclosed that substantial funds were being lost because the District failed to timely request reimbursement for expenditures paid for federal grants in a timely manner. Based on our review, the U.S. Treasury allowed the District to be paid \$3.3 million of the recalculated interest liability claim.
- We are auditing eight agencies to determine the extent to which they are implementing our past recommendations.
- We are placing special emphasis on a plan for continuous auditing of procurement and contract administration, a major function, which will be vacated by the Control Board.

#### STRATEGIC VISION

As the OIG evolves into an even more mature organization, my vision for helping to foster accountability and integrity in the District government rests on a commitment to strategically focus our limited resources. Specifically, we should work to address the risk factors that are the subject of today's discussions. I believe strongly that the OIG's oversight of District affairs does not and should not include the policymaking authority and managerial role that has been exercised by the Control Board. In fact, the effectiveness of the OIG is absolutely tied to our ability to be perceived as, and to be used as, a source of independent, objective analysis that can be considered by all. Therefore, I would like to share in concept several ideas, which comport with the unique and specific functions of an IG office. I will be happy to discuss them all in more detail, as you deem appropriate.

Procurement and Contract Administration

In the area of procurements, the OIG should develop a long-range plan to cover procurement and contract administration. Specifically, we should conduct three kinds of audits: 1) The cross agency audit of a procurement element or elements, which identifies systemic problems and the potential for monetary and management benefits. 2) The single agency audit in which procurement may be one of several functions under audit, and 3) The pre-award and post-award contract audit, which determines whether the price and cost of contracts are being properly estimated. In addition, this type of procurement would determine whether agencies are paying excessive costs; it would also identify problematic trends in procurement. We are now attempting to determine the universe of auditable procurement functions so that future audits are efficient and provide managed coverage to all elements of procurement.

Resident Auditors

The OIG should create a pilot program for the establishment of OIG resident audit sites at key District agencies. OIG resident auditors would provide an independent audit function to assess the results of various budgeted programs to ensure that appropriated funds are properly controlled and accounted for, to provide continual feedback on how well the agency is meeting its mission, and assess the efficiency of operations. Based on our early analysis, by choosing five or six of the agencies with the largest budgets and most complex operations, the OIG could cover approximately 50 percent of the District's operating budget.

More Inspections

The OIG should intensify its inspections of selected agencies, in accordance with the Standards for Internal Control recently promulgated by the GAO for federal agencies. With a continued focus on internal control of government operations, our inspectors should concentrate on effectiveness and efficiency of operations, reliability of financial

reporting, and compliance with laws and regulations. Currently, this new inspections division has a team of eleven who inspect 68 agencies.

Creation of a Contractor Integrity Group

We believe that it is necessary to create a Contractor Integrity Group, comprised of representatives from the OIG, Office of Contracting and Procurement, FBI, US Attorney's Office and the Office of Corporation Counsel, which would conduct background and prequalification checks of contractors seeking to do business with the District.

LEGISLATIVE PROPOSALS

I appreciate the opportunity to address this congressional committee today because the federal legislation that created the Control Board also had a significant impact on the role of the Inspector General's office. To enable the IG to assist the Control Board in addressing budget deficits and management deficiencies in the District government, section 303 of pub. l. 104-8, the D.C. Financial Responsibility and Management Assistance Act of 1995, provided the IG with duties crucial to the District's fiscal stability. Among those duties are (1) contracting authority to audit the complete financial statement of the District government for each year and (2) development of an annual plan of audits by the IG to be conducted in consultation with the Control Board, the Mayor, and the Council.

These two responsibilities provide us with a unique perspective of the District's fiscal health. For this reason, Section 209 of Public Law 104-8 places a duty on the IG to provide warnings concerning the emergence of certain fiscal weaknesses (such as the failure to make timely payroll or pension payments) which could trigger the initiation of a new control period. I can assure this body that my office will remain watchful of these weaknesses, which are set forth in federal law very specifically, and report on them accordingly.

At this point, I would like to note that the City Council has also amended the IG statute several times since the federal legislation was passed in 1995. On each occasion, these amendments have strengthened our authorities and clarified our mission. Nevertheless, I would like to recommend a number of proposals for additional legislative changes that I believe will assist my Office in addressing risks to the District in the post-Control Board years. I will now briefly summarize these legislative proposals for your consideration.

#### SUMMARY OF LEGISLATIVE PROPOSALS

- Full Law Enforcement Authority (Proposal #1)

Currently, OIG investigators are authorized to execute search warrants, carry firearms while on duty within the District of Columbia, and arrest for felonies occurring within their presence. However, OIG investigators may neither arrest the subjects of our own investigations, nor make warrantless arrests when there is probable cause to believe a felony has been committed. In addition, neighboring jurisdictions have declined to grant reciprocity to our investigators to carry firearms. This limited grant of law enforcement authority, therefore, undermines our statutory mission to independently investigate allegations of criminal misconduct, denies our investigators access to necessary investigative tools, and threatens the safety of our investigators as well as that of the public.

- Resolution of Audit and Inspection Findings and Recommendations (Proposal #2)

The District's Inspector General statute, D.C. Code § 1-1182.8, does not provide for timely resolution of disagreements between the OIG and another District agency regarding significant issues identified by an OIG audit or inspection. In order to avoid these stalemates, we recommend that the statute be amended to require the Inspector General to forward to the Mayor for resolution any significant findings and recommendations that have not been resolved within six months of the final report. We additionally recommend that the statute mandate publication of the status of these unresolved issues in the Inspector General's annual report.

- Access to Tax Documents and Information Stored in an Electronic Format (Proposal #3)

D.C. Code § 1-1182.8(c)(1) grants the OIG access to the records, documents,

accounts, papers and other property belonging to District employees (except the Council and courts). Access to the tax records of individuals and businesses is a vital tool for the OIG Investigations Division and Medicaid Fraud Control Unit (MFCU); however, because our statute does not expressly include these records, our investigators often face time-consuming hurdles in order to obtain this information. We also recommend that our statute reflect technological changes in the storage of information and records, and specifically include information stored in an electronic format.

- Coordination by the District of Columbia Auditor (Proposal #4)

The Inspector General statute requires the OIG to “give due regard” to the D.C. Auditor’s activities. While we support the intent of the requirement, it does not go far enough to fulfill its purposes in that it does not mandate reciprocity from the District’s Auditor. Coordination from both agencies is essential to prevent the Auditor from inadvertently compromising our investigations as well as duplication of our agencies’ efforts.

- Penalties for Obstructing OIG Inspections and Audits (Proposal #5)

At present, the D.C. Code prescribes criminal penalties for obstruction of OIG investigations. Unlike federal law, however, there is no District provision criminalizing obstruction of an OIG audit or inspection. Therefore, we recommend that a provision be adopted to deter and punish conduct intending to impede or obstruct a District auditor or inspector, which closely resembles the federal counterpart and complements existing District law.

- Independent Investigations of the District of Columbia Housing Authority (Proposal #6)

At present, the Inspector General’s authority to conduct investigations regarding employees and contractors of the District Housing Authority, an independent agency of the District government, is limited to only those allegations referred by the Council. In order to fulfill the statutory duty to independently investigate allegations of misconduct in District government operations, the Inspector General must be authorized to act upon allegations received from all reliable sources, to include Housing Authority personnel, the Mayor, and District citizens.

- Application of the Federal Ethics in Government Act to the District of Columbia (Proposal #7)

It has been our experience that the District has neglected to focus upon creation of a system of clear ethical standards for government employees and, consequently, has not assigned this critical area the priority it deserves. We strongly suggest that systematic changes to the regulations and enforcement

process be explored and implemented to ensure uniform compliance by all District government employees and officials.

- Inspector General Removal and Salary Cap (Proposal #8)

The Inspector General statute provides that during a non-control year, the Mayor may remove the Inspector General with cause. We recommend placing a “check” on the Mayor’s ability to remove the Inspector General by requiring that the Council approve any such action by a two-thirds majority. The Inspector General statute further provides that the Inspector General’s salary may not exceed level IV of the Executive Schedule. This salary cap should be eliminated in order to attract the most highly qualified applicants for the Inspector General position in future years.

- Additional Personnel Authority (Proposal #9)

The current statutory scheme allows the Mayor to hire and fire OIG employees, who – for the most part – may be fired without cause. Additionally, the statute permits the Mayor to designate 60 excepted service positions to the OIG, which currently has a complement of 105 employees. We recommend transferring this authority to the Inspector General, to enhance the OIG’s independence and to eliminate the confusion created by the statute.

- Applicability of the Federal False Statements Statutes (Proposal #10)

Under federal law, it is a felony offense for a person to make an oral or written statement that is materially false to any branch of the federal government. The District’s false statements law, however, applies only to written statements and is punishable as a misdemeanor offense. We recommend including the District of Columbia government within the scope of the federal statute to avoid the limitations occasioned by the District’s law and to allow prosecutors greater flexibility in charging more egregious false statement violations.

Again, thank you for the opportunity to share my views today. I look forward to working with the Committee and with others as we do all we can to ensure the fiscal health of the District in years to come. I will be pleased to respond to any of your questions at this time.

## LEGISLATIVE PROPOSALS

### Proposal No. 1: Full Law Enforcement Authority

#### I. Purpose

Currently, OIG investigators are limited to the ability to execute search warrants, to carry firearms while on duty within the District of Columbia, and to arrest for felonies occurring within their presence. However, our investigators fall short of full law enforcement authority in two important respects: a) OIG investigators cannot arrest the subjects of our own investigations, even when armed with a valid warrant; and b) OIG investigators cannot make warrantless arrests when there is probable cause to believe that a suspect has committed a felony.

This limited grant of law enforcement authority hampers not only our ability to efficiently conduct and close our investigations, but also affects the safety of our investigators and the public. Without statutory full law enforcement authority, neighboring jurisdictions have declined to grant reciprocity to our investigators to carry firearms. This means that when it is necessary for our investigators to travel into Maryland or Virginia pursuant to an ongoing case, they cannot carry their firearms with them without a permit issued by that state. This is true even when they are visiting District facilities located in adjoining states.

#### II. Proposed Amendment

In order to give our investigators the full range of investigative authority, we propose that three sections of the D.C. Code be amended. The first two sections are found in D.C. Code § 1-1182.8, the principal statute governing the OIG. The recommended changes to subsection (f-1) would supplement our present powers with the authority to arrest, with probable cause, for any federal or District of Columbia offense, and further add the authority to apply for and execute arrest warrants. The statute, then, would be amended to read as follows:

(2) To make an arrest without a warrant if the employee has probable cause to believe that a felony violation of a federal or District of Columbia statute is being committed in his or her presence, or for any felony violation of a federal or District of Columbia statute if the employee has probable cause to believe that the person to be arrested has committed such felony, provided that the arrest is made while the employee is engaged in the performance of his or her official duties within the District of Columbia or a District government facility located outside of the District; and

(3) To serve as an affiant for, to apply to an appropriate judicial officer for, and execute a warrants for the arrest, search of premises,

or the seizure of evidence if the warrant is issued under authority of the District of Columbia or of the United States upon probable cause.

In addition, we propose amending Chapter 5 of Title 23, the section governing warrants and arrests, to include an OIG investigator within the definition of a "law enforcement officer." Accordingly, paragraph (2) of D.C. Code § 23-501 would be amended as follows:

(2) The term "law enforcement officer" means an officer or member of the Metropolitan Police Department of the District of Columbia, or of any other police force operating in the District of Columbia; an investigative officer or agent of the United States; animal control officer employed by the District of Columbia; or the Fire Marshal and any member of the Fire and Arson Investigation Unit of the Fire Prevention Bureau of the Fire Department of the District of Columbia, for the purpose of enforcing arson and the fire safety laws of the District of Columbia, who is so designated in writing by the Fire Chief; or an employee of the District of Columbia Office of the Inspector General as designated in writing by the Inspector General.

### III. Analysis

The OIG requires full law enforcement authority to fulfill its statutory mission to independently investigate allegations of criminal misconduct for three principal reasons. First, OIG investigators presently lack the ability to fully complete their investigations and effectively prevent fraud, waste, abuse and public corruption in the District of Columbia Government. Although we have developed a sound working relationship with the FBI and MPD, we have found that obtaining external assistance in conducting and closing our investigations is both burdensome and inefficient.

#### A. Independence

Currently, during the course of our investigations, we must rely on the assistance of these other agencies to arrest subjects who have been charged with criminal misconduct. We must further rely upon the availability of MPD or FBI personnel to stand-by when we execute our search warrants in case there is a need for an immediate arrest or in dangerous areas where there may be weapons secreted. Even in situations where there is a valid outstanding warrant for a suspect's arrest, we are forced to seek the assistance of the FBI or MPD to act and arrest our suspect. The following examples illustrate the problem:

- (1) A District vendor stole over \$500,000 in District funds and fled to another state. This Office had to rely upon another agency to arrest the suspect once he was located and returned to the District. This individual might not have gotten to another

jurisdiction if our agents had the authority to make an arrest on probable cause.

- (2) A contractor recently stole a substantial amount of computer-related equipment from a District agency. Although a warrant was issued for the suspect's arrest, OIG had to rely upon Maryland State authorities to make the arrest.
- (3) An ANC official stole in excess of \$40,000 in District funds. Another agency had to execute the arrest warrant for the suspect.
- (4) A DCPS contractor stole over \$300,000 in District funds. The OIG had to rely upon the cooperation of the FBI to arrest this individual.
- (5) A District employee stole over \$70,000 in District funds, and a warrant was issued for the individual's arrest. However, we were required to enlist the assistance of another agency to execute the arrest warrant.
- (6) A District contractor stole in excess of \$2 million in District and Medicaid funds. Searches were conducted, and an arrest warrant was issued. Yet, once again, the OIG had to rely upon the assistance of others to handle the arrest.
- (7) An OIG investigation resulted in the prosecution of a high level District official for bribery and related charges. An arrest warrant ensued, but the individual was arrested by the FBI rather than this Office.

Once we have uncovered criminal misconduct, we must be able to act immediately; indeed, delay seriously compromises the integrity of our investigations. Should one of our investigations yield probable cause to make an immediate arrest, we risk the loss of critical evidence by having to seek assistance from another law enforcement agency. In some situations, the delay may prevent a timely arrest, allowing the suspect greater opportunity to flee from the jurisdiction and escape prosecution.

The reliance on other agencies occasioned by our limited law enforcement authority also hinders our independence and, at times, makes it difficult for us to direct the course of our own investigations. This is true especially in cases that are of more interest to us than to the FBI or the MPD, both of which have limited resources to be used in cases most important to their own missions.

Exacerbating the problem is a steady rise in the number of investigations initiated by the OIG Investigations Division (ID) since Fiscal Year (FY) 1998. For example in FY 1999, the number of cases opened by the ID increased by 35% over the previous fiscal year. At the commencement of FY 2000, the ID had 197 pending cases. Although the ID was able to close a number of those cases, it currently has 243 open cases, not including the referrals to District agencies that ID monitors. The ID presently has three ongoing investigations - involving ten subjects - which are at the stage where arrest warrants will likely be forthcoming; however, we will be forced to draw upon the resources of the MPD and FBI to execute the arrests of each of these individuals. With increased

exposure and growth of the Office as a whole, we expect the ID's caseload to continue to rise. This increase will, in turn, place an even greater burden on local and federal law enforcement authorities to provide timely assistance to our investigators.

#### B. Safety

A second reason for expansion of OIG law enforcement authority is the safety of our investigators and the public at large. Although OIG investigators presently may carry firearms in the District while on duty, the states of Maryland and Virginia do not recognize them as "full law enforcement" officials. In fact, representatives of the Attorney General's Office in Maryland have advised us that reciprocity for the carriage of firearms in Maryland – even for official purposes - must be denied unless our own legislation characterizes us as law enforcement officers with authority to arrest with a warrant. Thus, OIG investigators cannot lawfully carry their firearms with them in Maryland without a permit. Our authority to carry a weapon in the State of Virginia, which is also limited, would be resolved as well by the passage of this proposed legislation. There is a continual need for OIG investigators to travel into these neighboring jurisdictions to conduct investigations and/or to visit District facilities located therein. For example, even though an OIG investigator may be involved with a criminal investigation involving a D.C. government employee living or working in Maryland, without a state-issued permit that investigator must leave his/her weapon behind.

A related concern is that many OIG investigators cannot carry their weapons with them off-duty, even with a Maryland permit. Only current or retired law enforcement officers with the authority to arrest with a warrant may receive reciprocity in Maryland to carry their weapons while off-duty. Because our investigators are sometimes involved in undercover operations, they may be exposed to potentially life-threatening situations while off-duty (e.g. if they are recognized or their "cover is blown"). OIG investigators, then, may find themselves at-risk without a means of protection.

#### C. Access to Law Enforcement Databases

A final disadvantage of our limited law enforcement authority is that OIG investigators are not privy to all necessary law enforcement investigative tools. Currently, we do not have access to the FINCEN database, which would provide us with extensive financial background information regarding individuals and companies. Access to this database is especially critical in our investigations of complex "white-collar" crimes. We additionally lack full entry into the FBI's National Criminal Information Center (NCIC) database, which affords access to critically needed national criminal information.

It is noteworthy to mention that an expansion to full law enforcement authority is in accordance with the trend in the federal Inspector General (IG) community. We are aware of two federal IG agencies, the Department of Agriculture and the Department of

Defense's Criminal Investigative Services, which have statutorily based full law enforcement authority.<sup>1</sup>

In addition, those federal IG offices that lack statutory law enforcement authority have traditionally exercised such powers through special deputation by the United States Marshals Service. The Department of Justice is currently developing a draft bill to submit to Congress through the Senate Governmental Affairs Committee to formalize the special deputation program. By statute, federal IG agents will then have the authority to carry firearms, make warrantless arrests for felonies, and obtain and execute arrest and search warrants. Similar to the reasons outlined above, the need stated in the federal bill for additional law enforcement powers is to reduce requests for assistance to "traditional" law enforcement agencies, to achieve independence from the agendas of other law enforcement agencies, and to ensure agent and public safety. Our enabling statute, D.C. Code § 1-1182.8, was modeled after the federal IG statute in both form and purpose; it follows, then, that so long as the need is equivalent, our statute should evolve as well.

OIG investigators have the training, skills and judgment necessary to implement full law enforcement authority. Many OIG investigators are former federal agents, police officers, or detectives with extensive law enforcement training and experience. All newly hired investigators are required to complete an eight-week law enforcement training course at the Federal Law Enforcement Training Academy in Glynco, Georgia. This is the same training received by most federal law enforcement investigators. In addition, we require that all OIG investigators meet both FBI and MPD firearm qualifications standards, and submit to random drug testing. Finally, we have an agreement with the MPD that its Force Investigation Team will investigate any incident where an OIG investigator has discharged his/her firearm.

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<sup>1</sup> 7 U.S.C. § 2270 (providing that investigators with the Office of the Inspector General, Department of Agriculture, may make warrantless arrests for felonies, execute arrest and search warrants, and carry firearms); 10 U.S.C. § 1585a (authorizing special agents of the Defense Criminal Investigative Service to execute search and arrest warrants and make warrantless arrests for felonies).

Proposal No. 2: Resolution of Audit and Inspection Findings and Recommendations

I. Purpose

The Office of the Inspector General (OIG) is charged with the responsibilities of coordinating with, and making recommendations to, District government departments and agencies as a result of its investigations, audits and inspections of government operations. D.C. Code § 1-1182.8(a-1)(1) and (2) (1999 Repl.). However, it is not uncommon for agencies to disagree with the findings and recommendations issued in our audit and inspection reports. These issues are ultimately never resolved because under the current statutory scheme, there is no mechanism for final resolution. Therefore, we recommend that D.C. Code § 1-1182.8 be amended to provide for timely resolution of these disagreements where a significant issue regarding the operation or program of a District agency is in controversy. We additionally recommend that the status of these unresolved issues be reported within the Inspector General's annual report.

II. Proposed Amendment

To provide for resolution of any unresolved audit or inspection finding and recommendation, we recommend amending D.C. Code § 1-1182.8(a)(3) to create the following new subsection ("J"):

(3) The Inspector General shall . . .

(J) Forward to the Mayor for resolution any significant finding and recommendation resulting from an audit or inspection, which has not been resolved between the Inspector General and the agency subject to the audit or inspection within six months from the date of the Inspector General's final report.

We also recommend that D.C. Code § 1-1182.8(f-2)(6) be amended to include the following provision (subsection "A"):

(f-2) The Inspector General shall prepare an annual report not later than 60 days after the beginning of the fiscal year . . . . The annual report shall include:

(6) A description of the recommendations for corrective action made by the Office during the reporting period with respect to significant problems, abuses or deficiencies identified . . .

(A) The Inspector General shall also provide a description of the status of all significant findings and recommendations that have remained unresolved for

over six months and that the Inspector General has forwarded to the Mayor for final resolution. The Inspector General shall provide an opinion as to the appropriateness of the final resolution and the risks, if any, to the District that may result from the final resolution.

### III. Analysis

The federal Inspector General Act of 1978, upon which our legislation is based, requires each federal inspector general to provide in its semi-annual reports "information concerning any significant management decision with which the Inspector General is in disagreement." 5 U.S.C. Appendix 3, § 5(a)(12) (1996). In addition, the federal government employs a system whereby an "audit follow up official" is appointed by the agency head to resolve disagreements among management officials regarding audit recommendations. *See* Office of Management and Budget, Circular No. A-50 Revised (Sept. 29, 1982). The federal semi-annual reports must also describe significant recommendations listed in previous reports upon which corrective action has not been completed. 5 U.S.C Appendix 3, § 5(a)(3) (1996).

The District's Inspector General statute, in its present form, does not require resolution of unresolved recommendations. We recommend that the statute mirror the federal requirement to mandate resolution of disputed audit and inspection findings and recommendations so that corrective action may be taken, where necessary. Such a system will allow the District to "follow-up" upon deficiencies identified in OIG audits and inspections and, where disagreement occurs, resolve any outstanding issues with a view toward improving government operations and doing so in a timely manner.

**Proposal No. 3: Access to Tax Documents and Information Stored in a Electronic Format**

I. Purpose

The Office of the Inspector General (OIG) requires complete and unfettered access to all documentation and information produced and maintained by entities within the District government. The District's Inspector General statute reflects this need and grants the OIG access to "the books, accounts, records, reports, findings, and all other papers, items, or property belonging to or in use by all departments, agencies, instrumentalities, and employees of the District government . . ." D.C. Code § 1-1182.8(c)(1) (1999 Repl.).<sup>2</sup> Because tax documentation and information stored in an electronic format are not specifically included within this section, the OIG has experienced some difficulty in obtaining this information. Therefore, we recommend that the statute be clarified to prevent delay in our criminal investigations and administrative inquiries.

II. Proposed Amendment

To ensure that OIG investigators have access to all information necessary for thoroughly conducting their investigations, we recommend amending D.C. Code § 1-1182.8(c)(1) to include tax records and information that is stored in an electronic format:

(c)(1) The Inspector General shall have access to the books, accounts, records, reports, findings, and all other papers, items, or property, including tax documents and information stored in an electronic format, belonging to or in use by all departments, agencies, instrumentalities, and employees of the District government, including agencies which are subordinate to the Mayor, independent agencies, boards, and commissions, but excluding the Council of the District of Columbia, and the District of Columbia Courts, necessary to facilitate an audit, inspection or investigation.

III. Analysis

Although the statute appears all encompassing, the OIG has encountered resistance in obtaining individual and corporate tax documentation from other District agencies. For example, employees of the D.C. Treasury's Office have taken the position that our investigators may only obtain tax records if the investigation is substantially a tax case. The wording of the OIG statute mirrors the language found in the provision granting the District of Columbia Auditor access to "all books, accounts, records, reports, findings and all other papers, things, or property belonging to or in use by any department, agency, or other instrumentality of the District government and necessary to facilitate the audit."

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<sup>2</sup> The District of Columbia Courts and the Council are the only District entities excluded from this provision. *Id.*

D.C. Code § 47-117(c). However, aside from its auditing responsibilities, the OIG serves an investigatory function for the District government as well. Access to the tax documents of individuals and businesses is essential to investigations conducted by our Investigations Division and the Medicaid Fraud Control Unit.

The Inspector General statute similarly omits specificity with regard to critical information that is stored in an electronic format (i.e. electronic mail, calendars, Internet information, etc.). Modification of the statute is necessary to reflect technological advances and the District's growing reliance on these tools to record and manage information. We note that the District's Financial Responsibility and Management Assistance Authority (the Control Board) is given statutory authority to directly access "information systems, records, documentation or information or data as will enable [] [it] to carry out its responsibilities . . ." D.C. Code § 47-391.3(c)(2). Similarly, the OIG relies heavily upon the availability of financial information that is maintained by the District's information systems.

Accordingly, the OIG recommends an amendment to D.C. Code § 1-1182.8, to specifically include access to tax documents and electronically-stored information. While we believe the statute already encompasses this information, other agencies have expressed disagreement and have refused to provide critical information as a result. Certainly, the OIG may subpoena this documentation, if necessary; however, as "sister agencies" we are striving for the same goals, and to require an OIG subpoena to obtain government information from other District agencies would amount to a waste of time and resources.

**Proposal No. 4: Coordination by the District of Columbia Auditor**

I. Purpose

The Inspector General is required by statute to “give due regard to the activities of the District of Columbia Auditor” to promote “coordination and cooperation” and avoid duplicating efforts. D.C. Code § 1-1182.8(b)(2) (1999 Repl.). The Office of the Inspector General (OIG) and the District of Columbia Auditor each conduct audits of various government programs, which sometimes overlap one another or with an OIG inspection or investigation. While we concur that the OIG must be attentive to the Auditor’s role in the District government, the goal of coordination and cooperation cannot be achieved unilaterally.

II. Proposed Amendment

In order to ensure effective coordination between the OIG and the D.C. Auditor, we recommend amending two subsections of D.C. Code § 1-1182.8. First, subsection (a)(3)(B) exempts the D.C. Auditor from the requirement that D.C. government entities provide the OIG with advance notification of any external audit conducted by the entity. We recommend modifying this subsection to delete the exception for the D.C. Auditor in the following manner:

(3) The Inspector General shall:

(B) Receive notification in advance of all external audits conducted by any District government entity, ~~with the exception of the District of Columbia Auditor,~~ and immediately provided with a copy of any federal report issued . . . .

Second, subsection (b)(2) should be amended to mandate cooperation from both the OIG and the D.C. Auditor:

(b)(2) ~~The Inspector General and the District of Columbia Auditor shall give due regard to the activities of the District of Columbia Auditor~~ their respective organizations with a view toward avoiding duplication and insuring effective coordination and cooperation. ~~The Inspector General and the District of Columbia Auditor shall take appropriate steps to assure that work performed by auditors, inspectors and investigators within or for the Office of the Inspector General~~ their respective offices shall comply with the standards and procedures determined through the application of this subsection. However, this subsection should not be interpreted to require the sharing of confidential information, which if divulged, would be detrimental to the mission of either organization.

### III. Analysis

The District of Columbia Auditor is responsible for conducting an annual audit of the accounts and operations of the District government, as well as performing many other audits of individual District government entities and programs. D.C. Code § 47-117(b) (1999 Repl.).<sup>3</sup> Similarly, the Audit Division of the OIG oversees the completion of the District's Comprehensive Audit and Financial Report and further conducts performance and financial audits of D.C. government agencies, programs and operations, which are either requested by the Mayor or Council or designated by the Inspector General as necessary or desirable. *Id.* § 1-1182.8(a)(3). The OIG Inspections and Evaluations Division complements the Audit Division's work by inspecting the management of various agencies within the District and making recommendations to improve the services these agencies provide to the city's residents. The OIG Investigations Division and the Medicaid Fraud Control Unit are also intricately involved in these same agencies and programs, investigating administrative and criminal misconduct.

Accordingly, our efforts are numerous, and not limited to auditing. While we have established a working relationship with the D.C. Auditor's Office to foster cooperation, we cannot completely avoid duplicating efforts because the Auditor's Office has no reciprocal responsibility to provide notice of its audits. The lack of full cooperation has made it difficult to coordinate with the Auditor's Office and plan our audits and other activities. In addition, some of our investigations require evaluation of financial documentation maintained by agency personnel; a lack of communication between District agencies could lead to inadvertent compromise of these investigations. We have not encountered these problems with other District entities as these agencies have a duty to provide us with advance notice of all external audits as well as all federal reports that are issued. D.C. Code § 1-1182.8(a)(3)(B).

Therefore, we recommend that D.C. Code § 1-1182.8 be amended to provide joint accountability for cooperation between the OIG and the District of Columbia Auditor. Sharing the burden with the D.C. Auditor is essential to full coordination of efforts and would allow each agency to better serve the best interests of the District.

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<sup>3</sup> Examples of other audits and reviews that the D.C. Auditor is statutorily required to conduct include those of the Economic Development Finance Corporation, the Armory Board, the Boxing and Wrestling Commission, the Lottery and Charitable Games Control Board, the Washington Convention Center Authority, and the Public Service Commission Agency Fund. See D.C. Code §§ 1-2220(a), 2-310, 2-607(f), 2-2519, 9-831(a), and 43-612(a)(6) (1999 Repl.).

**Proposal No. 5: Penalties for Obstructing OIG Inspections and Audits****I. Purpose**

Under District law, it is a criminal offense to purposefully obstruct or impede an investigation conducted by the Council or any agency of the District government. D.C. Code § 22-721(a)(6) (1999 Repl.). This provision, however, does not extend to District government audits and inspections. Therefore, the Office of the Inspector (OIG) recommends that new legislation be enacted to prevent obstruction of OIG audits and inspections to ensure the OIG's effectiveness as an aggressive and independent "watchdog" for government fraud and abuse.

**II. Proposed Amendment**

We recommend creating a new statute, D.C. Code § 22-724, entitled "Obstruction of a District of Columbia Audit," which would provide as follows:

- (a) A person commits the offense of obstruction of a District of Columbia audit if that person, corruptly, or by threats of force, in any way obstructs or impedes or endeavors to obstruct or impede a District of Columbia auditor in the performance of official duties.
- (b) Any person convicted of obstruction of a District of Columbia audit shall be sentenced to a maximum period of incarceration of not more than 5 years, or shall be fined not more than \$10,000, or both.
- (c) For the purposes of this section, the term:
  - (1) "Corruptly" means acting with an improper purpose, personally or by influencing another, including making a false or misleading statement, or withholding, concealing, altering, or destroying a document or other information.
  - (2) "District of Columbia auditor" means any person employed on a full-time or part-time, or contractual basis to perform a financial or performance audit or quality assurance inspection or review, for or on behalf of the District of Columbia.

### III. Analysis

The District statute attaching criminal penalties for obstructing justice prohibits an act which, *inter alia*, “[c]orruptly, or by threats of force, [in] any way obstructs or impedes or endeavors to obstruct or impede the due administration of justice in any official proceeding.” D.C. Code § 22-722(a)(6). Conviction of this offense could result in a three-year to life prison term and/or a fine of up to \$10,000. *Id.* § 22-722(b). Section 22-722(a)(6), however, is limited in coverage to only “official proceedings,” which are defined as “any trial, hearing, investigation, or other proceeding in a court of the District of Columbia or conducted by the Council of the District of Columbia or an agency or department of the of the District of Columbia government, or a grand jury proceeding.” D.C. Code § 22-721(4). Individuals who obstruct an OIG audit or inspection cannot be prosecuted under the District’s obstruction statute.

Under federal law, obstruction of a federal audit or inspection is punishable by up to five years imprisonment or a fine. 18 U.S.C. § 1516 (2000). We recommend creating a similar provision for the District of Columbia to enforce compliance with audits and inspections of District programs and contracts. The OIG conducts numerous audits and inspections, which require complete cooperation and open disclosure from the agencies and contractors involved. If the examined party is obstructive and not forthright with the auditors, the integrity of the process is compromised and delays result. The proposed legislation seeks to remedy these hindrances by ensuring mandatory and scrupulous compliance.

**Proposal No. 6: Independent Investigations of the District of Columbia  
Housing Authority**

I. Purpose

On May 9, 2000, the District of Columbia Housing Authority Act of 1999 (D.C. Law 13-105), was enacted and added a new subsection to the District's Inspector General statute. The new provision requires the Inspector General to perform an annual inspection as well as an independent fiscal and management audit of the District of Columbia Housing Authority. D.C. Code § 1-1182.8(e-1) (1999 Repl.). In addition, the provision allows the Office of the Inspector General (OIG) to conduct investigations of the Housing Authority upon the Council's request. *Id.*

This restriction on the Inspector General's authority conflicts with the basic meaning and intent of the OIG statute. Limiting the OIG to investigating allegations lodged by only one District source inhibits the independence of the Inspector General and prohibits the OIG from fully exercising its statutory duty to conduct investigations that are "necessary and desirable" in the Inspector General's judgment.

II. Proposed Amendment

To allow the Inspector General to investigate allegations of misconduct made by Housing Authority employees, the Mayor, and the public, we recommend amending D.C. Code § 1-1182.8(e-1) as follows:

(e-1) The Inspector General may conduct an annual inspection and independent fiscal and management audit of the District of Columbia Housing Authority, beginning the first fiscal year of the Authority. In addition, the Inspector General may undertake reviews and investigations of the District of Columbia Housing Authority, and make determinations or render opinions, as requested by the Council or upon the Inspector General's own initiative.

III. Analysis

One of the statutorily delineated purposes of the OIG is to "*independently* [] [c]onduct and supervise audits, inspections and investigations relating to the programs and operations of District government departments and agencies, including independent agencies . . ." D.C. Code § 1-1182.8(a-1) (1999 Repl.) (emphasis supplied). Similarly, the D.C. Inspector General statute requires the OIG to "*independently* conduct audits, inspections, assignments the Mayor shall request, and any other audits, inspections, and investigations that are necessary or desirable in the Inspector General's judgment . . ." *Id.* (emphasis supplied).

However, the newly enacted provision regarding the Housing Authority limits the OIG's authority to conduct investigations of that agency to merely those requested by the

Council. This limitation directly contradicts the authority granted elsewhere in the Inspector General statute, which specifically permits the Inspector General to conduct those investigations of District agencies that he/she deems necessary or desirable. The OIG routinely receives allegations of misconduct in District government programs and operations from numerous sources other than the Council, including the Mayor, government employees, and - perhaps most importantly - District residents. To eliminate these other sources serves not only to restrict the OIG's authority, but also to filter out critical sources of information regarding District agencies and contractors. In sum, the OIG must be able to undertake investigations referred by all reliable sources in order to fully complete its statutory mission.

**Proposal No. 7: Ethics in Government Act Research and Perspective****I. Need**

It has been our experience that the District has neglected to focus upon ethical standards for government employees and, consequently, has not assigned this critical area the priority it deserves. We strongly suggest that systematic changes to the regulations and enforcement process be explored and implemented to ensure uniform compliance by all District government employees and officials.

**II. Background**

High level management must not only display due regard for high ethical standards, but also ensure that employees at all levels within the District government are fully informed as to the standards themselves. The regulations, in their current form, contain vague language yielding conflicting interpretations of some of the standards of conduct. In addition, the District does not employ a mandatory training program for all District employees to ensure that government personnel is fully informed as to applicable ethical standards.

The OIG is directly affected by the problems in this area because we are limited in our ability to hold others accountable for standards that have not been clearly defined or articulated to employees. For example, we have encountered two interpretations of the gift ban – while the Office of Campaign Finance has opined that government employees may solicit/receive “nominal” gifts of up to \$100 in value, the District’s Ethics Officer has set the appropriate “nominal” amount at \$25 or less. We have also issued a Management Alert Report in which we found that ineffective monitoring and enforcement of the District’s financial disclosure system, which is designed to ferret out conflicts of interest, negatively affects the integrity of the reporting process and leaves the city vulnerable to such conflicts.

We have researched the ethical standards of five states with major cities to determine whether those jurisdictions had adopted the federal Ethics in Government Act. It appears that each of the following states has crafted its own body of ethics regulations: a) Florida; b) Virginia; c) Illinois; d) California; and e) New York.

**III. Solution**

While it is not within the authority of this Office to develop clearer standards, we would be pleased to work with the Office of Personnel, the District’s Ethics Officer, and all other involved parties in this endeavor. Our initial impression is that the standards developed must be clearly articulated to all District employees in a uniform manner. We additionally note that whatever mechanism for enforcement is decided (e.g. enforcement responsibility is divided among the agencies), the position with enforcement responsibility for the reporting requirements, be it the Ethics Counselor for the District or another individual, needs to be staffed and budgeted appropriately. It may be that the

most direct and efficient solution, however, is simply to amend the Ethics in Government Act to make it applicable to the District.

**Proposal No. 8: Inspector General Removal and Salary Cap**

I. Purpose

The District's Inspector General Statute currently allows the Mayor to remove the Inspector General (IG) without the approval of the District of Columbia Council in a year where the activities of the Control Board are suspended. Because the IG occupies a unique position within the District government, we recommend amending the statute to place a "check" upon the Mayor's authority, in order to safeguard the IG's ability to conduct investigations, audits and inspections without interference or influence.

In addition, the statute prohibits the IG's salary from exceeding level IV of the Executive Schedule. This salary cap is inconsistent with the compensation of other executive level officials within the District government and will hinder the ability of the District to attract the most highly qualified applicants for the position in the future.

II. Proposed Amendment

To require Council's approval where the Mayor seeks to remove the Inspector General, we recommend amending D.C. Code § 1-1182.8(a)(1), to include the following provision:

There is created within the executive branch of the government of the District of Columbia the Office of the Inspector General. The Office shall be headed by an Inspector General appointed pursuant to subparagraph (B) of this subsection, who shall serve for a term of 6 years and shall be subject to removal only for cause by the Mayor (with the approval of the District of Columbia Financial Responsibility and Management Assistance Authority in a control year) or (in the case of a control year) by the Authority. During a year which is not a control year, the Inspector General shall be subject to removal only for cause by the Mayor, with the approval of a two-thirds majority vote of the Council.

We further recommend eliminating the IG's salary cap from subsection (a)(1) of the statute as follows:

(E) The Inspector General shall be paid at an annual rate determined by the Mayor, ~~except that such rate may not exceed the rate of basic pay payable for level IV of the Executive Schedule.~~

### III. Analysis

*Removal of IG.* During a control year, the IG may be removed from office with cause by either the Control Board or by the Mayor, subject to the Control Board's approval. D.C. Code § 1-1182.8(a)(1) (1999 Repl.). This requirement of approval from the Control Board serves as a "check" upon the Mayor's authority to prevent retaliation or the exercise of undue influence upon the IG and increases the IG's ability to carry out his duties in an independent manner.

In a non-control year, however, the Mayor will be able to remove the IG without another entity's approval, so long as the Mayor cites cause for the action. Indeed, for the IG's appointment in a non-control year, the statute subjects the Mayor's nominee to another body's scrutiny – the Council – to ensure that the nominee will be able to perform the duties of the position free from political pressure and other influences. D.C. Code § 1-1182.8(a)(1)(C); *cf.* D.C. Code § 1-633.7(a) ("The Mayor shall nominate persons to serve as subordinate agency heads in the Executive Service . . . subject to the advice and consent of the Council.").

In general, subordinate agency officials serve at the pleasure of the Mayor. D.C. Code § 1-611.51(b). However, the responsibilities and duties of the IG place him/her in a unique situation in that the IG has the authority to conduct investigations, inspections or audits of District government agencies and operations *independently* of those requested by the Mayor. *Id.* § 1-1182.8(a)(3)(D). The IG is further empowered to investigate all agencies within the executive branch of the District government, to include the Executive Office of the Mayor. The IG must be able to undertake inquiries that are "necessary or desirable in the Inspector General's judgment" without the threat of retaliatory removal. Requiring approval from the legislative branch for the removal of the IG will place a "check" on the Mayor's authority to remove the IG and deter potential abuses of discretion.

*Salary Cap.* Subordinate agency heads within the District government are compensated pursuant to the Executive Schedule pay scale. D.C. Code § 1-611.52(a). The Mayor establishes the salary range for each of these officials, and the Mayor may change these ranges through Council resolution. *Id.* §§ 1-611.52(c)-(e).

The Mayor may similarly set the IG's salary; however, the Mayor may not authorize the IG's salary at a rate greater than level IV of the Executive Schedule. We are recommending that this limitation be eliminated because the salary cap will hinder the District in its future efforts to attract an applicant pool of individuals with superior credentials to fill an IG vacancy. In the case of other executive level vacancies, the Mayor may submit a proposal to Council to revise the salary for the position in order to fill the vacancy. D.C. Code § 1-612.6(a). However, the IG statute prohibits the Mayor from revising the IG's salary beyond level IV of the Executive Schedule, thereby limiting the Mayor's ability to select an IG with the highest qualifications.

Certainly, the rationale for this limitation may be to prevent the Mayor from exerting any control over the oversight activities of the IG. This risk of this consequence is minimal,

however, given that there are inherent checks within the appointment process: 1) any nominee the Mayor proposes must be approved by the Council prior to his/her appointment to the IG position; and 2) the statute requires that the IG be appointed “without regard to party affiliation and solely on the basis of integrity and demonstrated ability . . .” D.C. Code §§ 1-1182.8(a)(1)(B) and (E). To enhance the Mayor’s ability to find the applicant with exceptional qualifications of “integrity and demonstrated ability,” we recommend eliminating the salary cap for the IG position.

**Proposal No. 9: Additional Personnel Authority**

I. Purpose

Under the District's Merit System, the Office of the Inspector General (OIG) is deemed a "subordinate agency" or one that is subject to the Mayor's direct administrative control. D.C. Code § 1-603.1(17) (1999 Repl.). As a result, the Mayor is the personnel authority for the OIG and, therefore, he/she has the authority to hire and fire OIG personnel. We recommend transferring the Mayor's authority in this regard to the Inspector General, so that the Inspector General may independently appoint and remove OIG personnel. Transferring appointment and removal authority to the Inspector General will not only enhance the OIG's independence, but also eliminate the confusion created by D.C. Code § 1-610.3, which permits the Mayor to appoint 60 excepted service positions within the OIG.

II. Proposed Amendment

To provide the Inspector General with independent personnel authority, we recommend amending D.C. Code § 1-1182.8, to create a new subsection - (a)(1)(A) as follows:

(A) Employees of the Office of the Inspector General shall be appointed by, shall serve at the pleasure of, and shall act under the direction and control of the Inspector General.

D.C. Code § 1-610.3(a)(2), which designates the number of excepted service positions the Mayor may assign, would also need to be amended to allow the Inspector General to appoint excepted service employees to the OIG. The statute would then provide the following:

(2) The Mayor may appoint persons to 220 positions; ~~of which 60 may be allotted to and designated by the Office of the Inspector General.~~ In a control year, a maximum of 20 positions subject to appointment by the Mayor shall be allocated to and designated by the Office of the Chief Financial Officer. In addition to the 220 Excepted Service positions, the Chief of Police may designate up to 1% of the total number of authorized positions within the Metropolitan Police Department as Excepted Service policy positions, no more than 10 of which may be filled by sworn members or officers, and the Inspector General may designate the total number of authorized positions within the Office of the Inspector General as Excepted Service policy positions;

### III. Analysis

Although the Inspector General does not have statutory authority to retain and remove OIG personnel, it has been the practice of the Office of Personnel to allow the Inspector General to independently make determinations in this regard. Since 1998, the OIG has hired employees within the excepted service, which translates to a lack of job tenure for our employees. If the Mayor chose to exercise his/her authority to fire an OIG employee, he/she could do so without cause.

In addition, D.C. Code § 1-610.3, allows the Mayor to allot 60 excepted service positions to the OIG. This provision is confusing because the OIG currently places all new employees within the excepted service and, with only a few exceptions, the vast majority of this Office's 105 current employees are in the excepted service. D.C. Code § 1-610.3, further implies that the Mayor could appoint persons to fill these positions, thereby limiting the independence of the OIG.

**Proposal No. 10: Applicability of the Federal False Statements Statute**

I. Purpose

In federal law, it is a felony offense for a person to make an oral or written statement that is materially false to any branch of the federal government. 18 U.S.C.A. § 1001 (2000). The District of Columbia has a similar law, but the District's counterpart is a misdemeanor offense that applies only to written statements. D.C. Code § 22-2514 (1999 Repl.). We recommend including the District of Columbia government within the scope of the federal statute to allow prosecutors greater flexibility in charging more egregious false statement violations and to avoid the limitations occasioned by the D.C. Code.

II. Proposed Amendment

We recommend amending 18 USC § 1001, to include the District of Columbia government in the following manner:

(c) Except as otherwise provided in this section, whoever, in any matter within the executive, legislative, or judicial branch of the Government of the United States **or the District of Columbia**, knowingly and willfully-

- (1) falsifies, conceals, or covers up by any trick, scheme, or device a material fact;
- (2) makes any materially false, fictitious, or fraudulent statement or representation; or
- (3) makes or uses any false writing or or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry;

shall be fined under this title or imprisoned not more than 5 years, or both.

III. Analysis

The District's statute that criminalizes false statements has several limitations, which affect both the scope of its application as well as its ability to address more egregious violations. First, D.C. Code § 22-2514 is applicable only to written statements. Second, the document in which the statement is made must contain a written warning that false statements are punishable by criminal penalties. Finally, the maximum penalty for a violation of the statute is a \$1,000 fine, 180 days imprisonment, or both. D.C. Code § 22-2514(b).

These deficiencies in Section 22-2514 have caused Office of the Inspector General (OIG) investigators difficulty in securing full cooperation from witnesses and subjects and have further thwarted our attempts to obtain full and open disclosure in OIG investigative interviews. Thus far we have not been able to obtain prosecution under the District's false statements statute of those who have purposefully made falsehoods or submitted fictitious information to our investigators.

Extending the applicability of Section 1001 to the District government would assist in remedying these difficulties. The federal false statements statute covers oral statements, contains no written warning requirement, and may be prosecuted as a felony (fine and/or imprisonment of no more than 5 years). 18 U.S.C.A. § 1001(a). Therefore, we would no longer be limited by the statutory prerequisites of D.C. Code § 22-2514, that statements be written or contain a written warning to the subject being interviewed.

Including the District of Columbia government within the scope of the federal statute would also benefit prosecutors. Section 1001 allows prosecutors greater flexibility in charging more serious violations of the statute. The federal statute gives prosecutors an additional option in negotiating plea bargains – felony versus misdemeanor - and otherwise provides an additional tool for securing the cooperation of codefendants.

Mrs. MORELLA. I'm pleased now to recognize Joshua Wyner who is the executive director of the DC Appleseed Center. Thank you, Mr. Wyner.

Mr. WYNER. Thank you, Madam Chairman.

The DC Appleseed Center, as you may know, is an independent, nonprofit organization that performs research and analysis on DC issues and also advocates for DC government reform. Earlier this week, after 8 months of study, DC Appleseed released a report about the chief financial officer and financial management in the District of Columbia, and I appreciate the opportunity to say a few words here today about our findings and recommendations.

The DC Appleseed report was researched and written by a team of volunteer professionals who are quite knowledgeable about financial management in general and the District's finances in particular. Among the volunteers you may be familiar with are Ed DeSeve, former Controller of the U.S. Office of Management and Budget; Bert Edwards, former CFO of the State Department and the first external auditor for the District after home rule in the mid-70's; and Michael Rogers, former city administrator for the District of Columbia.

I would like to say a few words about the context here. There were many reasons for the District's financial collapse in the early to mid-1990's; and DC Appleseed strongly agrees with Congresswoman Norton and Control Board Chair Rivlin that much of it had to do with the structural impediments to raising revenue, and we applaud the efforts to address those issues, and we have addressed them in prior reports as well.

Another reason, however, was the structure of financial management under the original Home Rule Act. In the 20 years before the Control Board was created, the Mayor of the District of Columbia had sole responsibility under the Home Rule Act for financial management. That meant that the Mayor had complete control over the personnel who fulfilled financial management functions. They served at the pleasure of the Mayor.

The poor financial management practices that existed under Mayoral control contributed to the District's financial collapse; there is little doubt about that. Over the past 6 years, with an independent CFO in, the District financial management has improved.

I agree with GAO that challenges remain; our research revealed that. But it's clear to us that with the Control Board going out of place, the challenge is how do we devise a structure for future financial management that builds on the progress made over the last 6 years, but also does so in a manner consistent with a return to home rule government.

Our report addresses this question in three general areas. First, what should be the particular responsibilities of the CFO? Second, how should the CFO's independence be guaranteed? And finally how extensive should the CFO's control be over financial personnel in the District's agencies? Let me start with the CFO's responsibilities.

We are in agreement with the Council legislation on the particular responsibilities of the CFO, by and large. The CFO ought to estimate revenue, prepare the annual budget, working with the

Mayor, perform the Treasurer and Controller functions of the system, assess and collect taxes, maintain financial systems. The bottom line here is that an independent CFO, we believe, is the government official most likely to maintain professional financial operations and least likely to be unduly influenced to take actions inconsistent with sound financial management principles.

DC Appleseed also recommends that the CFO play a role in certifying fiscal impact statements, and I know, Congresswoman Morella, that this was one of the areas that you expressed concern about. We do believe that for Council-enacted legislation, the CFO ought to certify the consistency of that legislation with the budget and financial plan of the District before it's signed by the Mayor, and we will make those views clear to the Council in the hearing the third week of June.

The second area that I'd like to cover is financial personnel. Again here, we believe the CFO should have direct responsibility for the financial personnel that work in agencies. We believe that some of that ought to be delegated to the agency directors, and we think that's exactly what's done in the Council legislation. So we're supportive of that.

The important principle here—it's embedded in both DC Appleseed's report and the Council legislation—is that agency financial personnel have to have adequate incentives not only to maintain sound financial management—and the Mayor alluded to this earlier—but also to provide agency directors with the information and services they need to implement programs. Those are the issues that we are trying to balance in our set of recommendations there, and we believe the Council effectively does in its legislation.

Finally, DC Appleseed strongly supports continuing independence for the CFO after the Control Board becomes dormant. To enable this to happen, DC Appleseed recommends that the Mayor have the authority to appoint the CFO to a fixed, renewable 4-year term. We decided it ought to be coterminous. The 6-month stagger in the legislation introduced by the Council seems to us reasonable, as well, although there are arguments for having a staggered term.

Our belief is that a 4-year term makes sense, rather than a 5- or 6-year term so that it's happenstance as to whether the Mayor gets to appoint the CFO or not. Our view is that you should have at least the length of the term be similar, and we err on the side of coterminous with the Mayor's, but we would understand a 1-year stagger and certainly it is not something we would oppose.

We think the Mayor should have the authority to remove the CFO for cause, subject not to two-thirds confirmation by the Council—we think that would overly politicize matters—but rather to a 10-day period within which the Council may prevent the removal.

And then the final indication of independence is not whether you can hire and fire somebody, but whether you can affect their ability to procure supplies, to hire their own personnel and to budget. We believe that the CFO ought to retain separate and independent procurement personnel and legal council authority. Legal council is not addressed in the Council's bill, and again we will make our views clear when the Council holds its hearing on that. And we believe that the budget authority for the CFO ought to be somewhat different than it is for other agencies, as indicated in our report.

Finally, let me just say a thing or two about one other section of the DC Appleseed report that's really supportive of a number of things that were said earlier. During our research, an issue that kept coming up with everybody we spoke with and in looking at other jurisdictions is that the timing of the congressional appropriations process makes it unduly difficult and uniquely difficult for the District to estimate revenue accurately, to prepare its budget thoughtfully and to establish government programs in a timely manner. With the District's improved financial condition and a well-functioning CFO in place, Congress may want to consider providing the District greater budget autonomy.

And certainly Congresswoman Norton is working on a bill; we will wait to comment further on that until we have a copy of that.

Overall, our recommendations seek to establish financial operations for the District that are independent, professional, transparent and responsive to the policy and program goals of locally elected leaders. We'll continue to be available to support the work of this committee and the District's elected leaders as the structure for the District's future financial operations is devised.

I appreciate the opportunity to appear before you today, and would be happy to answer questions later on.

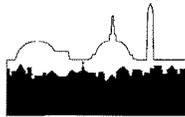
Mrs. MORELLA. I appreciate you appearing before us and your succinct testimony.

[The prepared statement of Mr. Wyner follows:]

**Testimony of the DC Appleseed Center before  
the House Subcommittee on the District of Columbia and  
the Senate Subcommittee on Oversight of Management,  
Restructuring and the District of Columbia, Committee on Government Affairs.**

**Statement of  
Joshua S. Wyner**

**June 8, 2001**



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**Testimony of the DC Appleseed Center before  
the House Subcommittee on the District of Columbia and  
the Senate Subcommittee on Oversight of Management,  
Restructuring and the District of Columbia, Committee on Government Affairs: June 8, 2001**

My name is Joshua Wyner, and I am Executive Director of the DC Appleseed Center, an independent nonprofit organization that seeks to reform the government of the District of Columbia. Earlier this week, DC Appleseed released a report entitled, *After the Control Board: The Chief Financial Officer and Financial Management in the District of Columbia*, a copy of which has been provided to committee staff to be entered into the record. I appreciate the opportunity to say a few words about our findings and recommendations.

DC Appleseed's report was researched and written over the past eight months by a team of volunteer professionals, including several who are quite knowledgeable about financial management in general and the District's finances in particular. Among the volunteers for this project are G. Edward DeSeve, former Controller, U.S. Office of Management and Budget; Bert T. Edwards, former Chief Financial Officer ("CFO"), State Department; and Michael Rogers, former City Administrator, District of Columbia.

The context for today's hearing is extremely important. In the 20 years before the Control Board was created, the Mayor of the District of Columbia had sole responsibility under the Home Rule Act for financial management. This meant that all of the government officials responsible for the District's financial operations served entirely at the pleasure of the Mayor. While there were several reasons for the District's financial collapse in the early 1990s, there is little doubt that poor financial management practices that developed within the District's executive branch were a contributing factor.

Recognizing that shortcoming, Congress simultaneously created a powerful and independent CFO and the D.C. Financial Responsibility and Management Assistance Authority ("Control Board"). Over the past six years since, the District of Columbia's finances have improved dramatically, as substantial deficits and poor bond ratings have given way to four consecutive years of surpluses and investment grade borrowing rates. As a result, the Control Board – which was created to help restore financial order in the District – is scheduled to become dormant on October 1, 2001.

One of the reasons for the District's financial turnaround is the significantly improved financial management put in place by the CFO. For this reason, it is essential that the District continue to have an independent CFO after the Control Board becomes dormant if the District is to avoid another financial crisis. Defining the specific responsibilities of the CFO and creating the structure for the CFO's independence are, of course, the \$6.4 billion dollar questions (the approximate size of the District's fiscal year 2000 revenues).

DC Appleseed's report concludes that the CFO should maintain primary responsibility for virtually all of the District's financial responsibilities, including direct control over those offices that estimate revenue; prepare the annual budget; perform the treasurer and controller

functions; assess and collect taxes; and maintain financial systems. An independent CFO is the government official who is best qualified to oversee core financial functions, most likely to maintain professional financial operations, and least likely to be unduly influenced to take actions inconsistent with sound financial management practices.

DC Appleseed has also concluded that the CFO should have primary responsibility over the financial personnel that work directly for the District's agencies (e.g., the Department of Public Works, the Police Department), but that part of that responsibility should be delegated from the CFO to the agency directors. Specifically, DC Appleseed recommends that: (1) the central CFO delegate to each agency director the authority to choose an agency CFO from a list of candidates selected by the CFO; (2) the central CFO delegate responsibility to agency directors for evaluating agency CFOs on the fulfillment of programmatic responsibilities, while retaining the authority to evaluate agency CFOs on financial management responsibilities; and (3) the central CFO retain authority to remove each agency's CFO, but only after consulting with the agency director. This structure would help ensure that agency financial personnel have adequate incentives to provide agency directors the information and services they need to implement programs, as well as the authority to maintain adequate financial controls at the agency level – where most of the District's budget is spent.

The CFO should also continue to play a role in two other financial management functions critical to the District's financial health: review of fiscal impact statements that accompany D.C. Council legislation, and certification of contracts before they are executed. DC Appleseed recommends that, for each piece of legislation passed by the Council, the CFO be required to comment on whether the fiscal impact is consistent with the budget and three-year financial plan. We further recommend that, before any contract is executed, the CFO continue to certify that sufficient funds are available, and the Chief Procurement Officer continue to certify that contracts have gone through proper contracting procedure. We also recommend that the current requirement for Council review of individual contracts be eliminated (or the threshold for Council review be increased from \$1 million to \$10 million) to streamline the procurement process.

Finally, DC Appleseed strongly supports continuing independence for the CFO after the Control Board becomes dormant in order to ensure that (1) the District's fiscal management not return to its pre-1995 state, when financial officials in the District government were provided no independence, and (2) the CFO is able to continue building a strong professional staff to carry out essential financial management functions. However, DC Appleseed also recommends that the Mayor be given the opportunity to choose a CFO with whom he or she can work, primarily so that financial operations are well-integrated into the District government after the Control Board becomes dormant. To achieve a balance between independence for the CFO and the

integration of financial operations into government, DC Appleseed recommends that, beginning on October 1, 2001:

- the Mayor have the authority to appoint the CFO to a fixed, renewable four-year term, coterminous with the Mayor's term, subject to Council confirmation;
- the Mayor have the authority to remove the CFO for cause, subject to a ten-day period within which the Council may prevent the removal (as opposed to the two-thirds Council approval requirement now in the law);
- the requirement for a 30-day layover in Congress for appointment or removal of the CFO be eliminated;
- the CFO retain separate and independent procurement, personnel, and legal counsel authority for a two-year transition period, at the end of which these authorities will be subject to the Mayor's control; and
- the budget for the Office of the CFO follow the same process as all other agency budgets, except that the Council receive the budget request originally made by the Office of the CFO to the Mayor, and the CFO continue to have an independent right to appear before the Council during the budget process.

Finally, DC Appleseed recommends that Congress alter the terms under which its approval is required before the District spends revenues. The timing of the Congressional appropriations process makes it unduly difficult for the District to estimate revenue accurately, prepare its budget thoughtfully, and establish government programs in a timely manner. With the District's improved financial condition and a well-functioning independent CFO in place, Congress should feel comfortable providing the District greater budget autonomy. DC Appleseed recommends that, at the very least, Congress grant the District autonomy to spend revenues raised that are above and beyond original revenue estimates without going through the current supplemental budget process. The second section of DC Appleseed's report contains a discussion of several ways that increased budget autonomy could be granted.

The recommendations in DC Appleseed's report seek to establish financial operations for the District of Columbia that are independent, professional, transparent, and responsive to the policy and program goals of locally elected leaders. The attainment of those goals will depend not only on the structure of the government's financial operations but also on the dedication of the CFO and the District's elected leaders to work together to establish professional financial management for the District. DC Appleseed will continue to be available to support the work of this committee and the District's elected leaders as the structure for the District's future financial operations is devised.

I appreciate the opportunity to appear before you today.

Mrs. MORELLA. I'm now pleased to recognize Renee Boicourt, Managing Director of Moody's Investors Service. Thank you for being with us.

Ms. BOICOURT. Thank you.

Madam Chairman, Congresswoman Norton, thank you for the opportunity to speak today. I am Renee Boicourt, managing director of Moody's Investors Service, and I'm pleased to join you here today to discuss the views of our firm on the credit condition of the District of Columbia. As you know, Moody's is a leading global credit rating research and analysis firm which publishes credit opinions, research and ratings on fixed income securities throughout the world.

As the Authority prepares to wind down its operations, we look back at the accomplishments over the last 6 years and ahead to the challenges the District faces in the future. We will focus our comments on issues that play a prominent role in the rating, both its history and its future. As requested by the subcommittees, our testimony will consider the purposes set out in the District of Columbia Financial Responsibility and Management Assistance Act of 1995, the financial management improvements made by the District government and the role of oversight mechanisms during the post-control period.

As we testify here today, it's clear that the credit condition of the District is very different from what it was 6 years ago. In 1995, we had just lowered the District's rating to noninvestment grade or junk status. The District had posted years of either deficit or barely balanced operations and had relied on the Federal Government for the cash to barely supply the necessary services.

Today, in contrast, Moody's rates the District's general obligation bonds Baa1, four rating levels higher than in 1995. The accumulated deficit has been eliminated without the need for deficit funding bonds, and the District has balanced its budget for 4 years. In summary, we can say that many, although not all, of the goals of the 1995 legislation have been realized.

First, let me focus on the financial arena. We see substantial progress in this aspect of the 1995 legislative goals. Budget deficits, once a chronic feature, have been absent since 1997 and cash reserves are more than adequate. Largely because of this turnaround, the District's access to the capital markets is solid. While the District was never completely denied market access, costly credit support from commercial bank facilities was necessary to market some of the District's offerings. Now, the relatively strong Baa1 rating produces wide market interest in the District's bonds.

Another goal of the 1995 legislation was the role between the District and the Federal Government with respect to service responsibilities and revenues, and here again, we see significant positive results. The 1997 Revitalization Act did much to refine the District's relationship to the Federal Government, such that it could balance its budget on a recurring basis. By taking action such as removing the unfunded pension liability from the District's balance sheet and removing funding responsibility for certain services such as courts, the 1997 legislation did much to improve the District's structural budget balance position.

Among the key goals of the 1995 legislation was to ensure the economic vitality of the District. Today, the District economy is clearly much stronger than in 1995, and you can see that in a number of indicators, including employment, personal income, the real estate market and the construction industry. Moreover, District forecasters are actually expecting a modest increase in population by 2004, a very significant milestone if borne out.

Although the District economy has shown improvement, continued economic progress will be closely linked to improving the quality and efficiency of service delivery as others have addressed today. The District continues to pursue the goal of improving the quality and efficiency of public services, and this option has been made possible by its recent financial stability.

Before the District could put its primary focus on this goal, it needed first to establish a baseline degree of financial control and accountability. With that foundation now reasonably well established, service delivery objectives have moved to the forefront of the District's agenda. Performance measures were developed quickly and early in the Clinton administration and resulted in a number of short-term projects, measured.

But in some service areas, limited management information on agency performance has made it extremely difficult to set goals and measure progress. Increasing the degree of management accountability, a building block toward improving services, has been a central target in these last few years with some success, but again, the inadequacy of the information systems, including accounting, procurement and personnel is a major obstacle. These limitations have been thoroughly reported on by the USGAO. The District's plans to continue to invest in management information systems will be key to continued credit improvement.

Over the past 6 years, the District has made improvements in all of the dimensions that drive the bond rating, debt level and structure, finance, economic growth and administrative issues. However, the financial dimension has been the most dramatic, and our written testimony details the progress in this area, and I invite you to read that in full.

In brief summary, we see budgets balanced, cash liquidity restored, chronic overspending patterns reversed and realistic revenue projections established, and these have been key to our ratings upgrades.

Let me turn now to our thoughts regarding the post-Control Board era. In many ways, the District is in a similar position to that other formerly distressed cities found themselves in at this stage of financial recovery. Having emerged from a cash crisis, established financial control and accountability, and posted a multiyear record of successful budget results, the District is now deeply engaged in the challenge of improving services and ultimately the economic prospects of its citizens. However, a difference in the pattern of the District's financial recovery which others have noted today is the absence of long-term deficit funding bonds and a corresponding slow phaseout of Control Board oversight. In other cities, we've seen a slow phaseout, and during that period, for the most part, the role of the control boards has been focused on commentary, analysis and monitoring.

Under the District's recovery legislation, which was modeled, in part, after the laws in those cities the absence of deficit funding bonds means that a slow phaseout of the Control Board's oversight role is not provided for. On the other hand, the role of Congress in the District's budget process is unique, and oversight from bodies such as the U.S. General Accounting Office is not found in other cities.

In Moody's view, certain activities have been important to the continuing financial and economic recovery as they have exited financial control periods, and those will be important here. They include multiyear financial planning along the lines of the District financial plan; multiyear fiscal analysis of proposed legislative actions, what people today have been referring to as "fiscal impact analysis"; frequent and prompt reporting regarding actual expenditure and revenue performance throughout the fiscal year; and a thorough public vetting of revenue and spending forecasts. These activities have created the capacity incentive for the financial policymakers in various cities to enact sound budgets and financial plans and to take the necessary steps to keep financial operations on balance when unexpected hurdles emerge.

In summary, Moody's sees tremendous improvement in the District's credit condition as evidenced by the upgrades from junk status to Baa1, but we also see significant challenges. A number of the goals of the 1995 act have been achieved; others are moving forward on the building blocks of improved financial control and accountability.

Thank you for giving us an opportunity to share our views regarding the credit condition of the District at this important time. We'd be happy to field questions.

Mrs. MORELLA. Thank you Ms. Boicourt. We appreciate your being here for this hearing.

[The prepared statement of Ms. Boincourt follows:]

**TESTIMONY OF**

**Renee Boicourt, Managing Director  
Moody's Investors Service**

*regarding*

**"The Outlook for the District of Columbia Government:  
The Post-Control Board Period"**

*before the*

**House Subcommittee on the District of Columbia, Committee on Government  
Reform**

*and the*

**Senate Subcommittee on Oversight of Government Management, Restructuring,  
and the District of Columbia, Committee on Governmental Affairs**

**Washington, D.C.**

**June 8, 2001**

Mr. Chairman, Madam Chairwoman, and Members of the House and Senate  
Subcommittees:

I am Renee Boicourt, Managing Director of Moody's Investors Service, and I am pleased to join you here today to discuss the views of our firm regarding the credit position of the District of Columbia. As you know, Moody's is a leading global credit rating, research and risk analysis firm, which publishes credit opinions, research and ratings on fixed-income securities, issuers of securities and other credit obligations. Moody's provides credit ratings and analysis on more than \$30 trillion of debt, including 85,000 corporate and government securities and 68,000 public finance obligations. Moody's neither invests nor makes recommendations to invest in securities.

As the Authority prepares to wind down its operations, we look back at the accomplishments of the past six years and ahead to the challenges of the future. We will focus our comments on issues that play a prominent role in the history and future of the District's bond rating. As requested by the Subcommittees, our testimony will consider the purposes set out in the District of Columbia Financial Responsibility and Management Assistance Act of 1995, the financial and management improvements made

by the District government, and the role of oversight mechanisms during the Post-Control Board period.

As we testify before you today, it is clear that the credit condition of the District is very different from what it was six years ago. In 1995, Moody's had just lowered the District's bond rating to non-investment grade, or junk status. The District had posted years of deficit or barely breakeven operations and it faced severe cash shortages, relying on the federal government to supply the cash necessary to keep basic government operations running. Today, in contrast, Moody's rates the District's general obligation bonds Baa1, four rating levels higher than in 1995. The accumulated deficit has been eliminated without the need for deficit bonds and the District has balanced its budget for four years. In summary, we can say that many, although not all, of the goals of the 1995 legislation have been realized.

#### MANY OF THE 1995 GOALS ACCOMPLISHED; OTHER AREAS STILL DEVELOPING

The District has successfully reached several of the goals laid out in the 1995 Act. Progress in the financial arena has been substantial. Budget deficits, once a chronic feature of the District's financial condition, have been absent since 1997, and cash reserves are more than adequate. Largely because of this financial turnaround, the District's access to the capital markets is solid. While the District was never completely denied market access, costly credit support from commercial bank facilities was necessary to market some of the District's offerings. Now the relatively strong Baa1 rating produces wide market interest in the District's bonds.

Another goal of the 1995 Act, the reexamination of the District/Federal government relationship, has also met with significant positive results. The 1997 Revitalization Act did much to refine the District's relationship to the Federal Government such that the District could balance its budget on a recurring basis while delivering necessary services. By taking actions such as removing the unfunded pension liability from the District's balance sheet and removing funding responsibility for the District court system, the 1997 legislation did much to improve the District's structural budget balance.

Among the key goals of the 1995 legislation was to ensure the economic vitality of the District. Today, the District economy is clearly much stronger than in 1995, as measured by a number of indicators. These include employment, personal income, the real estate market, and construction activity. Moreover, District forecasters are projecting a modest increase in population by 2004, which if borne out, would be the first population growth in the District in decades.

In other areas, the District has made less progress in accomplishing the goals of the Act, although it has begun to put important building blocks in place. Although the District economy has shown improvement, continued economic progress will be closely linked to the goal of improving the quality and efficiency of service delivery, as it affects both residents and employers. The District continues to pursue the goal of improving the

quality and efficiency of public services, an option made possible by its recent financial stability. Before the District could put its primary focus on this goal, it needed first to establish a baseline degree of financial control and accountability. With that foundation now reasonably well established, service delivery objectives have moved to the forefront of the District agenda. Although performance measures were developed quickly and early in the current administration and the results of a number of short-term projects were realized and measured, the inadequacy of management information systems has hampered this approach. In some service areas, limited management information on agency performance has made it extremely difficult to set goals and measure progress. The District's plans to continue to invest in management information systems will be key to continued progress in service delivery quality and efficiency.

Increasing the degree of management accountability, another building block toward improving the quality and efficiency of services, has been a central target in these last few years, with some success. The choice by 80% of 1,100 District Managers in 2000 to forego their civil service protection in order to maintain their management roles is one example of fundamental change in management accountability. However, periodic reports of systematic breakdowns indicate that while progress has been made, in-depth change in District operations may still be years away. Again, the inadequacy of information systems, including the accounting, procurement, and personnel systems, is a major obstacle. These have been thoroughly reported on by the U.S. General Accounting Office.

#### FINANCIAL IMPROVEMENTS HAVE DRIVEN RATING UPGRADES

Over the past six years, the District has made improvements in all of the dimensions that drive the bond rating—debt level and structure, finances, economic growth, and administrative issues. However, the financial dimension has been the most dramatic. Improvement in this dimension may be measured in a number of ways. First and most obviously, the District operating budget, which had run either deficit or barely breakeven operations since 1990, finally broke that pattern in 1997 with a \$185.9 million surplus. Surpluses have been maintained in the three consecutive years since then, which had the effect of eliminating the accumulated deficit, which by 1996 had grown to over \$500 million. The fact that the District was able to shed its accumulated deficit without issuing long-term deficit bonds, which other troubled cities have had to do, speaks to the tight and effective rein the District has had on its finances since the control period began, as well as to the positive effects of the 1997 Revitalization Act.

Strong budget results mended the District's cash position. The chronic cash shortages of the mid-1990s, which were financed with Treasury borrowings and vendor payment delays, have eased considerably, ending the climate of crisis cash management. This improved liquidity occurred even as the federal payment fell. Significantly, the District has paid vendors on time since 1997. In addition, short-term borrowing patterns have improved. The once-routine practice of borrowing from the Treasury has not occurred since 1997 and even the District's seasonal cashflow borrowing has decreased in size. In fiscal 2000, the District needed to borrow only \$70 million to finance seasonal cashflow

needs, down from over \$500 million in fiscal 1996. For fiscal 2001, the District has not and does not intend to do a short-term borrowing, a clear indication of an improved cash position.

#### Chronic Overspending Pattern Reversed; Realistic Revenue Projections Established

When the control period began, expenditure control and spending within budget were primary goals of both the Authority and the Chief Financial Officer. Operating expenditures during the late 1980s and early 1990s frequently grew at double-digit rates, and agencies routinely spent over budget, with some spending as much as 15% over budgeted levels. In the early years of the control period, financial officials took firm measures to control spending, leading to a 9.2% decline in operating expenditure in 1996, the first full control year. Spending restraint has continued—an examination of the District's Annual Financial Reports show no significant overspending in any District agencies. The District has aided this effort by compiling and examining spending pressures on a monthly basis and addressing vulnerable areas of the budget well before year-end.

The agencies that have been removed temporarily from the control of the District government by the Court as a response to a lawsuit, known as the receiver agencies, are an exception to the pattern of success in spending control. Largely because of the District's limited control, the receiver agencies have frequently overspent their budgets by large amounts. Through most of fiscal 2000, the District had three agencies run by receivers. Future District control of these agencies should limit the overspending in these areas, further aiding the District's bottom line.

Realistic revenue estimates have also played a significant role in helping the District maintain operating surpluses and work its way out of the control period. The current forecast approach constitutes a dramatic change from the early 1990s, when overly optimistic revenue estimates, in combination with a soft U.S. economy, routinely contributed to budget gaps. Recent revenue estimates have been aided by a newly resilient District economy, particularly in the real estate market, which has prompted better-than-expected property tax revenues. This year's revenues are still on course, with tax receipts up 5.4% over projections through March. While individual income taxes are showing some weakness as they are throughout the country, property, sales, and the corporate franchise tax are showing surprising strength.

#### THE POST CONTROL BOARD ERA

In many ways, the District is in a similar position to that other formerly distressed cities found themselves at this stage of financial recovery. Having emerged from a cash crisis, established financial control and accountability, and posted a multi-year record of successful budget results, the District is now deeply engaged in the challenge of improving services and, ultimately, the economic prospects of its citizens and employers. However, a difference in the pattern of the District's financial recovery has been the absence of deficit funding bonds and the associated slow phase-out of control board

oversight. In other cities, such as Philadelphia and New York, various oversight mechanisms have been phasing out slowly as the deficit funding bonds are retired, even after these cities exited their control periods. During this phase-out, the role of the control boards has been focused on commentary, analysis and monitoring. Under the District's recovery legislation, which was modeled in part after these cities', the absence of deficit funding bonds means that a slow phase-out of the control board oversight role is not provided for. On the other hand, the role of Congress in the District's budget process is unique, and oversight from bodies such as the U.S. General Accounting Office, is not found in other cities.

In Moody's view, certain activities have been important to the continuing financial and economic recovery of other cities as they have exited financial control periods, and those will be important here. They include multiyear financial planning, multiyear fiscal analysis of proposed legislative actions, frequent and prompt reporting regarding actual expenditure and revenue performance throughout the fiscal year, and a thorough public vetting of revenue and spending forecasts. These activities have created the capacity and incentive for the financial policy makers in these cities to enact sound budgets and financial plans, and to take the necessary steps to keep financial operations on balance when unexpected hurdles emerge. In cities which actively engage in these planning and reporting activities, the management capacity of the city government has evolved to a level of effectiveness that has produced successful records of fiscal planning and responsiveness to fiscal contingencies as they emerge.

In summary, Moody's sees tremendous improvement in the District's credit condition, as evidenced by the upgrades from junk status to Baa1, but we also see significant challenges. A number of the goals of the 1995 Act have been achieved. Others are moving forward, on the building blocks of improved financial control and accountability.

Thank you for giving us the opportunity to share our views regarding the credit condition of the District of Columbia at this important time. We would be happy to answer questions.

Mrs. MORELLA. I'm pleased to recognize Parry Young.

Mr. YOUNG. Thank you.

Mrs. MORELLA. Public finance, Standard & Poor's.

Mr. YOUNG. Madam Chairwoman, and members of the subcommittee, thank you for inviting Standard & Poor's to participate in today's hearing. My name is Parry Young. I am a director in Standard & Poor's Public Finance Department and have been a lead analyst on the District of Columbia's credit rating for more than 10 years. Standard & Poor's provides independent financial information, analytical services and credit ratings to the world's financial markets. We are a division of the McGraw-Hill Companies. I would like to summarize the written testimony which has been submitted.

Standard & Poor's long-term issue credit ratings cover a range from AAA, highest, to D, lowest and includes default. The District's general obligation or G.O. bonds were initially assigned a single A rating in 1984, signifying S&P's opinion that the District had a strong capacity to meet its obligations. Today, the District's bonds are rated BBB-plus, which is just below the single A category and is defined as adequate capacity to meet obligations.

I would like to use the rest of my time to summarize the key rating actions and factors for the District from the initial rating in 1984 to today.

The 1984 single A rating of the District bond was based on a number of factors, including the District's special economic and financial relations with the Federal Government, such as access to the Treasury advances to meet operating expenses and debt service. Three years of strong revenue growth followed along with a reduction in accumulated deficit, and in fiscal 1998 the District reported a \$14 million deficit caused largely by increasing human services expenditures.

Over the next few years, actual and projected budgetary stress caused by a structural imbalance of revenues and expenditures, which continued and culminated in a lowering of the District's rating to single A-minus in 1990. A plus or a minus sign in the rating denotes relative position within the category.

The District sold G.O. bonds in 1991 to eliminate its accumulated deficit. However, the District's finances continued to be under stress, which was exacerbated by growing expenditures and sluggish economic indicators. In February 1995, S&P lowered the district's rating to BBB-minus after the reporting of a much-larger-than-anticipated deficit for fiscal 1994.

In April 1995, Standard & Poor's again lowered the rating of the District's G.O. bonds to single B, due primarily to weakening of the District's ability to requisition advances from the U.S. Treasury under the provisions of the newly enacted Control Board Act. While the act initially had an adverse effect on the District's rating, it contained the potential to be a positive force for the District's creditworthiness, which we have seen.

The Control Board Act and the 1997 National Capital Revitalization Act, along with strengthening economic factors, were significant factors in the District's improved financial and administrative position. The Control Board provided managerial oversight while under the Revitalization Act had the Federal Government assumed

the District's unfunded pension liability and the cost of certain District operations.

By fiscal 1998, the District had entirely eliminated its accumulated deficit, and in April 1999, Standard & Poor's raised the District's rating from BB to an investment grade rating of BBB which has been raised to BBB-plus in February of this year, due to the District's improved financial operations, enhanced debt position and the expectation of continued strengthening of its credit fundamentals.

The current rating reflects the assumption that the District's overall credit quality would maintain its positive momentum and included the expectation of the imminent phaseout of the Control Board at the end of 2001. We believe that the rating is not likely to change over the medium to longer term. The direction of any further rating action depends on the District's ability to demonstrate that it is adequately balancing its social and capital costs with available resources and that financial and management controls and improvements have been institutionalized.

This concludes my statement. Thank you for inviting us here. I would be very happy to answer any questions.

[The prepared statement of Mr. Young follows:]

**“The Outlook for the District of Columbia Government: The  
Post-Control Board Period”**

*House Subcommittee on the District of Columbia, Committee on  
Government Reform, and the Senate Subcommittee on the  
Oversight of Government Management, Restructuring and the  
District of Columbia, Committee on Governmental Affairs*

Joint Hearing—June 8, 2001

Testimony of Parry Young, Director, Standard & Poor’s, Public  
Finance Department

**“The Outlook for the District of Columbia Government: The Post-Control Board Period”**

*House Subcommittee on the District of Columbia, Committee on Government Reform, and the Senate Subcommittee on the Oversight of Government Management, Restructuring and the District of Columbia, Committee on Governmental Affairs*

Joint Hearing—June 8, 2001

Testimony of Parry Young, Director, Standard & Poor's, Public Finance Department

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Thank you for inviting Standard & Poor's to participate in today's hearing. My name is Parry Young. I am a Director in Standard & Poor's Public Finance department and have been a lead analyst on the District of Columbia for more than ten years.

**I. INTRODUCTION**

Standard & Poor's, a division of The McGraw-Hill Companies, provides independent financial information, analytical services and credit ratings to the world's financial markets. With more than 4,000 employees in 21 countries, Standard & Poor's is an integral part of the global financial infrastructure.

Standard & Poor's began assigning ratings over 80 years ago and, today, assigns credit ratings to debt issues of thousands of state and local governments in the United States and around the world. Standard & Poor's has rated the District of Columbia's (the District) general obligation bonds (G.O. Bonds) since they were initially offered to the public in 1984. Standard & Poor's rates other obligations of the District, but for purposes of my testimony, the discussion below addresses only our ratings on the District's G.O. Bonds.

My testimony will cover the following areas:

- Standard & Poor's rating definitions and rating criteria for municipal general obligation debt,
- Credit ratings of the District's G.O. Bonds, historical and current, and
- Comments on the District's G.O. Bond ratings in the post-Control Board period.

**II. RATING DEFINITIONS AND RATING CRITERIA FOR MUNICIPAL GENERAL OBLIGATION DEBT**

As more fully described in Attachment A, a Standard & Poor's issue credit rating is our current opinion of the creditworthiness of an obligor with respect to a specific obligation. An issue credit rating, like all of Standard & Poor's ratings, is not a recommendation to purchase, sell or hold any financial obligation, inasmuch as it does not comment as to market price or suitability for a particular investor.

An issue credit rating is based on current information furnished by the obligor or obtained by Standard & Poor's from other sources it considers reliable. Standard & Poor's does not perform an audit in connection with any rating and may rely on unaudited financial information. Ratings can be changed, suspended or withdrawn as a result of changes in, or the unavailability of, such information, or based on other circumstances.

Issue credit ratings are expressed in terms of default risk and can be either long-term or short-term. The issue credit ratings for the District's G.O. Bonds are (and at all times have been) long-term, meaning, in the U.S. market, that the obligations have an original maturity beyond 365 days. These ratings are based, in varying degrees, on: i) the likelihood of payment - the capacity and willingness of the obligor to meet its financial commitment on an obligation in accordance with the terms of the obligation; ii) the nature and provisions of the obligation; and iii) the protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganization, or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights.

Standard & Poor's long-term issue credit ratings cover a range from "AAA" (highest) to "D" (lowest, and includes default). The rating definitions for each rating category are set forth in Attachment A. The ratings from "AA" to "CCC" may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories. The District's G.O. Bonds were initially assigned an "A" rating in 1984 and are currently rated "BBBplus."

Standard & Poor's rates general obligation (G.O.) debt based on criteria developed specifically for this type of security (see Attachment B). With G.O. debt the issuer pledges its full faith and credit to pay the financial obligation. The capacity and willingness of a municipal government to repay its G.O. debt is assessed by examining four basic analytical areas:

- Economy,
- Financial performance and flexibility,
- Debt burden, and
- Administrative factors.

Debt secured by a general obligation pledge is generally regarded as the broadest and soundest security among tax secured bonds (full faith and credit). One factor that accounts for this strength is that G.O. debt creates a link between public and personal debt: homeowners unable to pay their property taxes will forfeit their houses in the same vein as the failure to make mortgage payments. Also, with the unlimited tax G.O. pledge, an issuer may be compelled to raise the property tax rate as much as necessary to pay the bonds. However, to Standard & Poor's knowledge, this action has rarely been taken. Other types of municipal debt include a variety of revenue bonds which are supported by the issuer's pledge of only a limited stream of revenues, for example, sales taxes.

### Economy

The economic base is the most important element in determining a rating. It is the foundation of the community's fiscal health upon which its prospects depend. Some of the areas reviewed include demographics, tax base and employment. Generally, communities with higher income levels and diverse economic bases have superior debt repayment capabilities, however, this is not always the case. The obligor must have the capability to capitalize on its primary economic strengths in order to succeed.

### Financial Performance and Flexibility

Financial analysis involves the following areas:

- Accounting and reporting methods,
- Revenue and expenditure structure and patterns,
- Annual operating and budgetary performance,
- Financial leverage and equity position,
- Budget and financial planning, and
- Contingent financial obligations.

The analysis of these factors will present a clear indication of the financial strengths and weaknesses of an issuer and provide the framework for evaluating its capacity to manage economic, political and financial uncertainties.

### Debt Burden

The analysis of debt focuses on the nature of the specific pledged security, the debt repayment structure, the current debt servicing burden, and the future capital needs. Accelerated debt issuance with a high debt load can overburden a municipality, force the reduction of necessary services, and consequently lead to lower ratings. A low debt profile may not necessarily be a positive credit factor since it may indicate underinvestment in capital facilities. Investment in public infrastructure is believed to enhance the growth prospects of the private sector. Neglecting critical capital needs may impede economic growth and endanger future tax revenue generation.

### Administrative Factors

The powers of a municipality establish its ability to plan for changes in the political, economic, and financial environment, and the capacity to respond to changes in a timely fashion. The range and growth potential of services provided by the issuer are examined in relation to the capacity to provide such services. Areas reviewed in this analysis include: planning goals, financial management, annual budget, capital improvement program, property tax administration, labor settlements and litigation and investment guidelines for various funds.

### III. CREDIT RATING HISTORY OF THE DISTRICT OF COLUMBIA'S GENERAL OBLIGATION BONDS

Many of the credit factors related to the District are unusual if not unique. As a consequence of the District's position as the federal capital, these factors include:

- Large government and government-related employment sector
- High percent of tax-exempt properties
- Major tourism sector
- Special fiscal relationships with the Federal Government
- Federal Government budget approvals
- Administrative constraints on revenue raising capacity.

Attached are rating reports and analysis for the District's G.O. Bonds beginning in 1984, and including rating changes since that date and until February 2001. The Outlook for these ratings also changed during this period and the ratings, on occasion, were subject to CreditWatch action. In addition, the ratings were affirmed at their various rating levels over the years. Please let me know if you would like copies of these additional rating actions.

#### A. Historical Ratings

##### 1. Initial Bond Rating (December, 1984)

Standard & Poor's issued an "A" rating to the District's initial G.O. Bond issue in December, 1984 (see Attachment C). Rating factors included the "District's special economic and financial relations with the federal government," including "access to Treasury advances to meet operating expenses and debt service..."

##### 2. Fiscal Years 1985-1987

Following the initial rating, the District had three fiscal years (1985-1987) of strong revenue increases, 8.5%, 10.7% and 10.2%, respectively, resulting in surpluses of \$20 million to \$25 million in each year. Such surpluses allowed for the reduction of the District's accumulated deficit from \$270 million at the end of fiscal 1984 to \$205 million at the end of fiscal 1987.

##### 3. Fiscal Years 1988-1990

In fiscal year 1988, in spite of continued strong revenue growth, the District reported a \$14 million deficit caused largely by increasing human services expenditures.

The District closed a projected \$175 million gap in fiscal 1989, and ended with a \$5 million surplus. Revenue growth was cut in half but expenditure increases were held to only 3.1%.

Based on existing and projected budgetary stress caused by a structural imbalance of revenues and expenditures, Standard & Poor's lowered the District's G.O. Bond rating from "A" to "A-minus" in May, 1990 (see Attachment D). For the fiscal year ended September 30, 1990, the District reported a deficit of \$118 million.

#### 4. Fiscal Years 1991-1993

In fiscal year 1991, the District sold \$330 million of G.O. recovery bonds, rated "A-minus" by Standard & Poor's, to eliminate its accumulated deficit. During the fiscal year, a special commission (the Rivlin Commission) issued a report which included a plan to improve the District's finances.

The District closed significant budget gaps in fiscal years 1992 and 1993, producing small surpluses, but was still under acute fiscal pressure exacerbated by growing expenditures and sluggish economic indicators.

#### 5. Fiscal Years 1994-1995

In June, 1994, Standard & Poor's changed the District's rating Outlook (see Attachment E) to negative from stable to reflect the ongoing budget stress. The negative Outlook indicates that the rating may be lowered (see Attachment F for the definition of Rating Outlook).

In February, 1995, Standard & Poor's lowered the District's G.O. Bond rating (Attachment G) to "BBB-minus" from "A-minus" due to the reporting of a worse than anticipated fiscal 1994 deficit (\$335 million) and still unresolved fiscal problems. In April, 1995, Standard & Poor's again lowered the rating on the District's G.O. Bonds to 'B' (Attachment H) due primarily to the weakening of the District's ability to requisition advances from the U.S. Treasury as contained in the planned "District of Columbia Financial Responsibility and Management Assistance Act of 1995" (Control Board Act). For fiscal 1995, the District reported a \$54.4 million deficit.

#### 6. Fiscal Years 1996-2000

Due to improved financial and administrative factors resulting from the Control Board Act and the National Capital Revitalization and Self-Government Improvement Act of 1997 (Revitalization Act), Standard & Poor's raised the District's rating (Attachment I) to "BB" with a positive Outlook in March, 1998. Key features of the Revitalization Act included the assumption by the Federal Government of the District's \$3.7 billion unfunded pension liability and of the cost of certain District operations, including court systems. The Revitalization Act also increased the District's Medicaid reimbursement rate to 70% from 50%. On the revenue side, the annual Federal payment (more than \$600 million) was eliminated. In fiscal 1996, financial operations resulted in deficit of \$33.7 million, and in fiscal 1997, a \$185.9 million surplus.

For fiscal 1998, the District reported a \$445 million surplus, entirely eliminating its accumulated deficit, and in April, 1999, Standard & Poor's raised the District's G.O. Bond rating again (Attachment J) to "BBB" from "BB" based on improved financial and administrative factors.

#### B. Current Rating

##### 1. Fiscal Year 2001

In February, 2001, following the report of a \$241 million surplus for fiscal 2000, Standard & Poor's raised the District's G. O. Bond rating to "BBB-plus" (Attachment K) based on improved financial operations plus enhanced debt position and the expectation of continued strengthening of its credit fundamentals. The stable Outlook reflected the expectation that the District's overall credit quality will maintain its positive momentum.

#### IV. THE DISTRICT'S GENERAL OBLIGATION BOND RATINGS IN THE POST-CONTROL BOARD PERIOD

The District's "BBB-plus" rating was assigned in February, 2001, with the expectation of the imminent phase-out of G. O. Bond the Control Board at the end of 2001. The stable Outlook means that the rating is not likely to change over the medium to longer term. At the time of the upgrade, Standard & Poor's stated that "the direction of any further rating action would depend on the District's ability to demonstrate that it is adequately balancing its social and capital costs with available resources and... financial and management controls and improvements have been institutionalized." Standard & Poor's also said: "Further improvements in management systems are needed to ensure more efficient operations." We stated further that: "Although the District's financial successes to date have been significant, the District will be challenged to continue this positive financial progress while focusing on improving the level and quality of services, implementing tax and economic incentives, and addressing capital program needs and costs. Financial pressures will come from the District's limited revenue raising flexibility, significant amount of capital needs, and risks associated with the district's unique economic profile."

## ATTACHMENT A

## Ratings Definitions

## ISSUE CREDIT RATING DEFINITIONS

A Standard & Poor's issue credit rating is a current opinion of the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations, or a specific financial program (including ratings on medium term note programs and commercial paper programs). It takes into consideration the creditworthiness of guarantors, insurers, or other forms of credit enhancement on the obligation and takes into account the currency in which the obligation is denominated. The issue credit rating is not a recommendation to purchase, sell, or hold a financial obligation, inasmuch as it does not comment as to market price or suitability for a particular investor.

Issue credit ratings are based on current information furnished by the obligors or obtained by Standard & Poor's from other sources it considers reliable. Standard & Poor's does not perform an audit in connection with any credit rating and may, on occasion, rely on unaudited financial information. Credit ratings may be changed, suspended, or withdrawn as a result of changes in, or unavailability of, such information, or based on other circumstances.

Issue credit ratings can be either long-term or short-term. Short-term ratings are generally assigned to those obligations considered short-term in the relevant market. In the U.S., for example, that means obligations with an original maturity of no more than 365 days—including commercial paper. Short-term ratings are also used to indicate the creditworthiness of an obligor with respect to put features on long-term obligations. The result is a dual rating, in which the short-term rating addresses the put feature, in addition to the usual long-term rating. Medium-term notes are assigned long-term ratings.

**Long-Term Issue Credit Ratings**

Issue credit ratings are based, in varying degrees, on the following considerations:

- • Likelihood of payment—capacity and willingness of the obligor to meet its financial commitment on an obligation in accordance with the terms of the obligation;
- • Nature of and provisions of the obligation;
- • Protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganization, or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights.

The issue rating definitions are expressed in terms of default risk. As such, they pertain to senior obligations of an entity. Junior obligations are typically rated lower than senior obligations, to reflect the lower priority in bankruptcy, as noted above. (Such differentiation applies when an entity has both senior and subordinated obligations, secured and unsecured obligations, or operating company and holding company obligations.) Accordingly, in the case of junior debt, the rating may not conform exactly with the category definition.

**AAA**

An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.

**AA**

An obligation rated 'AA' differs from the highest rated obligations only in small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong.

**A**

An obligation rated 'A' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.

**BBB**

An obligation rated 'BBB' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation. Obligations rated 'BB', 'B', 'CCC', 'CC', and 'C' are regarded as having significant speculative characteristics. 'BB' indicates the least degree of speculation and 'C' the highest. While such obligations will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.

**BB**

An obligation rated 'BB' is less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

**B**

An obligation rated 'B' is more vulnerable to nonpayment than obligations rated 'BB', but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation.

**CCC**

An obligation rated 'CCC' is currently vulnerable to nonpayment, and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitment on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation.

**CC**

An obligation rated 'CC' is currently highly vulnerable to nonpayment.

**C**

A subordinated debt or preferred stock obligation rated 'C' is CURRENTLY HIGHLY VULNERABLE to nonpayment. The 'C' rating may be used to cover a situation where a

bankruptcy petition has been filed or similar action taken, but payments on this obligation are being continued. A 'C' also will be assigned to a preferred stock issue in arrears on dividends or sinking fund payments, but that is currently paying.

*D*

An obligation rated 'D' is in payment default. The 'D' rating category is used when payments on an obligation are not made on the date due even if the applicable grace period has not expired, unless Standard & Poor's believes that such payments will be made during such grace period. The 'D' rating also will be used upon the filing of a bankruptcy petition or the taking of a similar action if payments on an obligation are jeopardized.

**Plus (+) or minus (-)**

The ratings from 'AA' to 'CCC' may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

*r*

This symbol is attached to the ratings of instruments with significant noncredit risks. It highlights risks to principal or volatility of expected returns which are not addressed in the credit rating.

*N.R.*

This indicates that no rating has been requested, that there is insufficient information on which to base a rating, or that Standard & Poor's does not rate a particular obligation as a matter of policy.

**Short-Term Issue Credit Ratings**

**A-1**

A short-term obligation rated 'A-1' is rated in the highest category by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is strong. Within this category, certain obligations are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitment on these obligations is extremely strong.

**A-2**

A short-term obligation rated 'A-2' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rating categories. However, the obligor's capacity to meet its financial commitment on the obligation is satisfactory.

**A-3**

A short-term obligation rated 'A-3' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

**B**

A short-term obligation rated 'B' is regarded as having significant speculative characteristics. The obligor currently has the capacity to meet its financial commitment on the obligation; however, it faces major ongoing uncertainties which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

**C**

A short-term obligation rated 'C' is currently vulnerable to nonpayment and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitment on the obligation.

**D**

A short-term obligation rated 'D' is in payment default. The 'D' rating category is used when payments on an obligation are not made on the date due even if the applicable grace period has not expired, unless Standard & Poor's believes that such payments will be made during such grace period. The 'D' rating also will be used upon the filing of a bankruptcy petition or the taking of a similar action if payments on an obligation are jeopardized.

**Local Currency and Foreign Currency Risks**

Country risk considerations are a standard part of Standard & Poor's analysis for credit ratings on any issuer or issue. Currency of repayment is a key factor in this analysis. An obligor's capacity to repay foreign currency obligations may be lower than its capacity to repay obligations in its local currency due to the sovereign government's own relatively lower capacity to repay external versus domestic debt. These sovereign risk considerations are incorporated in the debt ratings assigned to specific issues. Foreign currency issuer ratings are also distinguished from local currency issuer ratings to identify those instances where sovereign risks make them different for the same issuer.

**ISSUER CREDIT RATING DEFINITIONS**

A Standard & Poor's Issuer Credit Rating is a current opinion of an obligor's overall financial capacity (its creditworthiness) to pay its financial obligations. This opinion focuses on the obligor's capacity and willingness to meet its financial commitments as they come due. It does not apply to any specific financial obligation, as it does not take into account the nature of and provisions of the obligation, its standing in bankruptcy or liquidation, statutory preferences, or the legality and enforceability of the obligation. In addition, it does not take into account the creditworthiness of the guarantors, insurers, or other forms of credit enhancement on the obligation. The Issuer Credit Rating is not a recommendation to purchase, sell, or hold a financial obligation issued by an obligor, as it does not comment on market price or suitability for a particular investor.

Counterparty Credit Ratings, ratings assigned under the Corporate Credit Rating Service (formerly called the Credit Assessment Service) and Sovereign Credit Ratings are all forms of Issuer Credit Ratings.

Issuer Credit Ratings are based on current information furnished by obligors or obtained by Standard & Poor's from other sources it considers reliable. Standard & Poor's does not perform an audit in connection with any Issuer Credit Rating and may, on occasion,

rely on unaudited financial information. Issuer Credit Ratings may be changed, suspended, or withdrawn as a result of changes in, or unavailability of, such information, or based on other circumstances. Issuer Credit Ratings can be either long-term or short-term. Short-Term Issuer Credit Ratings reflect the obligor's creditworthiness over a short-term time horizon.

### **Long-Term Issuer Credit Ratings**

#### **AAA**

An obligor rated 'AAA' has EXTREMELY STRONG capacity to meet its financial commitments. 'AAA' is the highest Issuer Credit Rating assigned by Standard & Poor's.

#### **AA**

An obligor rated 'AA' has VERY STRONG capacity to meet its financial commitments. It differs from the highest rated obligors only in small degree.

#### **A**

An obligor rated 'A' has STRONG capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.

#### **BBB**

An obligor rated 'BBB' has ADEQUATE capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments. Obligor's rated 'BB', 'B', 'CCC', and 'CC' are regarded as having significant speculative characteristics. 'BB' indicates the least degree of speculation and 'CC' the highest. While such obligors will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.

#### **BB**

An obligor rated 'BB' is LESS VULNERABLE in the near term than other lower-rated obligors. However, it faces major ongoing uncertainties and exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitments.

#### **B**

An obligor rated 'B' is MORE VULNERABLE than the obligors rated 'BB', but the obligor currently has the capacity to meet its financial commitments. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitments.

#### **CCC**

An obligor rated 'CCC' is CURRENTLY VULNERABLE, and is dependent upon favorable business, financial, and economic conditions to meet its financial commitments.

#### **CC**

An obligor rated 'CC' is CURRENTLY HIGHLY-VULNERABLE.

**Plus (+) or minus (-)**

Ratings from 'AA' to 'CCC' may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

**R**

An obligor rated 'R' is under regulatory supervision owing to its financial condition. During the pendency of the regulatory supervision the regulators may have the power to favor one class of obligations over others or pay some obligations and not others. Please see Standard & Poor's issue credit ratings for a more detailed description of the effects of regulatory supervision on specific issues or classes of obligations.

***SD and D***

An obligor rated 'SD' (Selective Default) or 'D' has failed to pay one or more of its financial obligations (rated or unrated) when it came due. A 'D' rating is assigned when Standard & Poor's believes that the default will be a general default and that the obligor will fail to pay all or substantially all of its obligations as they come due. An 'SD' rating is assigned when Standard & Poor's believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner. Please see Standard & Poor's issue credit ratings for a more detailed description of the effects of a default on specific issues or classes of obligations.

**N.R.**

An issuer designated N.R. is not rated.

**Public Information Ratings**

Ratings with a 'pi' subscript are based on an analysis of an issuer's published financial information, as well as additional information in the public domain. They do not, however, reflect in-depth meetings with an issuer's management and are therefore based on less comprehensive information than ratings without a 'pi' subscript. Ratings with a 'pi' subscript are reviewed annually based on a new year's financial statements, but may be reviewed on an interim basis if a major event occurs that may affect the issuer's credit quality.

Outlooks are not provided for ratings with a 'pi' subscript, nor are they subject to potential CreditWatch listings. Ratings with a 'pi' subscript generally are not modified with '+' or '-' designations. However, such designations may be assigned when the issuer's credit rating is constrained by sovereign risk or the credit quality of a parent company or affiliated group.

**Termination Structure**

T subscript: Termination structures are designed to honor their contracts to full maturity or, should certain events occur, to terminate and cash settle all their contracts before their final maturity date.

## Short-Term Issuer Credit Ratings

### A-1

An obligor rated 'A-1' has STRONG capacity to meet its financial commitments. It is rated in the highest category by Standard & Poor's. Within this category, certain obligors are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitments is EXTREMELY STRONG.

### A-2

An obligor rated 'A-2' has SATISFACTORY capacity to meet its financial commitments. However, it is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in the highest rating category.

### A-3

An obligor rated 'A-3' has ADEQUATE capacity to meet its financial obligations. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments.

### B

An obligor rated 'B' is regarded as VULNERABLE and has significant speculative characteristics. The obligor currently has the capacity to meet its financial commitments; however, it faces major ongoing uncertainties which could lead to the obligor's inadequate capacity to meet its financial commitments.

### C

An obligor rated 'C' is CURRENTLY VULNERABLE to nonpayment and is dependent upon favorable business, financial, and economic conditions for it to meet its financial commitments.

### R

An obligor rated 'R' is under regulatory supervision owing to its financial condition. During the pendency of the regulatory supervision the regulators may have the power to favor one class of obligations over others or pay some obligations and not others. Please see Standard & Poor's issue credit ratings for a more detailed description of the effects of regulatory supervision on specific issues or classes of obligations.

### *SD and D*

An obligor rated 'SD' (Selective Default) or 'D' has failed to pay one or more of its financial obligations (rated or unrated) when it came due. A 'D' rating is assigned when Standard & Poor's believes that the default will be a general default and that the obligor will fail to pay all or substantially all of its obligations as they come due. An 'SD' rating is assigned when Standard & Poor's believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner. Please see Standard & Poor's issue credit ratings for a more detailed description of the effects of a default on specific issues or classes of obligations.

*N.R.*

An issuer designated N.R. is not rated.

### **Local Currency and Foreign Currency Risks**

Country risk considerations are a standard part of Standard & Poor's analysis for credit ratings on any issuer or issue. Currency of repayment is a key factor in this analysis. An obligor's capacity to repay foreign currency obligations may be lower than its capacity to repay obligations in its local currency due to the sovereign government's own relatively lower capacity to repay external versus domestic debt. These sovereign risk considerations are incorporated in the debt ratings assigned to specific issues. Foreign currency issuer ratings are also distinguished from local currency issuer ratings to identify those instances where sovereign risks make them different for the same issuer.

### **RATING OUTLOOK DEFINITIONS**

A Standard & Poor's Rating Outlook assesses the potential direction of a long-term credit rating over the intermediate to longer term. In determining a Rating Outlook, consideration is given to any changes in the economic and/or fundamental business conditions. An Outlook is not necessarily a precursor of a rating change or future CreditWatch action.

- • Positive means that a rating may be raised.
- • Negative means that a rating may be lowered.
- • Stable means that a rating is not likely to change.
- • Developing means a rating may be raised or lowered.
- • N.M. means not meaningful.

### **CreditWatch**

CreditWatch highlights the potential direction of a short- or long-term rating. It focuses on identifiable events and short-term trends that cause ratings to be placed under special surveillance by Standard & Poor's analytical staff. These may include mergers, recapitalizations, voter referendums, regulatory action, or anticipated operating developments. Ratings appear on CreditWatch when such an event or a deviation from an expected trend occurs and additional information is necessary to evaluate the current rating. A listing, however, does not mean a rating change is inevitable, and whenever possible, a range of alternative ratings will be shown. CreditWatch is not intended to include all ratings under review, and rating changes may occur without the ratings having first appeared on CreditWatch. The "positive" designation means that a rating may be raised; "negative" means a rating may be lowered; and "developing" means that a rating may be raised, lowered, or affirmed.

### **DUAL RATINGS DEFINITIONS**

Standard & Poor's assigns "dual" ratings to all debt issues that have a put option or demand feature as part of their structure. The first rating addresses the likelihood of repayment of principal and interest as due, and the second rating addresses only the demand feature. The long-term debt rating symbols are used for bonds to denote the long-

term maturity and the commercial paper rating symbols for the put option (for example, 'AAA/A-1+'). With short-term demand debt, Standard & Poor's note rating symbols are used with the commercial paper rating symbols (for example, 'SP-1+/A-1+').

**ATTACHMENT B*****Standard & Poor's Public Finance Criteria*****GO DEBT**

When a state or municipal issuer sells a GO bond, the issuer pledges its full faith and credit to repay the financial obligation. Unless certain tax revenue streams are specifically restricted, the GO issuer frequently pledges all of its tax-raising powers. Typically, local governments secure the obligation with their ability to levy an unlimited ad valorem property tax; state governments, which have a different tax structure, usually pledge unrestricted revenue streams, such as sales or income taxes.

GO bonds remain essential financing instruments of tax-supported capital projects.

However, since the 1970s, the increasing popularity of revenue bonds has reduced the dominance of GO financings in the municipal market. The reasons underlying the relative shift are many, but leading these developments are:

- The attractiveness of financing capital projects through user fees rather than broad-based taxes;
- The limited legal and practical capacity of governments to carry larger debt burdens; and
- Continuing market innovations, which favor revenue bond issuance.

The capacity and willingness of municipal governments to repay their GO debt can be assessed by examining four basic analytical areas:

- Economy,
- Financial performance and flexibility,
- Debt burden, and
- Administration.

**Economic Base**

The economic base is the most critical element in determining an issuer's rating and incorporates local and national economic factors.

The foundation of a community's fiscal health is its economy. Financial growth prospects and volatility of major revenue sources depend on the performance of the local economy. Economic conditions also influence the affordability and range of services delivered by a government in such categories of expenditures as social welfare, education, health care, and public safety.

An issuer's geography and proximity to transportation networks, cities, and markets plays a key role in the economic development of a community. The infrastructure of an area, including the road network, utility systems, and transportation facilities, will also be important. These two areas provide background about how a specific economy has developed to date but also provide information on what the future growth prospects of a community are.

**Demographics**

The demographic characteristics of a community also factor heavily into economic analysis. The local population base is profiled in terms of age, education, labor skills and competitiveness, and wealth and income levels. Demographic analysis also considers the impact of annexations and the effect of migration patterns. Specifically, we look at growth and shifts in population over several decades. Wealth characteristics are a very

critical element of a demographic review. High wealth and income characteristics are viewed very favorably and often contribute to superior debt repayment capabilities.

#### Tax Base

The initial focus is on size, structure, and diversity. The tax base's composition is reviewed to identify proportionate contributions from residential, commercial, and industrial tax revenue sources. To determine the degree of concentration, the leading taxpayers are profiled and assessed for their direct and indirect effects on the local economy. If a particular base is highly reliant on a few taxpayers for property taxes, there is vulnerability to any changes in the taxpayers assessment, especially when property taxes comprise a large portion of the revenue base. Significant changes in the tax base are analyzed to determine whether the causes are structural or cyclical. Assessed valuation trends are analyzed over the past five to 10 years as well as the level of building permit activity over the same time period.

#### Employment Base

The composition, output, and diversity of the employment base are prime consideration in evaluating the strength of the economy. The employment base provides the primary strength of a community and is often an attraction for continued economic growth and viability. Specifically Standard & Poor's analyzes:

- The industry mix and employment by sector to identify diversification trends or structural changes in the economy over time. Specifically, contributions from manufacturing, services, trade, construction, government, and agriculture sectors and how these have changed over time relative to national and state trends;
- Concentration in major employers or reliance on particular industries;
- Employer commitment to the community— importance of local facilities and employees to the overall strategy of local employers, business development plans, age of plant, and industry prospects. This is increasingly important if the employment base is concentrated;
- Unemployment rates over the last decade and labor force growth are focused on including performance through recession to gauge the cyclicity of the underlying base. Of increasing concern is the match between jobs and the skill level of the labor force. An economy may generate strong employment growth but if the local labor force is not adequately prepared to function in those jobs, there are structural economic problems. Analysis of this component of the employment base will be increasingly important as technology continues to play a greater role in all aspects of today's job market;
- The regional patterns of employment and growth will also be reviewed to the extent that a municipality participates in a regional economy; and
- The level of retail sales as well as growth trends over time are analyzed, particularly when communities rely on sales tax revenues for operations as well as debt service repayment.

#### Comparative Criteria

Specific comparisons of the general factors outlined above are made with available economic data. Where appropriate, these data also are compared with metropolitan statistical area (MSA) data—for example, wealth and income levels. Historical trends and their likely development are much more valuable than data comparisons for a specific point in time.

#### Sources

Since economic data for many governments below the county level are limited, Standard & Poor's relies on issuers to provide some data for its economic analysis. Greater consistency in methodology is available from data produced by federal and state economic agencies, including the U.S. Departments of Commerce, Labor, and Agriculture, the Federal Reserve Bank, and private economic consulting firms. Labor departments in each state and universities that maintain state economic models also are valuable sources of economic data. Standard & Poor's does not make its own economic forecasts for a local economy. Internal and external information sources are used to understand local economic risks and judge the credibility of tax revenue projections.

#### Summary

Generally, those communities with higher income levels and diverse economic bases have superior debt repayment capabilities. They are better protected from sudden economic shocks or unexpected volatility than other communities. Nevertheless, a strong economy does not always ensure a strong ability to meet debt payments. It is extremely important for an issuer to be able to capitalize on its primary economic strengths in terms of revenue collection. This leads into another very critical factor in credit evaluation—the financial management and performance of an entity.

#### Financial Indicators

Financial analysis involves several areas:

- Accounting and reporting methods;
- Revenue and expenditure structure and patterns;
- Annual operating and budgetary performance;
- Financial leverage and equity position;
- Budget and financial planning; and
- Contingency financial obligations, such as pension liability funding.

An analysis of these factors will present a clear indication of the financial strengths and weaknesses of an issuer. This analysis also will provide the framework for judging capacity to manage economic, political, and financial uncertainties.

#### Accounting and Reporting

The first important variable in judging financial performance is the method of accounting and financial reporting. Based on the guidelines of GAAP, Standard & Poor's assesses the fairness and comparability of financial reports. Emphasis is placed on the governmental funds (general, debt service, and special revenue funds) under the modified accrual basis of accounting. Further, GASB interpretations of accounting rulings are considered in evaluating the organization of funds, accruals, and other financial reporting methods.

GAAP reporting is considered a credit strength, and the ability to meet the Government Finance Officers Association's (GFOA) Certificate of Conformance reporting requirements also is viewed favorably. Enhancing public disclosure is a government's Comprehensive Annual Financial Report (CAFR), which should include significant financial data and various statistical data to supplement the accounting statements.

Issuers are expected to supply adequate and timely financial reports. Financial reports prepared by an independent certified public accountant are preferred. Lack of an audited financial report prepared according to GAAP could have a negative impact on an issuer's

rating since the quality of financial reporting may be considered suspect. In cases of extremely strong financial performance or consistently strong cash flow history, non-GAAP financial reporting may be given positive consideration. If financial reports are prepared by state agencies or other internal government units, Standard & Poor's is interested in any deviation from GAAP standards and the independence of the auditors preparing the reports.

#### Operating Account Analysis

Operating account analysis includes an examination of operating trends focusing on the structure of revenue and expenditure items, primarily within the general fund and debt service funds. If other funds are tax supported or include revenues related to general government purposes, they also have relevance in developing a complete understanding of financial performance.

Revenue analysis. Diverse revenue sources are preferable, as they can help to strengthen financial performance. While property taxes tend to be among the most stable revenue sources, the failure or inability to levy taxes on nonresidential economic activity can represent a lost opportunity. The increasing use of fees not only creates a new revenue stream, but also places the burden for municipal services on the users of the services. Although a balanced composition of revenues gives an issuer the flexibility to meet all of its financial obligations, it does not protect against general economic decline. For example, if a

government's tax collections depend on several major revenue sources, the direct and indirect effects of an economic downturn can be broad enough to affect revenue performance significantly.

Standard & Poor's reviews the composition of the municipalities' revenue stream and the stability of major revenues, such as:

- Property, sales, and income taxes;
- User charges;
- Intergovernmental aid; and
- Investment income.

These revenue sources are examined over a three- to five-year period. Standard & Poor's will review unusual patterns in revenue performance that could lead to significantly different financial performance in the future.

Expenditure analysis. Similarly, expenditure composition and stability are analyzed in the context of revenue patterns. Large expenditure items are identified and examined to determine

if continued expenditure growth could endanger existing services or require additional taxing efforts. To the extent that certain spending items are extraordinary or nonrecurring, their effect on long-term financial performance is discounted.

Transfers. The effect of any revenue transfers among other governmental and capital funds is considered in the review of financial performance. When the general fund and/or debt service fund is supported by interfund transfers, Standard & Poor's reviews the policy guidelines and historical transfer practices. Deterioration in revenue transfers that represents a deviation from past policy could be viewed as a sign of fiscal stress.

#### Balance Sheet Analysis

The balance sheet examination focuses on

liquidity, fund balance position, and the composition of assets and liabilities. In Standard & Poor's consideration of appropriate fund balance levels, several variables are important:

- The volatility and patterns of the tax revenue stream,
- The predictability of government spending,
- The availability of unencumbered reserves or contingency funds, and
- The ability of public officials to sustain a strong financial position.

The fund balance position is a measure of an issuer's financial flexibility to meet essential services during periods of limited liquidity. Standard & Poor's considers an adequate fund balance to be a credit strength.

#### Short-Term Financing

The analysis of financial performance takes into account the role of short-term financing and its implications. As available cash balances decrease, cash flow difficulties can become more prominent. Nevertheless, conservative financial strategies and management practices can enable an issuer to minimize cash flow problems.

In reviewing an issuer's cash management and investment practice, Standard & Poor's considers the types of investments, security precautions, and uses of investment income. Standard & Poor's is interested in the long-term fiscal strategy, the risks inherent in such a strategy, and the monitoring systems used to measure

performance against financial objectives. One measure of financial management strength is the review of financial results against original expectations. Variances between budget and actual results are indicative of management's financial planning capabilities, particularly when considered over a period of time. Assumptions behind the projections used in budget development and planning are extremely valuable and form the basis of discussions with the managerial team.

#### Pensions and Other Long-Term Liabilities

The management of pension fund and other long-term financial obligations is having an increasingly meaningful impact on financial performance and position. While meeting unfunded accrued liabilities should be a high priority, the task is often clouded by the variations in calculating future asset and liability values.

Recent GASB rulings regarding appropriate methods for rates of return on investments are designed to standardize pension fund reporting for the public sector. In view of current limitations and lack of standardization in valuation studies, no system-by-system comparative analysis can be employed. Despite these uncertainties, Standard & Poor's believes that the financial management team should undertake measures to address these obligations. Failure to contain the growth of unfunded pension liabilities endangers the government's ability to meet its long-term debt obligations.

A pension and employee benefits policy statement, which explains the degree of participation by employer and employees and describes appropriate actuarial methods and assumptions, should be made available to Standard & Poor's. A discussion of funding contributions and investment guidelines is important. Periodic actuarial reports and a review of the financial position of the program by independent professionals also should be submitted.

In cases where bonds are issued to fund the unfunded portion of the employee retirement pension obligations, the impact of the additional debt service exposure, above the prior cost incurred for annual pension payments, against government expenditures will be

considered. Reflecting the limited comparability of actuarial studies, no system-by-system comparison analysis is undertaken. Provided that the same actuarial standards are applied, the analytical focus will be on the trend of unfunded liabilities, the benefits package, contributions, and investment rates.

Other long-term contingent liabilities—such as accrued sick leave and vacation pay—should be included at least as a footnote within the financial statements. It is considered a strength if a reserve fund is established to cover some or all of such costs.

Insurance risk management for governmental issuers has become increasingly complex. In light of the difficulties in ensuring sufficient coverage under traditional insurance programs, Standard & Poor's is interested in the types of coverage and, where self-insured programs exist, the amount of insurance reserves set aside to meet claims.

#### Debt Factors

The analysis of debt focuses on the nature of the pledged security, the debt repayment structure, the current debt servicing burden, and the future capital needs of an issuer. Accelerated debt issuance can overburden a municipality, force the reduction of necessary services, and consequently lead to lower ratings. Alternatively, a low debt profile may not be a positive credit factor, since it may indicate underinvestment in capital facilities.

Investment in public infrastructure is believed to enhance the growth prospects of the private sector. Neglecting critical capital needs may impede economic growth and endanger future tax revenue generation. Although some capital projects are discretionary and can be deferred in difficult economic periods, the failure to maintain existing facilities can create a backlog of projects. Eventually, when the backlogged projects are funded, the cost may prove burdensome to future taxpayers.

In difficult fiscal situations where municipalities face operating deficits, some entities choose long-term financing of accumulated deficits as a solution. Standard & Poor's believes that the "bonding out" of financial problems is not a permanent cure and may complicate the ultimate resolution of the crisis.

#### Type of Security

A GO pledge takes various forms that provide different degrees of strength.

Unlimited ad valorem property tax debt, secured by a full faith and credit pledge, usually carries the strongest security. However, during a period of fiscal stress, debt service competes with essential services, such as police and fire protection.

Limited ad valorem tax debt, or a limited-tax pledge, carries legal limits on tax rates that can be levied for debt service. Standard & Poor's views this type of security more as a means to limit debt issuance than as a strict cap on revenues available to retire debt. In a limited-tax situation, the tax base's growth and the economy's health are often more significant credit factors than the limited source of payment. In fact, a limited tax bond can be rated on par with unlimited bonds if there is enough margin within the tax limit to raise the levy or if other tax revenues are available for debt service.

Double-barreled bonds are secured by an enterprise system's revenues, such as water or sewer user charges. They also carry a full faith and credit pledge, but taxing power is used only if the enterprise's revenues are insufficient. Standard & Poor's approach is to review both security pledges.

A well-run enterprise system can enhance the general government's credit by making substantial financial contributions to the general fund. In contrast, a troubled utility can threaten the integrity of the general fund.

Credit implications may be positive when the enterprise has:

- A solid track record of self support—no reliance on tax revenues;
- Covenants to maintain rates; and
- Other provisions that would work to prevent a potential fiscal drain on the general fund.

GO bonds are considered self-supporting when the enterprise can pay debt service and operating expenses from its own operating revenues. Such a self-supporting enterprise could use the full faith and credit support of a municipal government without diminishing the credit quality of the government's GO debt.

Special assessment bonds may have speculative characteristics, since economic and financial risks can be concentrated in relatively small parcels of property. Some of these credit concerns can be allayed if the bonds are on parity or have a senior lien on ad valorem property taxes or other legal protections. Low project risk and economic incentives for timely repayment also can mitigate concerns.

A moral obligation pledge occurs when an issuing entity relies on another to make up any deficiency in the debt service reserve fund. That pledge is nonbinding and most often given by a state to the debt of its agencies or authorities. The promise of a government to appropriate money to the debt service reserve fund usually enhances the creditworthiness of the issuing authority.

#### Maturity Schedule

The maturity schedule can become important in some circumstances. Prudent use of debt dictates that the debt's term matches the useful economic life of the financed facilities. For example, three-year bonds issued to finance police cars would be appropriate, while 15-year bonds would be viewed negatively.

An average maturity schedule for capital

projects is one in which 25% of the debt rolls off in five years and 50% is retired in 10 years. A faster maturity schedule may be desired to avoid increased interest costs; however, it can place undue strain on the operating budget.

#### Debt Limitations and Needs

Standard & Poor's looks for realistic debt limitations that permit the issuer to meet its ongoing financing needs. A city near its debt limit has less flexibility to meet future capital needs, but, more importantly, may be unable to borrow money in the event of an emergency. Restrictive debt limitations often result in the creation of financing mechanisms that do not require GO bond authorization or voter approval.

Standard & Poor's examines the community's future financing needs. Municipalities should regularly review their critical capital needs and schedule capital improvements for the project's life cycle. The history of past bond referendums is one indication of the community's willingness to pay for such improvements.

Standard & Poor's also measures the debt burden against a community's ability to repay.

Three indicators of that ability are:

- The tax base,
- The wealth and income of the community, and
- Total budget resources.

In general, a debt burden is considered high when debt service payments represent 15%–20% of the combined operating and debt service fund expenditures. This benchmark will vary with the structure of government and the level of services that an issuer provides.

#### Administrative Factors

As municipal operations expand and become more complex, an understanding of the organization of government is a prime necessity. The powers of a municipality establish the entity's ability to plan for changes in the political, economic, and financial environment, and the capacity to respond in a timely fashion. The entity's degree of autonomy is affected by home rule powers, as well as legal and political relationships between state and local levels of government.

The range and growth potential of services provided by the issuer also are examined in relation to the capacity to provide such services. The ability of officials to make timely and sound financial decisions in response to economic and fiscal demands can depend on the tenure of government officials and frequency of elections. The background and experience of key members of the administration are important considerations if they affect policy continuity and ability to reformulate plans.

#### Documenting the Planning Goals

Adherence to long-range financial plans is considered a reflection of good forecasting and planning. To clarify and communicate these plans, long-range financial planning goals and objectives should be documented. Income statement and balance sheet projections should be part of the planning documents. The ability to make accurate short-range forecasts to ensure the availability of funds for seasonal and other short-range requirements is of prime importance. Financial objectives should be closely aligned with projections included in the operating budget to reflect future operating and capital budget growth.

#### Financial Management

Financial management is a major factor in the evaluation of state and local government creditworthiness. Past performance against original plans, depth of managerial experience, and risk preferences of key leaders all have an impact on the bottom line.

Major aspects of financial management include:

- Economic analysis and revenue forecasting,
- Tax policies,
- Governmental accounting practices,
- Financial strategies, and
- Debt management.

Increasing attention is being paid to risk management. Risk management analysis includes investigating the adequacy of insurance coverage for accidents, health, and potential lawsuits for public officials' liability.

#### Annual Budget

An operating and capital budget, along with at least three years of financial audits, are required documentation in the debt rating process. Standard & Poor's views the budget as an expression of administrative capability and intent.

Timeliness of budget adoption is a factor in considering the efficiency of the budget process. In contrast, late budgets are a hindrance to planning and can be indicative of political or administrative difficulties.

A sound budget plan should anticipate risk elements that lie outside of administrative control, such as the uncertainty of economic performance and potential effects on major revenue sources. The administration is expected to present a realistic budget and exhibit willingness to address necessary intra-year revenues and expenditure changes to meet fiscal targets. Continuous budget surveillance should be maintained to identify problem areas and enable timely budget adjustments.

#### Capital Improvement Program

As part of the debt rating process, Standard & Poor's requires a well-documented capital improvement program (CIP). Necessary components of this plan include:

- The outlook for capital needs;
- The flexibility to modify the program in difficult economic periods; and
- The ability to finance investment through operating surpluses.

Since the reliance on long-term debt can have burdensome consequences on a government's budget, the ability to identify and use other operating funds for capital purposes can be a financial strength. The discussion of historical construction management experience also can carry implications for a government's ability to meet its budgetary constraints and project completion schedule.

#### Property Tax Administration

Administrative factors analyzed by Standard & Poor's include the issuer's property valuations and assessment trends, changes in assessment ratios, and assessment procedures. Standard & Poor's looks at the valuations by assessment categories—industrial, commercial, utility, and residential—and how the assessment ratio applies to the different classes of properties. Property tax administration also is analyzed by focusing on tax rates; levies; collection rates on a current and a total basis (which includes delinquencies); and delinquent tax collection procedures, which are examined over 10 years. Tax due dates and delinquency rates are noted for their possible cash flow effects. An administration's taxing flexibility is an important rating factor if delinquencies run at a high level.

#### Labor Settlements and Litigation

The labor environment—relationships between employer and employees and recent wage and salary increases—is part of the financial management discussion. Full disclosure of the nature and implications of labor disputes, if any, also should be included.

If a municipality faces litigation that may prove onerous, contingency plans are considered to assess the government's financial flexibility. The focus will include insurance coverage and the budgetary implications of these potentially large liabilities.

#### Operating Fund Investment Guidelines

Standard and Poor's general operating fund investment guidelines are based on what it considers normal prudent investment practices with regard to liquidity, leverage, credit quality, and oversight.

**Liquidity.** The weighted average maturity of the operating fund, as well as the maturity of individual securities in the fund should be limited to one year, or as needed for the issuer's normal disbursement patterns. Principle protection and liquidity should be the primary goals. In general, the longer the maturity or duration of investments—and the less liquid the securities—the more frequent the need for mark-to-market valuations of operating funds investments.

**Leverage.** Borrowing through leveraged instruments should be limited to nominal amounts, not to exceed 20% of the portfolio.

**Credit quality.** A municipality's operating fund investments must meet the minimum credit quality standards permitted by statute, or the investment policy of the issuer.

Permitted investments can include deposits in local financial institutions that are FDIC insured, commercial paper issued by investment grade corporations and financial institutions, bankers' acceptances, and Treasury or government agency securities.

**Review and oversight.** Municipal issuers should be aware of statutory investment requirements and may want to supplement those requirements with a written investment policy tailored to that municipality's situation. Officials should be aware of such policies, and periodic reporting of compliance and performance should be in place.

**Benchmark General Obligation Ratios**

Standard & Poor's representative ranges for key ratios of GO debt issuers provide an indication of what constitutes a high or low ratio for some key factors Standard & Poor's uses in the credit rating process.

The ratios represent benchmarks that Standard & Poor's analysts usually consider high, low, or moderate, regardless of rating category or point in the national economic cycle.

These ratios differ from typical median analysis. Median analysis usually examines a pool of bond issuers by rating category. However, medians will drift over the economic cycle and do not indicate the normal range of dispersion for individual ratios. For example, highly rated credits may have widely varying debt ratios, while overall medians by rating category may show only small variations.

In contrast, the key ratios help separate the significance of ratio variations for each independent ratio.

A related criteria element is the weighting of one ratio against another in the rating process. Variation in any factors can influence a bond rating. However, the heavier weighting usually placed on economic factors reflects that a wealthy and diverse economic base can afford higher debt burdens, or recover from financial problems more easily through a modest tax hike, than a poor economic base that might have more limited and less forgiving governmental options.

**A note of caution.** Ratios do not tell the whole story; they are only a portion of what Standard & Poor's uses in its analysis. Economic, administrative, structural, or subjective factors may

outweigh any of these ratios when a rating is assigned. Numbers alone can not determine an entity's willingness to meet its financial obligations; numbers alone can not reveal a history of late budgets or the operating restraints presented by the state/local framework. Not all of the key ratios are weighted equally, nor do they represent a complete set of the ratios Standard & Poor's uses in its analysis, which incorporates information from many internal and external databases. In addition, a municipal entity's trends in any of these ratios may be more important than the historical ratios. A rating, after all, is prospective in nature.

**State Ratings**

The approach to rating the GO bonds of states is similar to that of local government units. State governments have sovereign powers and therefore possess unique administrative and financial flexibility. These options and how they are exercised will affect the creditworthiness of a state's GO bonds. Conversely, the states' functional responsibilities

are more extensive than those of local units, increasing the likelihood of expenditure pressures.

#### Sovereignty Tested

Although most states have broad powers to establish their own tax structures and expenditure responsibilities, these sovereign characteristics can be limited. State constitutions—and voter referendums enshrined in these constitutions—can dictate tax or spending policies. For example, California's Proposition 98 mandates spending levels for primary, secondary, and community college education. Proposition 98 limits alternative expenditure allocations. Colorado's Amendment 1, which strictly limits how much revenue the state can collect and spend, is another example.

Many states historically have failed to respond in a timely manner to the financial pressures that stem from regional or national recessions. The failure to react to the changing economic environment can lead to reductions in GO bond ratings. In 1989, Massachusetts' sharp credit deterioration was based, in part, on its lack of timely financial decision making and on Standard & Poor's concern about the commonwealth's willingness to adhere to sound fiscal policies. California's record budget delay in 1992 and its flawed budget solutions contributed to that state's ratings decline. These states, among others, failed to employ their sovereign powers in a manner consistent with their rating levels.

#### State/Local Relationships

States' relationships with their localities continue to evolve. Successful legal challenges to some states' funding of primary and secondary education have bolstered state aid to schools—most notably in Kentucky and Texas. Reliance on state aid by local governments grew in states such as California and Massachusetts, as property tax limitation measures restricted local revenue growth. In areas outside of education, budgetary pressures at the state level and federal actions are contributing to states reducing local assistance. While downloading responsibilities to local governmental units can ease a state's financial burden, these actions can weaken credit ratings of local governments unless accompanied by new local revenues or mandate relief.

Standard & Poor's analysis for states include all of the factors considered in any GO rating. These factors are grouped under four broad categories. The discussion below highlights areas of difference between state and local ratings.

Economic base analysis is the most critical element of the rating process. As with local governments, the economic condition of a state defines its ability to generate tax revenues, perform its functions, and repay debt. A state's economy is generally more diverse than that of a local unit. It encompasses urban, rural, and suburban communities. The larger nature of the state's economic base often may avoid the problems of employment or tax base concentration, low income levels, and economic dependency on a neighboring community that can exist for local units.

Financial factors. Since many states can unilaterally establish funding levels for certain local programs (such as education), they have a greater degree of control over expenditure levels. Funding levels are usually statutorily, not constitutionally, determined. However, the political reality is such that once a certain funding level has been established, it may be difficult to change. Nevertheless, states enjoy considerable discretion in establishing or changing disbursement dates and funding levels for state

assistance. States also enjoy flexibility in setting and modifying tax rates and their collection dates. These discretionary powers can immediately and favorably influence a state's cash flow, as well as its fiscal condition.

Debt considerations. States generally issue a wide variety of tax-supported debt in addition to GO debt. Such issues include authority debt that is secured by state lease rental payments, subject to appropriation; moral obligation debt; and debt secured by specific taxes, such as the sales tax.

When Standard & Poor's examines the debt burden of a state, it looks not only at the direct GO debt, but also at these other types of debt and at all obligations incurred as local government debt. A calculation is then made using the Standard & Poor's Index, which is per capita total debt divided by per capita personal income. The index yields a measure of the debt burden relative to the income level. It also can be used as a balancing indicator, since states differ in their relationships with local governments. Some states issue a great deal of GO debt for local purposes (roads, schools, and the like), and others very little, leaving these functions to the local units. The Standard & Poor's index evens out these jurisdictional variations.

To deal with timing differences between receipts and disbursements, some states enter the short-term debt market because of prohibitions against—or limitations on—interfund borrowing. Others use the maximum interfund borrowing and then issue short-term debt as necessary. Standard & Poor's looks at internal and external liquidity supports to assess the effect of the alternative used on creditworthiness.

Administrative factors are as important to state creditworthiness as they are to local governments. Tax structure, or the ability of a state to benefit from the economic activity within its boundaries, is an important rating factor, as well as the degree of flexibility existing in this structure, both legally and politically. Expenditure pressures and disbursement schedules also are important, as state officials deal with the needs of a wide variety of local communities.

For many states, the voter initiative process and its effects are becoming increasingly important. When decisions about specific tax levels and spending allocations are placed in the hands of the electorate, state managers have reduced flexibility to respond to changing economic or financial situations.

**ATTACHMENT C****District of Columbia**

\$80 million general obligation bonds (first offering)  
Sold, December 4, Salomon Brothers Inc.  
Rated 'AAA' (MBIA insured)  
December 10, 1984

**Rationale:** S&P issued an 'A' analytical rating to the District of Columbia's \$80 million first publicly issued general obligation bonds. Subsequently, the underwriters purchased insurance from the Municipal Bond Insurance Association (MBIA) to secure the bonds. The issue is therefore rated 'AAA'. The district, whose home rule status was established in 1975 by the federal government, has since made sizable, measurable improvements in financial management, financial reporting, and in reducing an accumulated general fund deficit inherited from the pre-home rule days. Long-term challenges include funding a \$3.4 billion unfunded pension liability. The district faces significant budgetary pressures, including absorbing a portion of the escalating cost of the Metro Rail System's operating losses. Also, \$1 billion in G.O. debt issuance is planned over the next six years. Although the federal government will probably provide additional aid in the future, particularly for the portion of the unfunded pension liability attributed to the pre-home rule days, the bulk of these multiple costs will have to be absorbed locally. Nevertheless, the property tax base quality and growth, particularly commercial construction, has and is expected to continue to be strong. The legal protections in the general obligation pledge include a perfected security interest in a special property tax. The district's special economic and financial relations with the federal government are important rating considerations. Aside from the obvious economic benefits of being the nation's capital city, there are a number of direct financial benefits. This includes annual federal payments that must be allocated for debt services if necessary as well as access to Treasury advances to meet operating expenses and debt service not available elsewhere.

**Debt and legal considerations:** The bonds will refund \$74.9 million in long-term general obligation Treasury loans. The loans are subordinate to the new public debt. The district is currently paying the Federal Government interest at taxable rates on over \$1.7 billion in such loans. Future refunding plans include a \$200 million issue perhaps as early as this February. The new bonds are general obligation full faith and credit secured by a special unlimited and perfected property tax pledge. The Bond Act requires the mayor to first set aside special property tax collections into a special property tax fund held by a trustee bank. The levy of such tax is automatic. Additional sources of payment include the annual federal payment which is made at the beginning of the October 1 fiscal year to compensate the district for the local impact of the federal presence. The Home Rule Act requires the mayor to pay debt service with such revenue if no other funds are available. The Bond Act provides that the mayor shall take advances from the Treasury to meet its general expenses including debt service. However, the federal statute providing for these advances could be repealed or modified. The district's six-year

capital plan estimates \$1 billion in future general obligation debt issuance. Debt ratios are currently high and will increase significantly.

**Economy:** The employment base of Washington, D.C. is dominated by federal employment and related service jobs. Employment in the district fell slightly more than the national average in the 1982 recession and has recovered less rapidly. The population of the district is 627,500. Per capita income levels for the district are significantly above the U.S. and major cities although this masks large pockets of poverty within the residential base. Nevertheless, the property tax base which will be supporting these bonds is extremely strong. Despite the tax-exempt status of over 40% of the property base, the market value of taxable property is a nearly \$38,000 – well over the national average. Furthermore, nearly 50% of the taxable base is comprised not of residential homeowners but rather of vibrant commercial property. The rate of tax base growth and value, particularly commercial construction, is extraordinary. Commercial assessed valuation increased from just under \$5 billion in 1981 to over \$11 billion in 1985 reflecting a 26% jump in 1985.

**Fiscal policy:** The district's charter, which may be altered by an act of Congress, grants the district all of the responsibilities of a state and most, but not all, of the powers of taxation. The district provides all levels of local services including education and social service but without shared funding by a state entity. Special federal payments in addition to entitlement programs are sizable, however, this only equals the revenue loss from non-taxable, federal property which encompasses nearly 40% of the district's property base. The district's mere 69 square miles account for approximately 36% of the Washington Metropolitan areas jobs. Nearly 63% of the jobs are taken by non-district residents. However, and significantly, the district's charter prohibits the imposition of an income tax on non-residents. Consequently, the district's progressive tax structure results in marketedly higher state and local income taxes than the surrounding counties' and cities' for families of four earning over \$25,000. The \$50,000 income group paid 44% higher state and local income taxes in Washington than in the surrounding jurisdictions in 1982. The state and local income tax burden for Washington residents was also substantially above the average of the largest city in each state (51-city average). The \$50,000 group paid 71% higher income taxes than the 51-city average in 1981. These differentials widen as the income grouping increases reflecting the progressive nature of the district's tax structures. In fact, in 1983, 21% of the tax payers – those making \$25,000 or above—accounted for nearly 62% of district's income taxes paid.

The same comparison for all four major state and local taxes, income, sales, property and automobile reveals less of a differential although still a significantly higher tax burden for Washington residents. This lower differential partly reflects the below-average property tax burden of district residents. District residents paid only 15% more taxes than the metropolitan average in the \$50,000 income group in 1982.

**Operations:** The District of Columbia has markedly improved its financial operations, reporting, and management since it was granted home rule status in 1975. For the fourth consecutive year the district has produced an audited financial report in conformance

with generally accepted accounting principles (GAAP). This has been rewarded with four certificates of conformance with the Municipal Finance Officers Association's (MFOA) standards.

When the district became a self-governing entity in 1975, it inherited substantial financial liabilities including an accumulated financial deficit in the general fund which was first reported Sept. 30, 1979 at \$287 million. Additionally, the district tax-payers inherited an unfunded pension liability of \$1.9 billion, in 1979, the federal government signed an agreement to contribute \$52 million a year to help reduce this liability, nevertheless, benefits are pegged to increase with the consumer price index, as with other federal pension programs, which imposes a growth factor well above most municipal pension programs. Consequently, the unfunded pension liability as of Sept. 30, 1984 was \$3.4 billion. The district's limited measures to address this liability net pay-as-you-go plus 30% has resulted in continued growth in this long term liability.

Following a large operating loss in the fiscal year ending Sept. 30, 1980, fiscal years' 1981-1984 have resulted in operating surpluses for the district's general fund causing a reduction in the GAAP deficit by \$114 million. Although significant budgetary pressures existed, general fund spending has averaged less than 7% per year growth since fiscal 1980. Consequently, the district was able to achieve these operating surpluses without a tax increase. Also, revenue growth was relatively stable during this period despite the occurrence of a national recession, attributable to strong property tax base growth and the imposition of the Washington lottery. Budgetary pressures continue, including increased funding of the Metro Rail System and human service costs. Future implementation of a regional transportation tax is a possibility. Whether this will actually occur remains to be seen.

Federal aid is a large 34% of revenues, nearly half of which is the growing "federal payment" to the district. Over time, the District of Columbia is becoming financially and politically independent of the federal government. There is evidence, at the same time, of increased recognition by the federal government of its special financial responsibility to the district. A decade ago, as mentioned, the federal government handed over to the district substantial liabilities. It was not until 1979 that the federal government provided for an annual contribution of \$52 million to address (although not sufficiently) the pension liability. Discussions are currently under way to increase the federal contribution although the timing of the resolution of this issue is uncertain. In fiscal 1984 and 1985, a special federal allocation was made in recognition of criminal justice costs to the district. However, more indicative of a change in the federal government's approach is revealed in the way it has transferred St. Elizabeth's Mental Institution (90% of whose patients are district residents) to the district. The federal government has provided a six-year subsidy of \$299 million and will assume the total cost of federally referred patients. This substantially reduces the district's share of operating costs to a minor level, over the next six years.

**Attachment D**

HEADLINE: S&P Downgrades Wash DC Uninsured GOs to 'A-' from 'A'

NY – S&P CreditWire 5/3/90 – S&P lowers its rating on the District of Columbia's general obligation bonds (GOs) to single-'A'-minus from single-'A', affecting about \$934 million of uninsured debt.

Affirmed are the triple-'A' ratings on nearly \$1.0 billion of outstanding insured GOs and the SP-1- plus rating on \$200 million of tax and revenue anticipation notes, secured by a letter of credit provided by Sanwa Bank Ltd.

The downgrade reflects the district's reduced ability to balance rapidly growing expenditure requirements against current revenues, and its deteriorating unreserved general fund position. Slower economic growth, a flat federal contribution, and continuing pressures on human services and public safety programs have challenged district officials to produce balanced budgets for fiscals 1990 and 1991. The approved budgets mark the third and fourth years of financial stress and contain a number of nonrecurring items. Also, these pressures have limited the district's ability to address the accumulated general fund deficit, at \$213 million on Sept. 30, 1989, and the \$4.5 billion unfunded pension liability, both of which were largely inherited from the district's pre-home rule period.

The single-'A'-minus rating continues to reflect the district's high debt burden, economic ties to the federal government, strong and growing taxable property base, and ability to draw on the U.S. Treasury to meet expenses.

The district successfully closed a projected \$175 million budget gap for year-end Sept. 30, 1989, producing an operating surplus of about \$5.5 million. However, several unanticipated revenue items contributed to this result, even as the unreserved general fund position fell to an accumulated deficit of \$263 million, equal to 7.7 pc of current expenses.

The revised fiscal 1990 and 1991 budgets, which must be approved by President Bush and the U.S. Congress, do not fundamentally resolve the revenue/expenditure imbalance. The district administration identified a potential \$73 million revenue shortfall for fiscal 1990, particularly in the income and sales tax components, as well as nearly \$47 million of unbudgeted spending needs. District council rejected some of the additional spending requests and cut other programs; and it plans to enact a higher tax on vacant property to stimulate development. The gap-closing measures also include one-time items such as the sale of surplus property and the redirection of prison construction funds to operating programs.

The approved fiscal 1991 budget is based upon lower estimates of revenue growth, reflecting a slowing economy, and includes property tax relief for homeowners. The approved spending plan is nearly \$122 million below the administration's request, particularly for education and human services, but neither plan fully funds the cost of future wage settlements.

Further credit deterioration in the near term is unlikely, given the district's special relationship with the federal government and continued favorable economic conditions, S&P said. ---CreditWire

Contact: Parry Young at 212/208-1725 or Jeffrey Thiemann at 212/208-1814

**ATTACHMENT E**

(June 27, 1994)

DISTRICT OF COLUMBIA

S&amp;P Contacts: Kathleen Quail (212) 208-1377, Bernhard Fischer (212) 208-8102, Parry Young (212) 208-1725

OUTLOOK TO NEGATIVE

OUTLOOK REVISED

TO FROM

Status Negative Stable

**OUTSTANDING RATINGS AFFIRMED**

\$1 billion G.O. bonds A-

\$2.2 billion insured G.O. debt AAA

\$85 million general fund recovery bonds series 1991-B1 AA-/A-1+

\$125 million general fund recovery bonds series 1991-B2 and B3 A+/A-1

\$150 million variable-rate refunding bonds series 1992A-1, 3, and 4 A+/A-1

\$150 million variable-rate refunding bonds series 1992A-2, 5, and 6 AA/A-1+

\$200 million LOC-backed TRANS series 1994 SP-1+

\$83 million certificates of participation series 1993 BBB

**RATIONALE**

The District of Columbia's rating is based on:

Limited control over revenue-raising options, combined with significant expenditure pressures;

A sluggish, but improving, economy, dependent on government employment and tourism;

Moderately high debt levels that currently are manageable; and

Management actions taken to address these concerns, including timely budget balancing actions and implementing strategies to contain costs.

The District's access to Treasury borrowing serves as an underlying credit factor.

However, in the event of a cash crisis, it does not guarantee full and timely debt service payments, limiting its impact on the long-term bond rating.

The outlook revision reflects acute budget stress, expected to continue through fiscal 1995, related to sluggish economic conditions which have curbed local revenue growth while expenditure pressures continue to persist. The resulting decrease in cash reserves and financial flexibility make the district more vulnerable in the near term as spending requirements, particularly mandated expenditures, grow rapidly. The District's ability to gain fiscal control over its pension obligations, personnel costs, and funding requirements for District of Columbia General Hospital are key to the District maintaining its current rating level.

A rating change is not warranted at this time, due to several positive measures the District has achieved, including timely budget gap closure actions, the revenue certainty gained from having the federal payment based on a formula, and recent action taken to stabilize general fund support of the District's hospital.

**OUTLOOK: NEGATIVE**

The outlook is revised to negative from stable to reflect recent significant budget stress, which will require strong management actions to balance the District's budgets over the next one to three years.

**ECONOMY**

The District's economy is fairly broad, with significant tourism and service employment and a large university presence. Federal government employment, historically the largest employment sector, continues to comprise 35% of total employment. Current economic conditions are sluggish and have slowed income and sales tax revenue growth over the past three years. While the economic outlook for the next several years is for some improvement, economic growth is not expected to offset the District's future budget growth.

The economy has diversified over the past decade, particularly in the service-sector, which currently comprises 38% the District's total employment base. DRI/McGraw-Hill projects the service-sector growth will create 42,500 jobs, and federal government employment will decline by 12,300 jobs, through 1999. However, several current federal office construction projects will help offset losses created by relocations to Maryland, Virginia, and West Virginia. Despite the fact that many of these service sector jobs are linked to the federal government, the service-sector (which includes tourism and health-care employment) remains likely to be the key to the District's economic expansion. Therefore, as the federal government continues its trend of downsizing employment and its relocation of agencies out of the District, the overall employment base should begin to diversify.

The District continues to exhibit sensitivity to the national business cycles as reflected by declining sales tax revenues and other taxes since 1990. Unemployment, which peaked in 1983 at 11.6% and bottomed out in 1988 to 4.8%, currently exceeds the national level at 8.3%. Unemployment rates are expected to be in the 7% range over the next five years with a relatively stable labor force base. Employment gains in the tourism, R&D, and construction sectors in the near term will help restart the District's slowed economy. Strong commercial building activity during the 1980s fueled over 10% annual tax base growth to its peak at \$48.7 taxable value in 1992. Commercial valuations have softened and resulted in a 7.7% contraction in the 1994 taxable tax base to \$44.98 billion. Assessed value (AV) is expected to stabilize at this level as major redevelopment projects continue to come onto the AV rolls. On the whole, the District is a mature, fully developed area that will not experience significant tax base growth over the long term. District population, which has declined steadily from 623,000 in 1984 to an estimated 570,000 currently, is expected to fall further, but at a slower rate, as migration to the suburbs continues. A significant dichotomy in wealth levels exists in the District, but average income levels continue to be 22% above the U.S. Future economic development projects are expected to include a new convention center and sports arena in the downtown area. Though these projects have not yet been confirmed, they are projected to generate significant jobs and revenues for the District. Overall, the District's underlying economy is stable, but vulnerable to economic cycles. However, the economy continues to show signs of improvement, as indicated by recovering retail sales activity and employment growth.

#### FINANCES

Over the past three years, the District faced midyear budget gaps of about 10% of budget, which were closed utilizing a variety of measures, such as a tax collection year change, water and sewer fund transfers, increasing numerous local fees and charges, and various expenditure reductions. Over this time frame, human service costs and other difficult-to-curb spending requirements pressured the District's revenue resource structure that was affected by a weakened economy. The present weak cash position in fiscal 1994 primarily resulted from increased receivable levels and a tax collection year change in fiscal 1993 which accrued and spent about \$180 million in revenues that were not yet received. Additional short-term budget stress is related to the recent pension

payment settlement, which requires the district to make an additional payment in fiscal 1995 to cover deferred current year obligations.

The District's local revenue structure relies on property, sales, and income taxes to generate approximately 52% of general revenues. The federal payment, which compensates the District for restrictions on its taxing power, became formula-based beginning in fiscal 1992. The federal payment, effective through fiscal 1995, produces revenues equal to 24% of local revenues collected in a base year. The base year is identified as two fiscal years prior to the current budget year. A bill has been introduced that will permanently extend this payment formula. The proposal will make minor changes in the calculation of locally generated revenues and will gradually increase each year until it reaches 30%. While this formula-based payment adds certainty to the District's revenue base, as the District's budget grows, it will actually decline as a percentage of the District's budget. The 1995 budget reflects a federal payment of \$674 million, or 24% of locally produced revenues two years ago, which is 19.8% of the District's expenditures.

Dependence on a revenue structure that is sensitive to economic cycles, combined with broad service delivery requirements, has produced a strained financial situation. With the District responsible for providing services typical of state, county, and city governments, the pressure of mandated expenditures and demands for increasing social service costs have created a fragile fiscal position. In the upcoming years, the District will be challenged to maintain its financial integrity, since future budget balancing options are now fewer and more difficult to implement. Economic improvement will help to alleviate some of this pressure, but it remains imperative that the District further reduce and/or streamline expenditures.

Adding to the financial pressure is the requirement to bring annual pension payments up to normal cost plus interest in fiscal 2005. Up until that time, the District is making nominal annual payments, along with a federal contribution of \$52 million. By not keeping current with its pension obligations, the unfunded pension liability, \$4.4 billion at fiscal year ended 1993, is expected to increase. The District is addressing some of these concerns by proposing to cover future employees under a defined contribution, plan and to negotiate the federal governments accepting greater responsibility for a portion of the unfunded liability.

#### DEBT

The District has approximately \$3.47 billion in G.O. debt outstanding, of which approximately \$2.2 billion is additionally secured by bond insurance and \$300 million variable-rate G.O. bonds series 1992 and \$230 million general fund recovery bonds series 1991, which are secured by LOCs. The District's water and sewer operations continue to support about \$309 million of the total debt. Additionally, the District is responsible for \$86.9 million of taxable U.S. Treasury loans incurred prior to 1984. In 1993, the District issued \$83 million of Certificates of Participation (COP's) for the purchase of the land upon which the District-owned One Judiciary Square Building stands. Also outstanding are \$200 million of TRANS, issued in April 1994 and due September 1994, for cash flow purposes. Annual debt service currently represents 8.3% of general fund budget and 10.2% of adjusted revenues under the district's debt limitations, but is expected to climb to 12.3% by 2000, based upon the current capital improvement plan. Under the Home Rule Act, the district's annual debt service may not exceed 14% of adjusted revenues, as defined.

Overall, the District's debt burden is high, due in part to the unique service responsibilities for which it is responsible. These responsibilities include those typically provided by both state and local governments, including human services, schools,

transportation, water and sewer, hospital and corrections. Debt per capita is \$5,954, and the S&P index, a measure of per capita debt as a percentage of per capita effective buying income, is very high at 33%. Principal amortization of outstanding G.O. debt is above average, with 64% retired within 10 years.

The District has taken several actions in light of the fact that aggressive issuances are planned over the next several years and rising debt service costs could incrementally add pressure to the District's already strained budget. During 1993, the District determined that it could not financially support the capital improvement plan adopted in 1993. The program was modified and alternate funding sources such as COPs, lease purchase arrangements, and other revenues were identified. The fiscal 1994-2000 capital plan recommends financing \$2.1 billion in gross funds, of which \$1.3 billion is appropriated. A ceiling of \$250 million in G.O. bond financing annually over the next six years is likely.

The District is currently evaluating current initiatives and priorities in addition to identifying alternative financing strategies primarily to free up G.O. bonding capacity. These strategies include the possible use of revenue-backed financing for upcoming water and sewer issuances. This issuance may also include the refunding of the current outstanding G.O. water and sewer debt with revenue-backed debt. This restructuring should not substantially affect the District's debt characteristics, due to its current self-supporting nature, but it would place increased emphasis on the rate structure in place at the water and sewer systems. S&P will continue to monitor the District's ability to effectively manage its debt burden while continuing the implementation of its long-range infrastructure plan.

Under the Home Rule Act, the District is required to use its annual federal payment, which is intended to compensate the District for the federal presence, for payment on bonds if no other funds are available. Additionally, the District, by federal statute, has the unique ability to access U.S. Treasury funds to meet its financing needs, if no other funds are available. This Treasury window privilege however does not guarantee full and timely payment of debt service.

#### TREASURY WINDOW

The District has the unique statutory ability to access U.S. Treasury funds to meet its financing needs. From 1939-1983, the U.S. Treasury made advances to the District to meet short-term cash and capital funding requirements. These advances were and continue to be authorized by Federal law (53 Stat. 1118, as amended) which states:

"The Secretary of the Treasury...is authorized and directed to advance, on the requisition of the Mayor of the District...such sums as may be necessary, from time to time, to meet the general expenses of said District, as authorized by Congress, and such amounts shall be reimbursed by the said Mayor to the Treasury out of taxes and revenue collected for the support of the government of the said District."

The District of Columbia has the right to draw on the U.S. Treasury to meet both general and debt service expenses. The authorization is fairly liberal, in that the Treasury is "authorized and directed" to advance monies as pursuant to D.C. Code Section 47-3401. Since the District escrows taxes for note and bond debt service payments, if ever a cash flow crisis were to arise, adequate time might be available for proper correspondences between the District and the Treasury, in the event market access was not available and the District required funds to meet its obligations.

Before the Treasury would consider advancing funds, it would need to be satisfied that the District is unable to obtain financing from other sources. It should be noted that other sources would include taxable financing, such as short-term, commercial bank loans. An instance did arise in late 1983 whereby the District faced an imminent need for cash

flow financing in the amount of \$150 million. The District was unable to secure a short-term loan as a result of a Supreme Court decision which potentially could have invalidated any bonds under the issuance. This uncertainty prevented private lenders in all market sectors from purchasing the notes, effectively leaving the District with no market access. In light of these circumstances, the Treasury agreed to advance \$150 million, if needed, to the District, in the event a court ruling would prevent the District from honoring its obligation under the RANs. In this instance, the Treasury provided the ultimate credit support and security, but was never called upon to advance any monies, and enabled the District to have market access.

This Treasury window privilege provides a certain degree of support for the District to meet its obligations on a timely basis, however does not guarantee full and timely debt service payments, limiting its impact on the long-term rating. Currently, the District's management utilizes limited interfund borrowing and short-term borrowing to meet cash flow requirements and considers a Treasury borrowing only as a provider of funds of last resort.

#### D.C. GENERAL HOSPITAL

D.C. General is the District's only public hospital and provides important residency programs to Howard and Georgetown Universities. As a result of an increasing draw on district finances, in the form of general fund appropriations, due to deficit hospital operations, District management engaged consultants late in 1993 to perform a comprehensive review and assessment of the hospital's operations. The report focused upon important issues to change the course of operations at the hospital and alleviate the ever-increasing district appropriations. During fiscal years 1992 and 1993, the District transferred \$69 million and \$58.7 million respectively, to the hospital. The plan sets a course of fiscal recovery and anticipates marginal profitability in three to five years, with continued annual district appropriations limited to \$47 million. Not factored into the plan is the elimination of the hospital's current accumulated long-term deficit of \$110 million, which is expected to be addressed beyond the plan's five-year time frame. Some of the plans recommendations have already been implemented. These include staff reductions, 257 out of a recommended 381, improved medicaid certification policies, revised rate structures, and improved nonresidency screening. Additionally, correctional care, a large part of the District's annual hospital subsidy, may be revised to a more manageable contract basis. Some of the longer-term structural changes recommended include creating a Public Benefit Corp., under a community hospital 501(c)(3) not-for-profit corporation, by 1996. This organizational restructuring would more favorably position the hospital in the marketplace under health-care reform and universal coverage. Management anticipates proposing legislation this summer for this organizational change and has installed a new CFO. The District is committed to the hospital and its mission to serve the public; however, it recognizes that it cannot continue to absorb deficits of the magnitude previously experienced. The consultants' plan gives the District a strong course of action and S&P will continue to monitor managements progress, as the lack of, or slowed, progress will place continued pressure on the already strained district finances.

#### WATER AND SEWER UTILITIES

The District's water and sewer operations provide residents with water and collects, treats, and disposes of wastewater for the District in addition to several neighboring jurisdictions.

The District is responsible for 75% of operating, maintenance, and capital costs for the U.S. Army Corps of Engineers, Washington Aqueduct Division, water production and

distribution facility. Facilities include several reservoirs and pump stations. The entire water system is metered and has minimal lead and copper problems.

The District-owned and operated Blue Plains Wastewater Treatment Facility, the largest advanced treatment facility in the world, serves approximately two million people in D.C. (44%), Fairfax (5%), and Montgomery and Prince George's Counties (50%). Costs of operations, maintenance, and capital are shared among the District and Intermunicipal Agreement signatories (IMA). The IMAs have no maturity or contract end date and are based on plant usage and percentage of flow. IMAs make mid quarterly payments and are reconciled to actual at year end. The service area is mostly residential, with industrial pretreatment where necessary. The enterprise fund annual budget totaled \$222 million in 1994, with debt service, which supports G.O. bonds issued on behalf of the utility, comprising \$40 million, or 18%. Total capital improvement plan needs for 1994 and 1995, primarily for plant expansion, equal \$108.6 million. The District contributes approximately 25%, IMAs 50%, and 25% is federal supported. Current operating capacity is 309mgd, with an average flow of 300mgd and 585mgd peak treatment capability. Improvements will expand capacity to 370mgd by 1996. Operations meet NPDES regulations, and permanent sludge facilities and land applications are in place. The facility permit was issued in February 1991 and expires in February 1996. Combined sewer overflow (CSO) problems in the District could possibly cost \$3 billion over 15 years to remedy. The District already has spent \$40 million on fixing CSO problems and plans to expend another \$100 million over the next several years. In 1986, four consecutive annual rate increases were approved by District Council and enacted. The District is currently performing a rate study in anticipation of upcoming debt issuances. Particular attention is being paid to these rates, given that the District is considering issuing revenue-secured bonds for the upcoming utility capital items while maintaining the self-supporting nature of outstanding G.O. water and sewer debt. S&P will continue to monitor enterprise operations, expects sound operations to continue despite a small deficit in 1993, and does not expect any further transfer of monies to the general fund from enterprise operations.

**ATTACHMENT F****RATING OUTLOOK DEFINITIONS**

A Standard & Poor's Rating Outlook assesses the potential direction of a long-term credit rating over the intermediate to longer term. In determining a Rating Outlook, consideration is given to any changes in the economic and/or fundamental business conditions. An Outlook is not necessarily a precursor of a rating change or future CreditWatch action.

- • Positive means that a rating may be raised.
- • Negative means that a rating may be lowered.
- • Stable means that a rating is not likely to change.
- • Developing means a rating may be raised or lowered.
- • N.M. means not meaningful.

CREDITWATCH	
CREDITWATCH REMOVALS	
ISSUER	RATING ACTION
District of Columbia	Lower G.O. debt and certificates of participation to '91215-

**DISTRICT OF COLUMBIA**

S&P Contacts: Parry Young (212) 208-1725, Kathleen Quail (212) 208-1377, Bernhard Fischer (212) 208-8102

DOWNGRADED TO FROM  
 \$1 bl. G.O. ends. 888-A  
 \$82 mil. certs. of part. ser. 1993 131313-BBS  
 OUTLOOK: STABLE



Ratings on the District of Columbia's G.O. bonds and certificates of participation (COPS) are lowered and removed from CreditWatch, where they were placed Dec. 13, 1994. This rating action does not affect the outstanding ratings on \$2.2 billion insured G.O. debt, \$510 million LOC-backed bonds, and \$250 million LOC-backed TRAns. The investment-grade ratings are supported by the access the district has to the U.S. Treasury (*see box*).

The downgrades reflect the continuing and deepening financial difficulties experienced by the district in an environment of weakened credit fundamentals with uncertain prospects. Specifically, the G.O. and COP downgrades reflect:

- Worse-than-anticipated fiscal 1994 deficit, reported at \$335 million, -
- A current-year budget gap that has rapidly grown to \$722 million, or 22% of general fund expenditures;
- Difficulties in developing and implementing

substantial additional federal monies to address critical budget issues, including Medicaid, essential service provisions, and the continuing pressures on cash balances; and

- Increasing concerns over the district's longterm structural budget gap, which has not been addressed effectively to date.

The Treasury window access allows the district to receive advances to meet expenditures, and is strong enough to keep the district's G.O. and COP ratings in the investment-grade range at this time even though the bonds and COPS have different security provisions. The Treasury may be used only if the district has no other access to raise needed cash. While bondholders can receive some comfort from this provision, it does not ensure full and timely payment of debt service.

The district's ratings were placed on CreditWatch pending successful implementation of plans to correct a \$492 million budget and cash shortfall for the 1995 fiscal year ending Sept.

**TREASURY WINDOW**

The District of Columbia has the unique statutory ability to access U.S. Treasury funds to meet its financing needs. From 1939-1983, the U.S. Treasury made advances to the district to meet short-term cash and capital funding requirements. These advances were and continue to be authorized by Federal law (53 Stat. 1118, as amended) which states:

"The Secretary of the Treasury...is authorized and directed to advance, on the requisition of the Mayor of the District...such sums as may be necessary, from time to time, to meet the general expenses of said District, as authorized by Congress, and such amounts shall be reimbursed by the said Mayor to the Treasury out of taxes and revenue collected for the support of the government of the said District."

The District of Columbia has the right to draw on the U.S. Treasury to meet general and debt service expenses. The authorization is fairly liberal, in that the Treasury is "authorized and directed" to advance monies as pursuant to D.C. Code Section 47-3401. Since the district esrows taxes for note and bond debt service payments, if ever a cash flow crisis were to arise, adequate time might be available for proper correspondences between the district and the Treasury, in the event market access were not available and the district required funds to meet its obligations.

Before the Treasury would consider advancing funds, it would need to be satisfied that

the district were unable to obtain financing from other sources. It should be noted that other sources would include taxable financing including short-term, commercial bank loans. An instance did arise in late 1983 whereby the district faced an imminent need for cash flow financing in the amount of \$150 million. The district was unable to secure short-term financing as a result of a Supreme Court decision that potentially could have invalidated any bonds under the issuance. This uncertainty prevented private lenders in all market sectors from purchasing the notes, effectively leaving the district with no market access. In light of these circumstances, the Treasury agreed to advance \$150 million, if needed to the district, in the event a court ruling would prevent the district from honoring its obligation under the RANs. In this instance, the Treasury provided the ultimate credit support and security, enabling the district to have market access, but the Treasury was never called upon to advance any monies.

This Treasury window privilege provides a certain degree of support for the district to meet its obligations on a timely basis; however, does not guarantee full and timely debt service payments, limiting its impact on the long-term rating.

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30, 1995, and evidence of the district's ability to put into place permanent steps to correct structural budget gaps. On Feb. 1, 1995, the district announced an additional \$230 million in budgetary problems for fiscal 1995, bringing the total to \$722 million. A large part of the total fiscal 1995 budget problem is due to agency overspending (\$250 million) and Medicaid cost settlements, increases, and accruals (\$200 million). Although the district has approved certain expenditure cuts and is developing and implementing plans to solve the remaining budget problem, it is uncertain that remedies will be identified and executed in time to close the 1995 gap as the midpoint of the fiscal year quickly approaches.

Further, the district revealed a \$335 million deficit for the fiscal year ended Sept. 30, 1994, which is significantly higher than recent estimates. The 1994 deficit was attributable largely to agency overspending, with the largest component in the human services area, Medicaid accrual increases, and a reserve for D.C. Gen

eral Hospital receivables. The district resorted to pension payment, debt service escrow account, and accounts payable deferrals totaling almost \$300 million to help close 1994 budget gaps.

The current financial stress is a product of inherent structural imbalances caused by the district's attempt to provide services at a level that its resources do not support. S&P believes that the magnitude and duration of the budgetary stress that the district is experiencing is not compatible with the 'A' rating category. Financial pressures are mounting at a time when the district's own-source revenue base has softened, hurt in part by a declining population and falling wealth levels. The district's debt burden is high, and its unfunded pension obligation is extremely onerous. Although the district's fiscal problems have been discussed at great length over the last several years, little headway has been made in correcting the deteriorating situation, resulting in the current crisis. Attachment G

## ATTACHMENT H

LEADLINE: District of Columbia \$1B GOs Downgraded; Off S&P Watch

NY – S&P CreditWire 4/11/95 -- S&P lowers its ratings on the District of Columbia's \$1 billion G.O. bonds to single-'B' from triple-'B'-minus and on the district's \$82 million certificates of participation (COPs) series 1993 to single-'B'-minus from triple-'B'-minus. S&P removes these ratings from CreditWatch, where they were placed April 4, 1995.

S&P assigns a stable outlook to both ratings.

This rating action does not affect the outstanding ratings on \$2.2 billion of insured G.O. debt, \$510 million of LOC-backed bonds, and \$250 million of LOC-backed notes.

S&P's definition of debt rated in the single-'B' category includes the statement that it "currently has the capacity to meet interest payments and principal repayments. Adverse business, financial or economic conditions will likely impair capacity or willingness to pay interest and repay principal."

The downgrades reflect a weakening of the district's ability to requisition advances from the U.S. Treasury to meet expenses, including debt service. The change to the district's authority to access the treasury is contained in the 'District of Columbia Financial Responsibility and Management Assistance Act of 1995,' which was passed by congress last week. Approval by the president is expected imminently. A key component to the investment grade ratings previously assigned to the district was the strong access it had to the treasury. The 1995 Act dilutes the support and financial flexibility given to the district by the earlier law by placing restrictions on the aggregate amounts outstanding, the timing of advances, and on the conditions under which requisitions may be made. The district's rating now rests primarily on its own credit fundamentals, which are weak, with reduced access to the treasury.

The district's single-'B' general obligation rating reflects a chronic structural imbalance between revenues and expenditures contributing to a \$335 million deficit in fiscal 1994 and a projected \$722 million budgetary problem in the fiscal year ending Sept. 30, 1995. Implementation of plans to fix this current imbalance has been slow and solutions to close the entire gap are uncertain. It is estimated that the district will need to draw funds from the treasury in several phases over the next few months to meet expenses under the 1995 budget.

In addition to altering the district's treasury access, the 1995 Act creates an oversight authority whose goals include the following:

- Elimination of budget deficits and cash shortages;
- Ensuring efficient delivery of services;
- Enhancing the district's access to the capital markets and ensuring the continued orderly payment of its debt service obligations; and
- Ensuring long-term financial and economic vitality.

The authority is an entity within the district government with the power to approve financial plans, propose various actions, and issue debt on behalf of the district. The authority is charged with assisting the district in restructuring its organization and achieving an appropriate relationship with the federal government. Efforts in these areas may lead to better structural balance for the district and the authority's powers appear to give it the potential to meet its goals. However, the success of such objectives remains to be seen over a longer-term period.

OUTLOOK: Stable

The outlook is based on the expectation that measures will be taken over the next 1-3 years to balance operations, S&P said. -- CreditWire

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**ATTACHMENT I****S&P Upgrades District of Columbia, Off Watch; Outlk Pos**

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New York (1) 212-208-8102

NY -- Standard & Poor's CreditWire 3/11/98 - Standard & Poor's today raised its rating on the District of Columbia's \$900 million general obligation bonds to double-'B' from single-'B', and certificates of participation to double-'B'-minus from single-'B'-minus.

Standard & Poor's also raised its rating on the District of Columbia Redevelopment Land Agency's sports arena special tax revenue bonds series 1996 to double-'B' from single-'B'.

These ratings are removed from CreditWatch, where they were placed Aug. 8, 1997. The outlook is positive.

The upgrade is based on improved financial and administrative factors resulting largely from federal legislation affecting the district. The higher rating will be assigned to the G.O. bond issue to be sold the week of March 30.

The ratings on an additional \$2 billion G.O. bonds that are rated triple-'A' due to the additional security of bond insurance, and \$380 million variable-rate G.O. debt with various bank credit and liquidity enhancements, were not placed on CreditWatch and are not affected by this action.

A critical component to the improvement in the district's creditworthiness was the implementation of the National Capital Revitalization and Self-Government Improvement Act of 1997. With this act, effective Oct. 1, 1997, the federal government assumed the majority of the district's unfunded pension liability, which totaled \$3.7 billion at the end of fiscal 1997. The costs of certain district operations also are being transferred to the federal government, including its court and felony offender systems, and the Medicaid reimbursement rate was increased to 70% from 50%. On the revenue side, the annual federal payment of \$660 million is eliminated. The net positive effect from the revitalization act on the district's finances is projected to range from approximately \$100 million-\$200 million annually from 1998-2001.

Improved management controls have resulted from the Financial Responsibility and Management Assistance Act of 1995, under which a control board (authority) was established to eliminate budget deficits and ensure efficient delivery of services in the district among other goals. The authority act established an independent chief financial officer and

requires that the authority approve the district's annual financial plan and budget during a control period.

The authority was given management oversight, under the revitalization act, for a number of critical district departments, including human services. Management reform plans have been developed and are being implemented for these departments as well as for the public schools and the police department. Additionally, plans are being developed to stimulate economic development in the district.

For the fiscal year ended Sept. 30, 1997, the district's general fund had a surplus of \$186 million, compared with a budgeted deficit of \$74 million, resulting in a year-end fund balance deficit of \$332 million. The improved results are attributed to a combination of favorable revenue and expenditure factors. The district expects to generate an operating surplus of \$250 million-\$350 million in fiscal 1998.

In spite of its recent financial success, the District of Columbia continues to face negative demographic and economic trends that will challenge its ability to meet its financial goals over the long term. These factors include a population that continues to decline and a stagnant property tax base. Although advances have been made in management systems, including those for tax collections, continued improvements are required to ensure more efficient operations and reporting. The district also has limited revenue-raising flexibility inherent to its unique status as the nation's capital. Although the unfunded pension liability has been lifted, the district still has a very high debt burden and a keen demand for additional capital financing, such as for schools and roads, exists.

**OUTLOOK: POSITIVE**

The positive outlook reflects the potential for further improvement in the district's creditworthiness if planned management controls and reforms, economic development initiatives, and other factors result in balanced operations over the long term, Standard & Poor's said. -- CreditWire

**CREDIT PROFILE:**

**ATTACHMENT J****District of Columbia's GO Bond Rating Raised to 'BBB';  
Outlook Revised to Stable**

Parry Young, New York (1) 212-438-2120; Bernhard H Fischer,  
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NEW YORK (Standard & Poor's CreditWire) April 22, 1999-- Standard & Poor's today raised its ratings on the District of Columbia's outstanding GO debt and revised the outlook to stable from positive (see list below).

The rating upgrades are based on the district's improved financial and administrative factors, resulting largely from federal legislation affecting the district and the expectation that strengthened management controls and reforms, economic development initiatives, and other factors will lead to solid credit fundamentals over the long term. Other rating characteristics include debt pressures and an economy that remains sluggish.

Standard & Poor's will conduct a telephone conference call on its upgrade of the District of Columbia's bond rating today at 2:00 P.M. eastern time. For information on how to participate in the call, please refer to an accompanying press release.

A critical component to the improvement in the district's creditworthiness was the implementation of the National Capital Revitalization and Self-Government Improvement Act of 1997. With this act, effective Oct. 1, 1997, the federal government assumed the majority of the district's unfunded pension liability, which totaled \$3.7 billion at the end of fiscal 1997. The costs of certain district operations were also transferred to the federal government, and the Medicaid reimbursement rate increased to 70% from 50%.

Improved management controls have resulted from the Financial Responsibility and Management Assistance Act of 1995, under which a control board was established to eliminate budget deficits and ensure efficient delivery of services in the district among other goals. Following a surplus of \$186 million in fiscal year-ended Sept. 30, 1997, the district's fiscal 1998 general fund recorded a surplus of \$445 million compared with a budgeted surplus of \$70 million. These surpluses eliminated the district's \$332 million accumulated deficit through fiscal 1997, resulting in a 1998 year-end fund balance of \$112.5 million or 2%-3% of budget. Additionally, the district is forecasting an operating surplus of nearly \$200 million in fiscal 1999 compared to a budgeted surplus of \$41 million. These surpluses are directly attributable to

aggressive collection efforts and economic growth, which have increased local revenues coupled with improved expenditure controls.

Despite recent financial success, the district continues to face sluggish demographic and economic trends that will challenge its ability to meet all of its financial goals over the long term. Further improvements in management systems are required to ensure more efficient operations and reporting. The district also has limited revenue-raising flexibility inherent to its unique status. Additionally, the district still has a very high debt burden and strong demand for capital projects.

Although the district's economic underpinnings have stabilized, they remain weak compared to national trends. Dependence on a contracting federal government sector, coupled with the continued out-migration of residents and employers, have eroded the district's tax, population, and employment bases. The outlook for the entire Washington metropolitan economy is one of moderate growth with the district's economic performance remaining weakest. New federal and district tax cuts and economic incentives were introduced in 1998 in an effort to stimulate private-sector investment and job creation in the district.

For most of the past decade, the district has had a structural imbalance between general fund revenues and expenditures, relying mostly on onetime revenue enhancements and minimal expenditure controls or reductions to achieve balanced operations. This weakness brought the district's financial position to a distressed level in 1995 when it posted a \$335 million general fund deficit for the fiscal year-ended the previous September. This led to the Financial Responsibility and Management Assistance Act of 1995, under which a control board was established to eliminate budget deficits and ensure efficient delivery of services in the district among other goals.

The district has made substantial progress in improving its financial performance. Through strengthening financial control and monitoring procedures, improving revenue collections, and investing in technology, budgetary performance has been enhanced. For fiscal years ended Sept. 30, 1997, and Sept. 30, 1998, the district's general fund had surpluses of \$186 million and \$445 million, which entirely eliminated the district's fiscal 1997 \$332 million accumulated deficit two years ahead of plan. Fiscal 1998 year-end fund balance of \$112 million represents 2%-3% of budget. The fiscal 1998 surplus is largely due to favorable variances from budget, including \$163 million in income taxes, \$68 million in sales taxes, \$129 million in other taxes, and \$92 million of human support services savings. The strength of the national economy and Wall Street performance has resulted in higher than usual capital gains, corporate profits, and related district tax yields. The district expects to generate an operating surplus of \$185 million in fiscal 1999 despite the complete elimination of the federal contribution. First quarter fiscal year 1999 cash flow schedules indicate tax

receipts, continuing to exceed estimates with expenditure disbursements trailing estimates and forecasting an operating surplus of \$185 million--which is much larger than the \$41 million budgeted surplus.

The district's overall debt burden is high due in part to its unique service responsibilities, which include elements of both city and state government. Debt per capita is over \$5,000 while the S&P Index, a measure of per capita debt to per capita personal income, is also high at 18.1%. Future debt service requirements will average about 13.2% of budget, which is up from previous levels of about 7%. The revitalization act increased the district's debt limit from 13% to 17% of revenues to compensate for the loss of the federal payment revenue.

OUTLOOK: STABLE

Although the district's debt and financial performance will be pressured in addressing the challenges of funding capital projects, tax restructuring, economic initiatives, and programmatic issues, movement toward a stronger credit profile is expected to continue and allow overall credit quality to remain stable, Standard & Poor's said. - CreditWire.

OUTSTANDING RATINGS RAISED; OUTLOOK REVISED TO STABLE

	Rating	
	To	From
District of Columbia		
\$1 billion GO bonds various series	BBB	BB
\$75 million certificates of participation series 1993	BBB-	BB-
\$108.03 million GO bonds series 1998A (SPUR)	BBB (SPUR)	BB
\$383.23 million GO refunding bonds series 1998B (SPUR)	BBB (SPUR)	BB

**ATTACHMENT K****District of Columbia**

Parry Young, New York (1) 212-438-2120; Kenneth A Gear, Washington D.C. (1) 202-383-3540;  
Robin Prunty, New York (1) 212-438-2081

**Auxiliary Deck**

**February 23, 2001**

**Rationale**

The upgrade to 'BBB-plus' from 'BBB' on District of Columbia's GO bonds reflects the district's improved financial operations, resulting largely from federal legislation affecting the district; enhanced debt position; and the expectation that improved management controls and reforms, economic development initiatives, and other factors will continue to strengthen credit fundamentals over the long term. The rating is based on the full faith and credit of the district and also reflects an economy that is showing signs of coming out of a long-term decline. A critical component of the improvement in the district's creditworthiness was the implementation of the National Capital Revitalization and Self-Government Improvement Act of 1997. With this act, effective Oct. 1, 1997, the federal government assumed the majority of the district's unfunded pension liability, which totaled \$3.7 billion at the end of fiscal 1997. The costs of certain district operations were also transferred to the federal government, and the Medicaid reimbursement rate increased to 70% from 50%.

Improved management controls have resulted from the Financial Responsibility and Management Assistance Act of 1995, under which a board was established to eliminate budget deficits and ensure efficient delivery of services in the district, among other goals. Following a surplus of \$186 million in fiscal year-ended Sept. 30, 1997, the district's fiscal 1998 general fund recorded a surplus of \$445 million. These surpluses eliminated the district's \$332 million accumulated deficit through fiscal 1997, resulting in a 1998 year-end fund balance of \$112.5 million, or 2%-3% of budget. Further, the district generated operating surpluses of \$134 million (restated) in fiscal 1999, and \$241 million in fiscal 2000. These surpluses were attributable to aggressive collection efforts and economic growth, which have increased local revenues, coupled with improved expenditure controls. Fiscal 2001 revenues are expected to be more than \$100 million over budget. This fiscal year is slated to be the final control year.

Despite recent financial success, the district continues to face structural and demographic weaknesses that will challenge its ability to meet all of its financial goals over the long term. Further improvements in management systems are needed to ensure more efficient operations. The district also has limited revenue-raising flexibility because of its unique status. Despite the planned use of tobacco settlement and other funds for debt reduction, the district still will have a high debt burden, projected at \$4,589 per capita and 6.1% of market value, which may be exacerbated by the demand for capital projects.

**Outlook**

The stable outlook reflects the expectation that the district's overall credit quality will maintain its positive momentum. The direction of any further rating action will depend on the district's ability to demonstrate that it is adequately balancing its social and capital costs with available resources and, with the imminent phase-out of the control authority, financial and management controls and improvements have been institutionalized.

**Economy**

The district's economic underpinnings are stabilizing, although some areas remain weak compared to national trends. Dependence on the federal government sector coupled with the out-migration of residents and employers have eroded the district's tax, population, and employment bases.

The district's economy is centered around the federal government and tourism sectors. Total employment levels in the district fell more than 20% from 1990-1998, before turning around in 1999. Federal government employment, which declined 4% from 1996-1999, is still a significant portion of the employment base. Services sector employment, which makes up 45% of total employment, has remained somewhat more

stable largely due to the strength of the tourism sector in the district. An estimated 20.9 million people visited the area in 1999, spending more than \$5.9 billion. District unemployment fell to 5.5% in 2000, compared to 4.0% for the nation, which was a considerable improvement over the district's average of 8% for the prior five years. District income demographics are varied. Although overall income levels remain well above national levels, with per capita personal income at 136% of the nation, a large segment of the district's population receives public aid. Employment losses, coupled with the high cost of housing in the district, have resulted in out-migration of residents to suburban Maryland and Virginia. The new 2000 census figures show a 5.7% population decline since 1990, which is a significantly smaller decrease in the population base than previous estimates.

An additional indicator of the district's lagging economic performance has been the erosion of its tax base. Driven by a collapse in commercial real estate (down 33%), total taxable property valuation fell 13% from 1992-1999, from \$48.7 billion to \$42.4 billion. In 2000, total taxable assessed value increased 1.9% and both residential and commercial values were up. Due to the high level of government and nonprofit activity within its borders, 42% of the district's property base is tax exempt. The new hockey and basketball MCI Center is spurring new development in the downtown area that, coupled with increased development as a result of new economic and tax incentives offered by the district, could further strengthen the district's tax base. Also, in 1998 the Washington Convention Center Authority sold \$524 million of bonds to help finance a new 2.3 million square-foot facility which should be completed in 2003. A major challenge will be the district's ability to continue to stimulate and grow the local economy. Key factors include the district's ability to continue implementation of a more competitive tax structure, improve the level and delivery of services, and continue financial improvement. Tax parity and clarity legislation was passed in 1999.

### Finances

Historically, the district has had a structural imbalance between general fund revenues and expenditures, relying mostly on onetime revenue enhancements and minimal expenditure controls or reductions to achieve balanced operations. This weakness brought the district's financial position to a distressed level in 1995 when it posted a \$335 million general fund deficit for the fiscal year ended the previous September. This led to the Financial Responsibility and Management Assistance Act of 1995, under which a control board (known as the authority from hereon) was established to eliminate budget deficits and ensure efficient delivery of services in the district, among other goals.

The district has made substantial progress in improving its financial performance. By strengthening financial control and monitoring procedures, and improving revenue collections, budgetary performance has improved. About 34% of local general fund revenue comes from individual income tax while 22% comes from property tax. The district is precluded from levying an income tax on nonresidents. For the years ended Sept. 30, 1997, and Sept. 30, 1998, the district's general fund had surpluses of \$186 million and \$445 million, respectively, which entirely eliminated the district's fiscal 1997 \$332 million accumulated deficit—two years ahead of plan. The fiscal 1998 year-end fund balance of \$112 million represented 2%-3% of the budget. In fiscal 1999, continuing economic growth and improved tax administration contributed to an ending fund balance of \$224 million (restated), or 5.6% of expenditures. The district reported a surplus of \$241 million for fiscal 2000 and an ending fund balance of \$465 million. In fiscal 2001, the district has experienced certain spending pressures particularly in the area of health care associated with the restructuring of its Public Benefit Corp. (PBC), which includes responsibility for D. C. General Hospital. Pressures totaled \$28 million, including \$90 million for the PBC, and were resolved largely through the use of part of the budget reserve (\$90 million) and \$91 million of the \$109 million in total additional revenues. The control authority has certified that the district has met the requirements, including four years of balanced budgets, fiscals 1997 through 2000, for the termination of the control period (Sept. 30, 2001).

Beginning in fiscal 2000, the district was required under the authority act, as amended, to establish a reserve of \$150 million, which may be spent under criteria established by the authority, mayor, council, and chief financial officer. The district is further required to maintain, by fiscal 2004, an emergency reserve fund of at least 4% of expenditures. Also, a contingency reserve fund of at least 3% of expenditures must be established by fiscal 2007.

The implementation of The National Capital Revitalization and Self-Government Improvement Act of 1997 was a critical component of the improvement in the district's creditworthiness. With this act, effective Oct. 1, 1997, the federal government assumed the majority of the district's unfunded pension liability, which totaled \$3.7 billion at the end of fiscal 1997. The costs of certain district operations are also being transferred to the federal government, and the Medicaid reimbursement rate was increased to 70% from 50%. The net positive effect from the revitalization act on the district's finances was forecast to range from about \$80 million-\$200 million annually through 2001.

Although the district's financial successes to date have been significant, the district will be challenged to continue this positive financial progress while focusing on improving the level and quality of services, implementing tax and economic incentives, and addressing capital program needs and costs. Financial pressures will come from the district's limited revenue flexibility, significant amount of capital needs, and risks associated with the district's unique economic profile.

**Debt**

The district's overall debt burden is high due to its unique service responsibilities, which include elements of city, county, and state government. Outstanding GO debt at Sept. 30, 2000, totaled \$3.1 billion, of which about \$2 billion was additionally secured by bond insurance. Outstanding revenue bond debt includes \$393 million for water and sewer purposes, \$770 million for the housing finance unit, and \$524 million for the new convention center. Also, the district is responsible for a \$75 million certificate of participation issue. After using tobacco bond sale proceeds for debt repayment, planned defeasances, and a \$65 million GO issuance in March, the district will have approximately \$2.6 billion of GO debt outstanding. At this level, debt per capita would be \$4,589, compared to \$5,461 in 1994 (with 1990 population). Debt service equaled 7.3% of expenditures in fiscal 2000, compared to 10.1% in fiscal 1998. The planned debt restructuring will lower annual debt service costs by at least \$50 million.

The district's 2001-2006 capital improvement program totals \$3.23 billion, including \$1.8 billion from long-term financing, the majority of which is for district infrastructure and school improvements.

Short-term borrowings for the district for seasonal cash needs in fiscals 1998, 1999, and 2000 were \$400 million, \$180 million, and \$70 million, respectively. The fiscal 2001 plan anticipates note borrowings of up to \$50 million.

Mrs. MORELLA. I want to thank you all.

I think I will start off with the two rating agencies, asking you, what challenges do you see facing the District government that will impact credit evaluation? What are the key factors that the District has to address in order to receive upgrades in its credit ratings? And if you would also comment, what actions, including the establishment of oversight mechanisms, do you recommend should be put in place during the post-Control Board period?

Let me start off with you then, Ms. Boicourt.

Ms. BOICOURT. Thank you. Let me address your—I think your second question first, which is what will it take for the rating to continue to improve.

We see the District as having substantial momentum in its improvement. In our view, we think the rating can go higher if the District meets the goals that it itself has laid out, continuing to improve reserves toward—they have a self-imposed 7 percent goal, continuing to post balanced budgets; we would add to that, from our point of view, continuing reporting at the frequency, and ideally of an improved quality, as information technology systems continue to improve, with the investments that they have planned.

We do see substantial challenges toward that improvement, principally in the short term in the form of information systems and technology. This is not unique to District of Columbia. We find this in many cities, that the ability to produce the information one needs to manage toward an improved financial result is often a very important obstacle.

In the longer term, in terms of higher ratings beyond the A range into the AA range, it's—we do see the structural budget balance issues as becoming more germane when you enter the AA range. It's not an accident that AA-rated cities have a much more favorable balance between the service responsibility and demographics of the population on the one hand and the resources in the form of their economy and their tax authority on the other. That's not to say this is an impossible goal for the District, but it's one where the challenge has become more serious.

Your third question, I believe had to do with our recommendations regarding the post-control era, if you will. We really don't see it as our role to make policy recommendations, particularly those that go to kind of fundamental governance issues. We see a lot of different models of governance across the country from city to city, State to State, widely varying models. Rather, I think our focus is on process, and financial process in particular, and I think our emphasis is on information, the transparency of information, the quality of information, the frequency of information.

The thing that I think bothers us the most, and Wall Street in general, is radio silence. I mean, I think that investors are very comforted by lots of good, frequent information. That's why you see so much attention by the analysts in general on quarterly reporting of corporations.

It's no different with municipalities. So our—I think our interest is—it echoes a little bit what Nat Gandhi said about, I think he said, activities rather than organization. I think that's factors rather than organizational form, and I think that's true of our point of view that we're very interested in outcome and in information, and

that we see by rating cities across the country that can be accomplished in many different forms of governance.

Mrs. MORELLA. Very good answer.

Let's hear from Mr. Young before my time is up.

Mr. YOUNG. Well, as far as the first part of your question, the challenges facing the District going forward, we feel that the District is still assimilating the certain factors of the Revitalization Act and the Tax Parity Act. There are a lot of things going on that still have to flow through the system. So over the near term—and also the change of the Control Board going away. So over the near term, we will be looking at what, how the District manages all these events, along with any changes that may occur in the economy, and as far as what they might do in the same vein.

As Renee said, we really don't see it as our role to recommend what political jurisdiction should do, but there are things that we have pointed out in the past that can help to improve creditworthiness, such as increasing reserves, improving financial management and those types of things. But that's about it.

Mrs. MORELLA. Thank you.

I now recognize Ms. Norton for her questioning.

Ms. NORTON. Thank you very much, Mrs. Morella. I want to turn, as well, to the two bond advisers, bond representatives.

All the testimony we have received today has been most important for the committee. We've listened to it closely. It seems to me you learn something from each and every one of those who has testified. It's very valuable to hear from the District, for example, who lives with this stuff every day. But in a real sense, your testimony is probably the most important because you're the most independent, because all of you are structurally required to be objective and because, in a very real sense, your testimony matters most to the implications for everything that the District does.

You have each offered a critique of what the District does. What is probably most noteworthy is how encouraging your testimony has been about the District's financial condition.

I'd like to ask you, because our concern is less with today than what will happen tomorrow, particularly given the surpluses the District had been running today, are there any early warning signs that the District's bond rate will decline; and looking at it from the other end, how much does it cost the District that, for reasons you have said are partly structural—they are operational reasons as well—how much does it cost the District to have a, is it a BBB-plus rating rather than the A rating that it had in 1984?

First, do you see any early warning signs that the rating will decline, or is it on an upward movement as far as you can see, whenever that will occur, and that of course we can't know.

Ms. BOICOURT. Sure. At the moment, as I said before, we see some positive momentum that if it's sustained in the post-Control Board era, whatever form that takes, offers the potential for the rating to rise again. The sorts of early warning indicators that we watch are both economic and financial. It's one of the reasons that the interim reporting on actual revenues and expenditures is so key to us.

Throughout the last couple of years there's been what we have viewed as a very valuable process of surfacing potential budget

risks and then managing those down. We expect to continue to see that and continued practices along those lines would be important to us. If we saw an early warning in the form of surfacing budget problems that were too big to manage down, that might slow down some of this momentum.

I would say the other financial management sort of early warning signals that we watch have to do with cash condition. We are very interested in cash condition, and the District reports to us on a frequent basis. On the economy side, the District has been doing better than many parts of the country in terms of the immediate business cycle softening that we're seeing in other regions.

Ms. NORTON. Why is that?

Ms. BOICOURT. I think that this part of the country, in general, is doing better. In addition, there's a fair amount of momentum in commercial activity and development-oriented projects that are getting traction in the District. But nevertheless we do still see some downside risks there, and that's something we're watching quite carefully. And we're very interested in just the fundamental trends of job growth, of property values, when we can get data on population. It's hard to wait 10 years for good data, but we do try to watch what we can.

So those are the kinds of warning signals we look at, both economic and fiscal.

Ms. NORTON. Mr. Young.

Mr. YOUNG. From our standpoint, we have a stable outlook on the District's rating, which means we expect that the District's rating will remain the same over an intermediate term. If we thought there was, that it was going to go down, we would have a negative outlook on it, and positive, if it were going to go up; but right now we think that the District's rating will remain the same.

And as far as looking for early warning signals, we use many of the same sources that Renee mentioned, plus the District also is very good at calling us when there is a potential problem or the appearance of a problem that could affect credit quality. Also their Web site helps. The improvements in financial management every day should make more and better information available to everyone.

Ms. NORTON. My time is up, Madam Chairman.

Mrs. MORELLA. Thank you. Picking up on our line of questioning, I would go to Inspector General. You have come up with a list of very laudatory recommendations, pilot programs, auditing system that you will be putting into effect. Do they link up with what you have heard—have they linked up to what you—with what they have noted as being important to the future direction with regard to bond rating and all?

Mr. MADDIX. Yes, Madam Chairman, they do; and in addition to that, let me just add some of the policies and procedures that we've put in place.

As you may know, from the beginning we instituted reports like MARs and MIRs, MARs being management alert reports and MIRs being management implication reports, and fraud reports. The first two are very important because in the process of our inspecting or auditing an agency, if we find systemic problems that relate to these deficiencies, we alert the agency right then and there to

make those corrections; and that's a part of our final report when we do a final draft.

In those instances where we issue the management implication reports, when we find systemic problems that are common probably across the District line, we alert the entire city, the Council, in the past, the Control Board and this—the Hill, as well, as to our recommendations and the systemic problems that we've found in one agency without naming that agency for them to correct.

The CAFR process, we examine the management letter that comes after the dependency of the CAFR process and we monitor those deficiencies to make sure that the recommendations are carried out, and if they are not carried out, we bring that to the attention of the appropriate officials.

One of the things that I alluded to in my statement, or one of the things in the future that I think will be beneficial, is putting audit—deputy auditors in different key departments which control the greater part of the budget and have a better impact on the financial situation. I think that a continuous auditing process in place will alert the appropriate officials of these triggers that may bring in a control period.

Mrs. MORELLA. Do you need to get legislative authority from the Council, or whatever authority, to come up with these projects you talk about: We should develop a long-range plan procurement and contract administration, the resident auditors, more inspection? Do you need further authority, or do you automatically have the authority to do that, sir?

Mr. MADDOX. That, I believe, I can do on my own. Of course, that will require probably additional resources, which I have not analyzed what that would be, but deploying my resources and my auditors in areas that significant, I can use my discretion on that, and I don't need the additional legislation to do that.

Mrs. MORELLA. I have to get to the chief financial officer.

Dr. Gandhi, a lot has been discussed about your role and, of course, we all feel the Mayor and the Council and the Control Board recommending the establishment of an independent CFO—one of the points that I brought out in my opening statement and I wanted to ask about is the specific provisions of the proposal to ask you, first of all, will they ensure sufficient financial oversight and your independence? For instance, should the agency CFOs be hired and fired by you, and what provisions of the current Control Board Act should be retained to ensure that your independent nature is maintained and why?

Mr. GANDHI. The overall comment that I would like to make is that I'm in complete correspondence with the Mayor, the Council and the Authority in their statement that CFO should be independent, but should be part of the District government and the home rule.

Second, as to what organizational structure it should take, I would simply leave that to the elected leaders of the District and the Congress.

Third is that, overall, the CFO role, as it was developed in the law or authorities, the Control Act, I think it has worked extremely well in terms of improving cities' financial fortunes. I think CFO should not be viewed merely in terms of the District CFO, but also

should be viewed in terms of the entire cluster, meaning the agencies' CFOs as well.

My guidance to the agency CFOs on a regular basis is that we have to work with the agency directors. There's no way around that. The primary reason is that, without their help, the agency directors will not be able to achieve their goals and the objectives as specified by the Mayor.

The financial cluster and CFO should not be adversaries with the agency directors. They have to work in congruence. But at the same time, the most important view, most important responsibility that I envision for the CFO and members of the CFO cluster is to maintain the District's financial viability. That is an absolute must, and whatever it takes to do that we will do it.

Mrs. MORELLA. My time has expired, but it appears as though you're leaving it to the Mayor and the Council to make some of those little decisions with regard to how it will be employed. I will be interested also to submit some questions to you with regard to that proposed legislation.

Congresswoman Norton.

Ms. NORTON. Thank you, Mrs. Morella. I would like to ask Mr. Gandhi and our two investment bond leaders, why do the District's expenditures continue to rise faster than revenue, given these extraordinary surpluses and the fact that the District apparently has come back faster than other cities that were in financial difficulty?

Mr. Gandhi.

Mr. GANDHI. Yes, I think the point we want to keep in mind here is that—that it is not that the expenditures rise faster than the revenue, which they do. The most important fact that you yourself pointed out is that there is a constraint on a revenue basis, and that—

Ms. NORTON. So it's not cost of government that is doing it, in other words?

Mr. GANDHI. No. I think the District will never let its expenditures rise more than its revenue for balanced budget purposes, because nobody wants the Control Board here again. If that would mean that we had to stall all the services, I think the District would do that. We are committed to making sure that there are balanced budgets, that there is a financial viability, that our friends on Wall Street are not concerned about that particular aspect.

But is that good government? I think a fundamental problem as you yourself pointed out, Ms. Norton, is that revenue basis constraint; and second is that when the economy is good out there, we do well. There is no question about that. In our last 4 or 5 years, the economy has done extremely well. It is an unprecedented level of prosperity that we had and we enjoyed it.

But just imagine for a moment, heaven forbid, that there is a recession out there, a sustained slowdown; that will be a serious problem for the District, given the kind of limited tax base that we have.

Ms. NORTON. So given the sources of revenue and the constraints on the sources of revenue, constraints that are beyond the District's control—

Mr. GANDHI. Absolutely.

Ms. NORTON [continuing]. No one can forecast, if there were serious recession, the District would have at its hands the ability to control its own expenditures. Yes?

Could I ask you both to comment on that it? Why you think it—

Ms. BOICOURT. Yes, I think inherent in your question is the notion of there being some fundamental expenditure trend that is on autopilot, that is inexorable; and of course, over the last few years, we've seen that's not the case, to some degree. To a large degree, that's a managed number, and the District in the last couple of years has managed it to a level that it has been able to eliminate the accumulated deficit and produce an accumulated surplus.

Ms. NORTON. Well, there are expenditures that are on automatic pilot. My question does not imply that—as the CFO says, that things can't be cut. At the same time, I would not agree with you that there are not some expenditures that this government has that are not on automatic pilot.

Ms. BOICOURT. And I would agree with you. Demographically driven expenditures to a large degree, in the face of both a policy desire and in many cases mandates to serve a population, are on autopilot, but there is—

Ms. NORTON. We've taken the District's Medicaid off of the terrible formula it had, but it can't get that Medicaid money if it can't come up with its match.

Ms. BOICOURT. And it still has an autopilot. It is just an autopilot on a more favorable formula than it was on before. So I think we agree with you that there is a component of the District's expenditures that are on autopilot.

On the revenue side, the District does have less revenue authority than many cities, and it does not have the ability to tax its commuters. Many of the highly rated cities in the West have the power to annex their growth boundary, and so they pick up that tax base. They also pick up that service responsibility, but they have a better structural balance.

To answer your question of how can it be that there's this imbalance yet there's all this money in the bank, I think the money in the bank was a deliberate target, aided by deliberate spending management and a good economy.

Ms. NORTON. Yes.

Mr. Young.

Mr. YOUNG. Getting to the issue of structural balance, the District was established with certain responsibilities and certain resources. And for the last 25 years it's been attempting to get those two factors into balance. The Revitalization Act was a step to lower the cost base of the District to help bring balance, but whether the District has achieved true structural balance remains to be seen. The revenue that we've talked about, the revenue sources are fixed, and property taxes and sales taxes and income taxes are probably at their limits for economic reasons. And some of the expenses are on autopilot.

As Dr. Gandhi said, the strong economy has helped to—the Control Board has had the wind at its back for the last 4 or 5 years. So that's why the years going forward may not be quite as easy

and something may have to be done to increase the revenue sources of the District or something about expenditures.

Mr. GANDHI. May I add one point, Ms. Norton?

The kind of arrangement that we just heard about, one additional factor that we ought to think about in the District is that we are accounting for expenditures which are generally State-like expenditures, about half a billion dollars or so. In any other jurisdiction, expenditures—

Ms. NORTON. You say that in spite of the fact that the Federal Government took over many costly State functions, the District still carries half a billion dollars—

Mr. GANDHI. Yes, ma'am.

Ms. NORTON [continuing]. In State functions?

Mr. GANDHI. And I'll give you an example. DCRA, for example, or the Office of Tax and Revenue or the University of District of Columbia; in any other jurisdiction, these are State-like expenditures. Now, this is the arrangement that we have, and in addition to this autopilot expenditure that we have, like Medicaid, you know we had to take care of these expenditures. There is no way around that.

Ms. NORTON. Thank you, Madam Chairman.

Mrs. MORELLA. Thank you.

I'm going to just ask maybe one last question, to all of you but particularly to—we've already taken care of our rating agencies—but particularly to the inspector general and the DC Applesseed Center and our CFO.

For the record, I still have the question about whether or not you would suggest or advise that we do need to have some kind of an audit advisory committee board, whatever you want to call it. We heard from the first panel the response that if you have some experienced people working for the CFO and working for the Council, that is adequate. I'm just wondering about whether or not—how does one involve the financial experts in being there for the revenue audits and for the other expertise that would be needed? And maybe it isn't necessary, but it just seems to me that this would be something that would be desirable, and perhaps you have some comments.

And also Dr. Gandhi, I would, and I don't know whether you will have a chance now, but I would, for the record, like to know how you respond to that legislation in terms of, like, the fiscal notes, remember. You know there was a comment made in the first panel, and I don't think it was completely responded to in terms of, would the CFO prepare fiscal notes for Council legislation for the term and for—as I say, the external review and for the term of office, right.

Mr. GANDHI. Right. First, the fiscal impact statement: Currently the Control Board requires that we need to get a fiscal impact statement for every legislation that goes to the Council, and we do that. I think it is prudent for any legislative body to assess what are the costs—not just costs in this year, but multiyear costing of a given legislation—and that will give them and the Mayor a proper chance to evaluate the legislation.

The legislation may be good in itself. The question is, it has to be weighed in terms of its financial imperatives, financial costs.

On the question of the advisory bodies, I entirely agree with you. We have recognized that need. You know, ever since I was the head of the Office of Tax and Revenue, I had an advisory committee there. As soon as I became the chief financial officer, particularly related to the revenue estimation, we have a technical advisory panel of experts who know the District economy—people from the CBO, people from the OMB, people from the Federal Reserve—and they come to us every 3 months or so, and we talk about revenue exemptions—you know, are we doing the right way, are these the right exemptions, what do you know.

We talk with—on that panel we have people from Virginia and Maryland, so we know—and then the counties also. And so we want to be properly informed as to how we do our job. So I really don't see any problem on taking technical experts' advice, not that they have to agree with us, but I would like to listen to what they have to say.

On the audit committee which is—which has basic overview—oversight on the CAFR process the inspector general has run, and any other—any large operation would have an audit committee consisting of a few directors who would overview the annual report and its audit. Again, I see no problem there; and in any case, I keep the members of the audit committee otherwise informed as to how the audit is going. After all, they constitute from the Council, the Mayor's office, the Control Board, people from the Hill and General Accounting Office.

So we are doing it on our own. The question is, how do you formalize that, and whether that constitutes—in some way, it can overshadow Control Board.

Mrs. MORELLA. Don't use that word.

Mr. GANDHI. I'm sorry.

And I would say, I would leave that to the decisionmakers, whether they want to formalize something like that or not. But I see nothing wrong in getting advice from technical people, because I would like to learn. We would like to do a process that is better.

Mrs. MORELLA. Mr. Maddox, with regard to—

Mr. MADDOX. Yes, Madam Chair.

Fundamentally, I would agree with the concept, I think we need to—first, we're talking about two different things. The CAFR oversight committee which requires the—first of all, the inspector general to pick independently the auditor to do the audit of the city's financial statement. My role as the IG is to independently select, competitively, that process.

We have from the beginning placed representatives from my office, Dr. Gandhi's office, CFO, from the Mayor's office, from the Council as representatives, and GAO has also sat on that committee; and we meet or have met every other week to discuss the process of the CAFR and the end goal of having it completed by the statutory date of February 1. That has worked. It has worked successfully in the past.

Now, whether or not you want to modify that committee and put in the so-called "audit committee," I really don't have any problems with that fundamentally, as long as the independence and the function of the committee as it has worked in the past 3 years is not compromised.

Now, they do different things. The CAFR committee for the oversight of the workings of the CAFR, to make sure that the auditor is getting the information that he or she needs from the agency, is making sure the agencies don't have a problem with the reasonableness of the request. I'm sort of a broker; I'm a referee in that sense. Everyone is informed. If there are critical areas or hiccups that happen along the way, everyone is informed. That's what has happened in the past.

Now, if there are experts that the government or the city feels as a security blanket they need to be a part of this process, then it could either be folded under the umbrella of the existing CAFR committee with the caveat that the independence with which I work is not compromised; and the—as an advisoree to the committee, the CAFR committee, and to the Congress and to the city, as long as that process is facilitated, I have no problem with that.

Now, it could also work as a separate committee where they can do their thing separately, and the IG could have a role as an observer. Whatever process works, I'm in favor of, but the main thing is, I would be troubled, and I would respectfully suggest that nothing is adopted that would hinder the independence of the IG to supervise the CAFR process.

Mr. GANDHI. If I may supplement a comment that I made, it's well and good to get technical advice. That is to say, I welcome all that; but I think the most important point, which I have already pointed out, is to build a professional technical staff within the Office of Chief Financial Officer.

A good example is the Congressional Budget Office. You know, we have a technical professional staff there. Nobody talks about giving them that advice even though they have established themselves as a very well-respected staff. I think we can do the same thing with the chief financial officer, build that staff so that people can come and go, the chief financial officer can come and go, but the staff will remain there and would have achieved such a level of technical expertise and respect so that anytime they put out a number, they put out information, people know it is transparent, it is expert, it's reliable, it is dependable and you can count on it.

Mrs. MORELLA. We're trying very hard to get OMB and CBO to have the same number so there could be some progress.

I defer to Congresswoman Norton for questioning.

Ms. NORTON. Thank you, Mrs. Morella.

What you just said, I must say, I found very informative because it is true that CBO, unlike the OMB, has built up the kind of reputation you're speaking of; and much of it does have to do with the staff who was there. Because sometimes Democrats have appointed the CBO, the Director of the CBO, and sometimes Republicans have and yet the reputation has not suffered. So the notion that there can be no substitute for taking our current CFO and building it into a strong, independent office is a point I take after hearing from you.

I think the Chair's concern about getting the proper technical advice is a concern well taken. I hear you saying that you—almost that it would be a matter of incompetence not to get technical advice from people in the private sector, in the public sector and in the region. If the city does, perhaps there should be something

more formal in D.C. law that says that there should be some technical advice that the CFO, or the IG, always makes available to himself, and he is required to make such advice available to himself.

The one thing I have not heard anyone overcome is the notion put forward in testimony presented by the prior panel that if there were a difference between the panel and the independent office with responsibility, there would be nobody who could, in fact, sort out that difference. I'd be very concerned with a Congress who keeps telling the District, streamline the government, don't have redundant layers, to have a layer that also could be adversarial and present more problems than it would solve, when you could simply have a group of people of the kind that you already have to do the same job.

I have one last question, and that's for Mr. Wyner.

You have testified that counsel review of contracts in excess of \$1 million should be eliminated. And this is something the Congress should be interested in because this constraint was added by the Congress before there was a Control Board, as I recall. Would you speak to your advice concerning the notion of eliminating that provision?

Mr. WYNER. Yes. Our research, we interviewed 15 to 20 groups or individuals who were quite familiar with the District's finances. And an issue that kept coming up was that the Council's review of contracts at \$1 million, which is a lot of contracts in today's dollars, in today's economy, really doesn't add a tremendous amount of value; that the Council does not have the expertise on staff—and this goes back to an issue that was raised by Dr. Rivlin earlier—which is that the Council does need to beef up its budget and financial staff, a point that we've made previously, and second, that it slows down the process of procurement.

And so if you don't get much benefit and you have substantial costs, it's something that you need to look at. That's not to say that we don't think contracts should be examined before they're executed.

We believe that the CFO, the current responsibility of the CFO to certify the availability of funds before contracts are executed should continue. We believe that the chief procurement officer should continue to certify that the proper contracting procedure has been gone through and, indeed, that the Council, when they think there's something amiss, should hold hearings and should, during the budget process, try to uncover any problems that may exist.

The inspector general officer can look into those things. It's the required review of every contract over \$1 million that strikes us as an unnecessary layer of bureaucracy.

Ms. NORTON. As far as I know, there is no other jurisdiction that requires a legislative body to look at contracts in this way.

Mr. WYNER. We looked at a number of other jurisdictions, and I think there are a few. But obviously it's less common in the jurisdictions that we looked at for legislatures to review individual contracts.

Ms. NORTON. On early warnings, or should I say "late warnings" in that regard, this is something that has come to my attention.

First of all, let me say that it obviously has the potential to become terribly political. I don't know that it has. I haven't heard those complaints, but if you keep putting million dollar contracts in front of people who are political animals and say, tell us what to do, at some point they're going to tell you what to do.

The problems I have seen in it have been when they have arisen, and I don't know anything about the day-to-day problems, not being a member of the City Council, but I can tell you about the Y2K problem and I can tell you happened to highway money. I had to get a waiver, something that is almost never done, in order for D.C. to qualify for highway funds. And the Congress put on a whole bunch of constraints about highway funds as a result of that. And come to find out that after all those constraints were put on, the great problem of the million dollar over. So Maryland and Virginia get their contracting out on the street within 60 to 90 days.

I met with some business people from the area recently, and they told me that it still takes the District as much as a year to get contracts, the season is over. Y2K almost didn't happen because the Congress—the Council was just doing what we told them to do, hold it for 45 days, and if nobody says anything, fine.

Well, they weren't saying anything for the most part. But if you hold a contract and the Y2K clock is running for 45 days, then that clock really does not wait for anyone.

So I do believe that we need to look at that, given that provision, since we impose that on the District for good reason. By the way, that is something that I totally agreed with, when the contracting power was—had constraints on it. Only the Mayor had it; there was no Control Board. I totally agreed with it; that was a fail-safe that was necessary.

Now you have described a whole set of constraints that are there, and this is the kind of thing that I think we ought to look at, government ought to look at itself continually to say things like, is the constraint that we put in 5 years ago for a purpose still needed, or is it doing more harm than good. I haven't heard value added here, and I think that's something that the Congress itself should look at.

Thank you very much, Madam Chair, I have no further questions.

Mrs. MORELLA. Thank you, Congresswoman Norton.

I didn't ask you anything, Mr. Wyner, but may I just have for the record your response to the Council's legislative draft?

Mr. WYNER. We think that it's strong. In broad-brush strokes, we think it covers most of the areas that need to be covered. We think there are several improvements that need to be made.

As mentioned, we think that the Council should not review contracts. We believe that fiscal impact statements should be reviewed by the CFO before being signed by the Mayor. We think that the two-thirds requirement in the Council again is overly political. And probably—I mean, if you imagine a scenario where the Mayor has decided to remove a CFO for cause, and we believe the standard should not be what's in the D.C. municipal regulations now, but cause with real teeth, and then it has to go before the Council and two-thirds of them have to say, well—

Mrs. MORELLA. Let me interrupt. In fact, it even says “two-thirds of those present and voting.” I mean, I could imagine that you have someone who might be there who does not vote and you might have one person who shows up. I mean—go on.

Mr. WYNER. It just strikes us that is a recipe for politicizing this.

And then, finally, we actually think in other respects the CFO needs greater independence for legal counsel, for setting the salary for agency CFOs, at least over the next 2 years, for procurement and personnel to transition back to centralize the systems. But we think those are relatively small changes.

They’re important, but if you look at most of the provisions, in 90 percent of the cases we’re in agreement with the Council, and we’re pleased that they’ve stepped forward and taken a role in this. And we think that they’ve gotten it right in most respects.

Mrs. MORELLA. I want to thank all of you for your patience in waiting. I know everybody is probably very hungry, but we have gotten a lot of nourishment from your offerings today. Thank you for your commitment to the fiscal and financial and social well-being of the District of Columbia. Dr. Gandhi, Mr. Maddox, Mr. Wyner, Ms. Boicourt and Mr. Young, we very much appreciate your testimony. We may be asking you questions.

So as I adjourn the joint subcommittee’s hearing, let me just acknowledge staff: Senator Voinovich’s staff, Andrew Richardson, Mason Alinger, Julie Vincent; Delegate Norton’s staff, Jon Bouker, Cheryl Williams; Senator Durbin’s staff, Marianne Upton; Congressman Davis’ staff, Howard Dennis, Melissa Wojciak, Victoria Proctor; my staff, Russell Smith, staff director, Matthew Batt, Robert White, Heea Vazirani-Fales, Jean Gosa, and Andrea Abrams. We gave you the whole list. So I want to thank all of you again and look forward to working with you.

So the subcommittee is now adjourned.

[Whereupon, at 2:23 p.m., the joint subcommittees were adjourned.]

