FISCAL YEAR 1997 DISTRICT OF COLUMBIA AUDIT REPORT AND CFO OVERSIGHT

HEARING

BEFORE THE

SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

FEBRUARY 11, 1998

Serial No. 105–126

Printed for the use of the Committee on Government Reform and Oversight

U.S. GOVERNMENT PRINTING OFFICE

49–284 CC WASHINGTON : 1998

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-057172-3

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

DAN BURTON, Indiana, *Chairman*

BENJAMIN A. GILMAN, New York
J. DENNIS HASTERT, Illinois
CONSTANCE A. MORELLA, Maryland
CHRISTOPHER SHAYS, Connecticut
STEVEN SCHIFF, New Mexico
CHRISTOPHER COX, California
ILEANA ROS-LEHTINEN, Florida
JOHN M. McHUGH, New York
STEPHEN HORN, California
JOHN L. MICA, Florida
THOMAS M. DAVIS, Virginia
DAVID M. McINTOSH, Indiana
MARK E. SOUDER, Indiana
JOE SCARBOROUGH, Florida
JOHN B. SHADEGG, Arizona
STEVEN C. LATOURETTE, Ohio
MARSHALL "MARK" SANFORD, South Carolina
JOHN E. SUNUNU, New Hampshire
PETE SESSIONS, Texas
MICHAEL PAPPAS, New Jersey
VINCE SNOWBARGER, Kansas
BOB BARR, Georgia
DAN MILLER, Florida

HENRY A. WAXMAN, California
TOM LANTOS, California
ROBERT E. WISE, JR., West Virginia
MAJOR R. OWENS, New York
EDOLPHUS TOWNS, New York
PAUL E. KANJORSKI, Pennsylvania
GARY A. CONDIT, California
CAROLYN B. MALONEY, New York
THOMAS M. BARRETT, Wisconsin
ELEANOR HOLMES NORTON, Washington, DC
CHAKA FATTAH, Pennsylvania
ELIJAH E CUMMINGS, Maryland
DENNIS J KUCINICH, Ohio
ROD R BLAGOJEVICH, Illinois
DANNY K. DAVIS, Illinois
JOHN F. TIERNEY, Massachusetts
JIM TURNER, Texas
THOMAS H. ALLEN, Maine
HAROLD E. FORD, JR., Tennessee

BERNARD SANDERS, Vermont (Independent)

KEVIN BINGER, *Staff Director*
DANIEL R. MOLL, *Deputy Staff Director*
WILLIAM MOSCHELLA, *Deputy Counsel and Parliamentarian*
JUDITH McCOY, *Chief Clerk*
PHIL SCHILIRO, *Minority Staff Director*

SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA

THOMAS M. DAVIS, Virginia, *Chairman*

CONSTANCE A. MORELLA, Maryland
ILEANA ROS-LEHTINEN, Florida
STEPHEN HORN, California

ELEANOR HOLMES NORTON, District of Columbia
THOMAS H. ALLEN, Maine

EX OFFICIO

DAN BURTON, Indiana

HENRY A. WAXMAN, California

RON HAMM, *Staff Director*
HOWARD DENIS, *Counsel*
ANNE MACK, *Professional Staff Member*
ELLEN BROWN, *Clerk*
CEDRIC HENDRICKS, *Minority Counsel*

CONTENTS

	Page
Hearing held on February 11, 1998	1
Statement of:	
DeSeve, G. Edward, Acting Deputy Director for Management and Controller, Office of Management and Budget	11
Farrell, John A., partner, KPMG Peat Marwick LLP, accompanied by John Reagan and Ronald Saluzzo; Marion Barry, Jr., Mayor of the District of Columbia; Linda Cropp, chair, District of Columbia City Council; Andrew Brimmer, chairman, D.C. Financial Responsibility and Management Assistance Authority, accompanied by Daniel A. Rezneck, general counsel; and Anthony Williams, Chief Financial Officer, District of Columbia	27
Letters, statements, etc., submitted for the record by:	
Barry, Marion, Jr., Mayor of the District of Columbia, prepared statement of	40
Brimmer, Andrew, chairman, D.C. Financial Responsibility and Management Assistance Authority, prepared statement of	62
Cropp, Linda, chair, District of Columbia City Council, prepared statement of	54
Davis, Hon. Thomas M., a Representative in Congress from the State of Virginia, prepared statement of	2
DeSeve, G. Edward, Acting Deputy Director for Management and Controller, Office of Management and Budget, prepared statement of	14
Farrell, John A., partner, KPMG Peat Marwick LLP, prepared statement of and the Independent Auditors' Report	30
Norton, Eleanor Holmes, a Representative in Congress from the District of Columbia, prepared statement of	8
Williams, Anthony, Chief Financial Officer, District of Columbia, prepared statement of	76

FISCAL YEAR 1997 DISTRICT OF COLUMBIA AUDIT REPORT AND CFO OVERSIGHT

WEDNESDAY, FEBRUARY 11, 1998

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Thomas M. Davis (chairman of the subcommittee) presiding.

Present: Representatives Davis, Morella, Horn, Holmes Norton, and Allen.

Staff present: Ron Hamm, staff director; Howard Denis, counsel; Anne Mack, professional staff member; Ellen Brown, clerk; and Cedric Hendricks, minority counsel.

Mr. DAVIS. Good morning and welcome. This oversight hearing this year is going to review the District of Columbia audit for fiscal year 1997, which ended September 30, 1997. We will also review the Office of Chief Financial Officer for the District of Columbia, an office created under the legislation which came from this subcommittee in 1995, the first year I was honored to be named as chairman.

I have a fairly lengthy statement that I will ask unanimous consent to be inserted into the record.

Without objection, so ordered.

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

DAN BURTON, INDIANA
CHAIRMAN
BENJAMIN A. GILMAN, NEW YORK
J. DENNIS HASTERT, ILLINOIS
CONSTANCE A. MORELLA, MARYLAND
CHRISTOPHER SHAYS, CONNECTICUT
STEVEN SCHIFF, NEW MEXICO
CHRISTOPHER COX, CALIFORNIA
ILEANA ROS-LEHTINEN, FLORIDA
JIM McHUGH, NEW YORK
PHIL ENGLISH, PENNSYLVANIA
JOR L. MICA, FLORIDA
THOMAS M. DAVIS III, VIRGINIA
DAVID M. McINTOSH, INDIANA
MARK E. SOUDER, INDIANA
JOE SCARBOROUGH, FLORIDA
JOHN SHADEGG, ARIZONA
STEVE C. LaTOURNETTE, OHIO
MARSHALL "MARK" SANFORD, SOUTH CAROLINA
JOHN E. SUNUNU, NEW HAMPSHIRE
PETE SESSIONS, TEXAS
MIKE PAPPAS, NEW JERSEY
VINCE SNOWBARGER, KANSAS
BOB BARR, GEORGIA
ROB PORTMAN, OHIO

ONE HUNDRED FIFTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

2157 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515–6143

MAJORITY (202) 225-5074
MINORITY (202) 225-5051
TTY (202) 225-6852

HENRY A. WAXMAN, CALIFORNIA
RANKING MINORITY MEMBER
TOM LANTOS, CALIFORNIA
ROB WISE, WEST VIRGINIA
MAJOR R. OWENS, NEW YORK
EDOLPHUS TOWNS, NEW YORK
PAUL E. KANJORSKI, PENNSYLVANIA
GARY A. CONDIT, CALIFORNIA
CAROLYN B. MALONEY, NEW YORK
THOMAS M. BARRETT, WISCONSIN
ELEANOR HOLMES NORTON
DISTRICT OF COLUMBIA
CHAKA FATTAH, PENNSYLVANIA
ELIJAH E. CUMMINGS, MARYLAND
DENNIS KUCINICH, OHIO
ROD R. BLAGOJEVICH, ILLINOIS
DANNY K. DAVIS, ILLINOIS
JOHN F. TIERNEY, MASSACHUSETTS
JIM TURNER, TEXAS
THOMAS H. ALLEN, MAINE
HAROLD E. FORD JR., TENNESSEE

BERNARD SANDERS, VERMONT
INDEPENDENT

REP. TOM DAVIS
CHAIRMAN, D.C. SUBCOMMITTEE
FEBRUARY 11, 1998
OPENING STATEMENT

Good morning and welcome. This oversight hearing will review the annual District of Columbia Audit for Fiscal Year 1997, which ended on September 30, 1997. We will also review the Office of Chief Financial Officer for the District of Columbia, an Office created under legislation which came from this Subcommittee in 1995, the first year I was honored to be named as Chairman. The Audit, known as the Comprehensive Annual Financial Review, or "CAFR", is by law presented to Congress by the CFO.

When Congress created the Control Board and the position of CFO for the District there were very real concerns that the City might run out of cash to meet debt service and payroll. The City's bond rating had slipped to "junk" status. The seriousness of the District's crisis was apparent to all. The House Leadership, along with this Subcommittee, did not hesitate to move quickly to save the City.We preserved "home rule" by helping the District find ways to rescue itself from fiscal and financial disaster. We did this in a non-partisan way, with the active involvement and full cooperation of the Ranking Member of this Subcommittee, Delegate Eleanor Holmes Norton.

This Hearing is about more than just looking at the CAFR and the

CFO. The Control Board law passed by Congress completely revised the District's budget process. It was our intention that the CFO work from within the City government. We thus provided the opening necessary for dealing with the District's cash and short-term budget problems.

During the past 3 years the CFO, the Control Board, and the City have had time to get used to each other and go through several rounds of resolving the differences that are a natural part of such a large undertaking. It is not and has never been the Subcommittee's intent to involve itself in micro-managing the relationship between the City, the CFO, and the Control Board. Had it been our intention to go down that road we would not have needed the Control Board or the CFO at all. Rather it was our intent to monitor the situation, in accordance with our Constitutional mandate. We have also remained prepared to resolve any major problems in the underlying law or its implementation if necessary.

The Annual Audit is a key milestone. Each year we have looked to it to gauge the progress that has been made and to look to the future. Policy choices can only have meaning if they are based on accurate financial data. Local officials must consider and account for the full costs of their policies before they act. This year's Audit shows that considerable progress has been made. It gives us cause for optimism that we are on the right path to sustained economic recovery and financial stability in the District.

The Control Board's most important job is to work itself out of a job. The periodic discussions over how long the Control Board is to remain in existence simply emphasizes the fact that the law itself was designed to deal with an emergency situation for a relatively short period of time.

While the Control Board law was passed in April, 1995, the Chief

Financial Officer was not appointed until October of that year. Those were very critical months, and it was necessary to play catch-up in a hurry under stressful conditions. The lack of reliable financial and managerial information created an unfortunate atmosphere that took additional time to resolve.

Today we have a different set of concerns. I believe that the vast majority of today's problems can be resolved between the parties themselves, specifically the Control Board, the CFO, and the City.

The CFO has a special relationship with the Control Board. During a "control year" the CFO supervises and performs all of the financial responsibilities of the Mayor as well as those normally delegated to a CFO. These include all tax collections and assessment, bill paying, approving contracts, allocating available money in compliance with appropriations, and ensuring that the budget is adhered to.

Unlike the Control Board, the Chief Financial Officer is an organic part of the District government. It is a permanent position with significant zones of independence. Specific areas of cooperation were carefully written into the law. That way policy decisions can be made with accurate information on costs, benefits, and options.

I am optimistic that the steady progress that has been made, as reflected in the Audit, will help to give the District of Columbia a period of stability so that key reforms can be completed and others commenced. I will continue to do all that I can to accelerate the significant progress that has already occurred.

Mr. DAVIS. Any other Members' statements may be included. I know Ms. Norton will want to say a few things.

I just want to say that the annual audit is a milestone. Each year we look at it to gauge the result that has been made, to look to the future.

The Control Board's most important job is to work itself out of a job. The periodic discussion over how long the Control Board is going to remain in existence simply emphasizes the fact that the law itself was designed to deal with an emergency situation for a relatively short period of time. When we first passed this legislation in 1995, the CFO was not appointed until the following October. Those were very critical months. It was necessary to play catch-up, and today I am proud to say we have a different set of concerns.

Those concerns are expressed more appropriately in the statement I have put together and in some questions we will be asking as we move through this hearing, but we want to hear from our first witnesses. Mr. DeSeve I know has other obligations in the White House.

Mr. DeSeve, we are happy to have you today. But before I call you up, let me yield to Ms. Norton for a statement.

Ms. NORTON. Mr. Chairman, I am particularly appreciative that you called this hearing to tell a very big good news story about the District. The general spending results confirmed by the 1995 audit confirm a $185.9 million operating surplus for the District, instead of the $74 million deficit that had been predicted.

For those who say this long-awaited and surprising turnaround may be due to conservative forecasting and budgeting, I say if it is true, the District deserves praise twice over, first for the surplus and second for prudent budgeting. After all, who can forget that it was wildly optimistic projections that ran the District into the ground, into bankruptcy.

CFO Tony Williams, Deputy CFO Earl Cabbell, Deputy CFO Natwar Gandhi and the entire staff deserve both personal praise for themselves and for their organizations. Congratulations are due as well to the many other hands that pulled these oars, including Mayor Barry, the City Council and the Control Board, each of whom worked individually and then together to help bring about these results.

To the credit of all concerned, the self-congratulation in the District is being tempered by the understanding that consistency and stability are the major financial tests the District has to meet, including 4 consecutive balanced budgets. The city understands that it must demonstrate that the city's financial condition is a result of systemic change that assures continuing improvement and permanent solvency.

Nearly $100 million of the general fund surplus is not what we must look to in assessing permanent recovery, because this amount consists of one-time, nonrecurrent items. On the other hand, the $110.9 million surplus from increased revenue gives a very hopeful and positive assessment of the city's financial improvement and is very welcome indeed.

However, about $65 million of this almost $111 million surplus comes from an unusually strong economy and Wall Street, sources

that historically are cyclical and unpredictable. The remaining $35 million of surplus comes from aggressive tax collection. That strong ongoing effort promises increased returns in future years. Considering these sources, however, the District understands that the city will remain dependent on strict financial discipline and controls as the only reliable approach to permanent financial stability and return of Home Rule.

There is one disturbing feature embedded in the "other" surplus, a local surplus of $41.5 million. About half of this surplus apparently should have been spent, including badly needed funds for employee training and for contracts for services for the city's poor. Most of these funds apparently were not spent because of the continuing deficiencies in city operations, including procurement and other aspects of contracting. These factors show we cannot and must not be lost, the inescapable link between services and finances.

To emphasize the services side of the equation, I put upon the table the possibility, however remote, that Congress was capable of reneging on its promise to return Home Rule after 4 balanced budgets. I voice this possibility not because I expect it but because I have seen such reneging by this body before, most recently in the anti-Home Rule Faircloth attachment involving management reform of nine agencies.

Because I represent the District in this body, I believed it was my obligation to bring the largely unattended problems of improving service delivery and restructuring the government forward now in order to ensure that these would never be put forward by the Congress in the future. We can prevent these issues from delaying the return of Home Rule now, since we might not be able to stop Congress later.

At the same time, I know I can say without fear of contradiction that Congress on both sides of the aisle is sure to be pleased by the plateau we have now reached. I can assure residents that no one here is plotting against the District yet. In order to renege on the 4-year Home Rule return commitment, the active acquiescence of the Speaker of the House and the Majority Leader of the Senate and the chairman of this subcommittee will be required. I work with these Members and do not expect their acquiescence. Members of Congress are not even thinking about the future of the District 3 years off.

Moreover, Chairman Davis and I were able to engage in negotiations to pass a Control Board bill that left Home Rule entirely intact. Since then, Chairman Davis has kept to our original Home Rule understanding, although of course this has not always been true of other Members. Bear this in mind, however, that even the very substantial changes made by the Appropriations Subcommittee and by Senator Faircloth came only after long periods of conflict between the Control Board and city officials or inaction by both.

I have every reason to believe that given the dire consequences to Home Rule the city has suffered as a result, no one in the District will be playing chicken with Congress. Although I never put all my trust in Congress when it comes to the District, all the signs are very positive that the District is doing what is necessary over

the next 3 years to deprive the Congress of reasons to renege on the return of Home Rule.

In the meantime, I intend to embark on a continuing effort to spread the good news throughout the House and Senate. Congress will adjourn for the President's Day recess tomorrow and will return on February 24th. That day, I will begin a campaign to inform and educate Congress about progress as it is made, beginning with the healthy 1997 surplus. I met with members of the D.C. City Council last week and proposed to them that I go on the floor on a regular basis to describe the progress, so Members of Congress will have a sense of the continuing change and improvement that is not always apparent or covered in the press. I have proposed this, have been saying the same to the Mayor.

I also will be doing informational "Dear Colleagues," including one on today's surplus. These "Dear Colleagues" will describe the work of the Council, the Mayor, and the Control Board on a regular basis. I hope to go on the floor at least once a week to describe both small and large improvements in services, finances, and Council activity in the District.

By the time the 3 years are up, therefore, the Congress shall have heard so much good news about the District that Members will have an offer, I believe, they simply cannot refuse. Congress has no trouble getting bad news. I intend to make it difficult to ignore the District's good news. I welcome today's witnesses who come bearing that good news.

Thank you, Mr. Chairman.

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

ELEANOR HOLMES NORTON
DISTRICT OF COLUMBIA

COMMITTEE ON
TRANSPORTATION AND
INFRASTRUCTURE

SUBCOMMITTEES
SURFACE TRANSPORTATION
PUBLIC BUILDINGS AND
ECONOMIC DEVELOPMENT

Congress of the United States
House of Representatives
Washington, D.C. 20515

COMMITTEE ON
GOVERNMENT REFORM AND
OVERSIGHT

SUBCOMMITTEE
RANKING MINORITY MEMBER,
DISTRICT OF COLUMBIA

CIVIL SERVICE

CO-CHAIR
CONGRESSIONAL CAUCUS FOR
WOMEN'S ISSUES

STATEMENT OF CONGRESSWOMAN ELEANOR HOLMES NORTON AT A D.C. SUBCOMMITTEE OVERSIGHT HEARING ON THE DISTRICT OF COLUMBIA COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) AND THE OFFICE OF THE CHIEF FINANCIAL OFFICER

February 11, 1998

The genuinely splendid results confirmed by the 1997 audit confirm a $185.9 million operating surplus for the District instead of the $74 million deficit that had been predicted. For those who say that such a large and surprising turnaround may be partly due to conservative forecasting and budgeting, I say that, if true, the District deserves praise twice over -- first for the surplus and second for prudent budgeting. After all, who can forget that it was wildly optimistic projections that ran the District aground into bankruptcy? CFO Tony Williams, Deputy CFO Earl Cabbell, Deputy CFO Natwar Gandhi and the entire staff deserve both personal praise for themselves and gratitude from District officials and residents. Congratulations are due as well to the many other hands that pulled these oars, including Mayor Barry, the City Council and the control board -- each of whom worked individually and then together to help bring about these results.

To the credit of all concerned, the self congratulation in the District is being tempered by the understanding that consistency and stability are the major financial tests the District has to meet, including four consecutive balanced budgets. The city understands that it must demonstrate that the city's financial condition is the result of systemic change that assures continuing improvement and permanent solvency.

Nearly $100 million of the general fund surplus is not what we must look to in assessing permanent recovery, because this amount consists of one-time, non-recurrent items. On the other hand, the $110.9 million surplus from increased revenue gives a very hopeful and positive assessment of the city's financial improvement and is very welcome indeed. However, about $65 million of this almost $111 million surplus comes from a strong economy and Wall Street, sources that historically are cyclical and unpredictable. The remaining $35 million of the surplus comes from aggressive tax collection. That strong ongoing effort promises increased returns in future years. Considering these sources, however, the District understands that the city will remain dependent on strict financial discipline and controls as the only reliable approach to permanent financial stability and the return of home rule.

There is one disturbing feature imbedded in the "other" surplus -- a local surplus of $41.5

815 5TH STREET N.W. SUITE 100
WASHINGTON, D.C. 20005-2[illegible]
(202) 783-[illegible]
[illegible]

1424 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515-5101
(202) 225-8060
(202) 225-[illegible] (FAX)
(202) 225-7829 (TDD)

2041 MARTIN L. KING AVENUE, S.E.
SUITE 300
WASHINGTON, D.C. 20020-5734
(202) 678-8800
(202) 678-8844 (FAX)

million. About half this surplus apparently should have been spent, including badly needed funds for employee training and for contracts for services for the city's poor. Most of these funds apparently were not spent because of continuing deficiencies in city operations, including procurement and other aspects of contracting. These factors show what cannot and must not be lost -- the inescapable link between services and finances.

To emphasize the services side of this equation, I put on the table last week the possibility, however remote, that Congress was capable of reneging on its promise to return home rule after four balanced budgets. I voiced this possibility not because I expect it but because I have seen such reneging by this body before, most recently in the anti-home rule Faircloth attachment involving management reform of nine agencies. Because I represent the District in this body, I believed it was my obligation to bring the largely unattended problems of improving service delivery and restructuring the government forward now in order to ensure that it would never be put forward by the Congress in the future. We can prevent the issues from delaying the return of home rule now. We might not be able to stop Congress later.

At the same time, I know I can say without fear of contradiction that Members on both sides of the aisle are sure to be pleased by the plateau we have now reached. I can assure residents that no one here is plotting against the District -- yet. In order to renege on the four-year home rule return commitment, the active acquiescence of the Speaker of the House, the Majority Leader of the Senate and the chairman of this subcommittee would be required. I work with these Members and do not expect their acquiescence. Members of Congress are not even thinking about the future of the District three years off. Moreover, Chairman Davis and I were able to engage in negotiations to pass a control board bill that left home rule intact. Since then, Chairman Davis has kept to our original home rule understanding, although, of course, this has not always been true of the other Members. Bear in mind, however, that even the very substantial changes made by the appropriations subcommittee and by Senator Faircloth came only after long periods of conflict between the control board and city officials or inaction by both. I have every reason to believe that given the dire consequences to home rule the city has suffered as a result, no one in the District will be playing chicken with the Congress. Although I never put all my trust in the Congress when it comes to the District, all the signs are very positive that the District in doing what is necessary over the next three years to deprive the Congress of reasons to renege on the return of home rule.

In the meantime, I intend to embark on a continuing effort to spread the good news throughout the House and the Senate. Congress will adjourn for President's Day recess tomorrow and will return on February 24th. That day, I will begin a campaign to inform and educate the Congress about progress as it is made, beginning with the healthy 1997 surplus. I met with members of the D.C. City Council last week and proposed to them that I go on the floor on a regular basis to describe the progress so Members of Congress will have a sense of the continuing change and improvement that is not always apparent or covered in the press. I have proposed the same to the Mayor. I also will be sending informational "Dear Colleagues" including one about today's surplus. These "Dear Colleagues" will describe the work of the

Council, the Mayor and the control board on a regular basis. I hope to go on the floor at least once a week to describe both small and large improvements in services, finances, and Council activity in the District. By the time the three years are up, therefore, the Congress shall have heard so much good news about the District that Members will have an offer they simply can't refuse.

Congress has no trouble getting the bad news. I intend to make it difficult to ignore the District's good news. I welcome today's witnesses who come bearing that news.

Mr. DAVIS. Ms. Norton, thank you.

Are there any other Members who would like to make a statement? We will be happy to put their statements in the record.

I would call our first witness to testify, the Honorable Edward DeSeve, Acting Deputy Director of the Office of Management and Budget. As you know it is a policy for witnesses to be sworn before they can testify.

[Witness sworn.]

Mr. DAVIS. Ed, we will put your whole statement in the record. We would like to get through the questions as quickly as possible. We don't want to constrain you from presenting what you feel appropriate, but try to limit yourself, then we can move through our questions and include your whole statement. I ask unanimous consent that it be put in the record.

STATEMENT OF G. EDWARD DeSEVE, ACTING DEPUTY DIRECTOR FOR MANAGEMENT AND CONTROLLER, OFFICE OF MANAGEMENT AND BUDGET

Mr. DESEVE. Thank you very much, Mr. Chairman, for inviting me here to speak with you about the current financial situation of the District of Columbia.

Mr. DAVIS. Let me just say one other thing. The OMB has been a very key component, not at the White House, but in bringing this back, the District. I think I would be remiss if I didn't say the same for your former bosses, both Alice Rivlin and Frank Raines. You have played key roles in this. It has been a very good partnership. We appreciate the efforts you have brought to date, and we look forward to your testimony.

Mr. DESEVE. Thank you very much, Mr. Chairman. As you will see, we will continue those efforts as well.

Today we find ourselves at the end of the beginning. The committee's foresight and hard work are paying off. In early 1993 you recognized the problems facing the District, and then again in 1997 you acted swiftly to provide solutions to these problems. The Clinton administration has been a partner with you, the city government, the Financial Responsibility Authority, and others in Congress in implementing these solutions to maintain the financial integrity of the District, to assure its liquidity and rapid return to public credit markets.

For example, since 1997 the U.S. Treasury has provided short-term advances to the District totaling $749 million for operating and capital purposes. This lending allowed the District to meet obligations on a timely basis with no threat of financial default. This backstop reassured the credit markets and allowed the District access to long and short-term credit while the underlying problems were being resolved.

The comprehensive annual financial report of the District, as of September 30, 1995, shows the results of the work of this committee and its other governmental partners. On a GAAP basis the District posted a fiscal year 1995 surplus of $185,892,000, including a significant Medicaid accrual adjustment. On a budgetary basis—that is, annual revenues minus annual expenditures—the District posted a surplus of $108,876,000. I focus on the budgetary basis because it best represents the going forward position of the District

and will be the foundation for the fiscal year 1999 District budget which will be presented soon.

As others will testify, the surplus reflects the effects of the expenditure controls that the legislation initiated by this committee contemplated, as well as a strong general economic climate. The improvement in the cumulative fund balance of the District reduces its cash needs and meets the test of continuous and substantial improvement in fund balance contemplated by the Financial Responsibility and Management Assistance Act of 1995.

All of this progress is before the effects of major work by this committee and others to enact the National Capital Revitalization and Self-Government Improvement Act of 1997. Current estimates indicate that the budgetary benefit of this act to the District will be in excess of $230 million, that is net, for fiscal year 1998, and are estimated to grow to $290 million, by fiscal year 2002. I have not seen a revised District budgetary plan that projects out 4 years, but would expect city and Authority officials to testify that the next several fiscal years are projected to be in surplus, thus fulfilling another test of the Financial Responsibility Act, i.e., annual surpluses beginning no later than fiscal year 1998.

All of this good financial news comes ahead of schedule. Now District officials and the Authority must make difficult strategic choices. How should revenue burdens be minimized and service delivery be maximized while eliminating structural imbalances and promoting the growth of the economy? The Clinton administration has never intervened in such local decisions. We have attempted to take on certain State-like functions and give the District a sound basis for managing its own affairs.

In furtherance of the goal of continued and sustainable economic growth in the District, President Clinton's fiscal year 1999 budget contains a proposal for $100 million in addition to the moneys contemplated in the Revitalization Act. This money would spur economic development by funding a locally chartered economic development corporation, provide moneys for transit improvements at a new convention center site, and further the work of the Authority and the District on management improvements. In addition, the Department of Education is providing an additional $20 million, to help the District schools implement reforms to improve student achievement.

Beyond these initiatives, the President's budget also contains increased funding for the cultural institutions that make the District uniquely attractive to tourists. As First Lady Hillary Rodham Clinton said recently, "Very few people leave or live in the District without paying a visit to our cultural and historical institutions. As we enter the millennium," she said, "they shed light on our creativity and innovation, on who we are and who we want to be. To preserve and strengthen them for the ages, the President's budget includes $1.5 billion, 9 percent more than in 1998."

The President said in his recent State of the Union Address, "Last year, this Congress took strong action to help the District of Columbia. Let us renew our resolve to make our capital city a great city for all who live and visit here."

The President, OMB Director Frank Raines, the First Lady, D.C. Task Force Director Carol Thompson-Cole, members of the Task

Force, a dedicated OMB staff, and other Federal employees join me in pledging to work with you to see that the District continues to achieve the goal of greatness the President has envisioned for it.

Thank you very much, Mr. Chairman. I would be happy to take your questions.

[The prepared statement of Mr. DeSeve follows:]

TESTIMONY February 11, 1998 DC Subcommittee

Thank you, Mr. Chairman, for inviting me here today to speak about the current financial situation of the District of Columbia.

Today we find ourselves at the end of the beginning. The Committee's foresight and hard work are paying off. In early 1993 you recognized the problems facing the District of Columbia and acted swiftly to provide solutions to these problems. The Clinton Administration has been a partner with you, the City government, the Financial Responsibility Authority and others in Congress in implementing these solutions to maintain the financial integrity of the District, to assure its liquidity and rapid return to the public credit markets.

For example, since 1995 the United States Treasury has provided short-term advances to the District totaling $749 million for operating and capital purposes. This lending allowed the District to meet obligations on a timely basis with no threat of financial default. This backstop reassured the credit markets and allowed the District access to long and short credit while the underlying problems were being resolved.

The Comprehensive Annual Financial Report of the District, as of September 30,1997, shows the results of the work of this Committee and its other governmental partners. On a

GAAP basis, the District posted a Fiscal year 1997 surplus of $185,892,000 including significant Medicaid accrual adjustments. On a budgetary basis - that is annual revenues minus annual expenditures - the District posted a surplus of $108,876,000. I focus on the budgetary basis because it best represents the going forward position of the District and will be the foundation for the fiscal year 1999 District budget which will be presented soon.

As others will testify, the surplus reflects the effects of the expenditure controls that the legislation initiated by this Committee contemplated as well as a strong general economic climate. The improvement in the cumulative fund balance of the City reduces its cash needs and meets the test of continuous and substantial improvement in fund balance contemplated by the Financial Responsibility and Management Assistance Act of 1995.

All of this progress is before the effects of major work by this Committee and others to enact the National Capital Revitalization and Self-Government Improvement Act of 1997. Current estimates indicate that the budgetary benefit of this Act to the District will be in excess of $230,000,000 for fiscal Year 1998 and are estimated to grow to $290,000,000 by fiscal year 2002. I have not seen a revised District budgetary plan but would expect City and Authority officials to testify that the next several fiscal years are in surplus. Thus fulfilling another test of the Financial Responsibility Act, i.e. annual surpluses beginning no later than Fiscal Year 1998.

All of this good financial news comes ahead of schedule. Now District officials and the Authority must make difficult strategic choices. How should revenue burdens be minimized and service delivery be maximized while eliminating structural imbalances and promoting the growth of the economy? The Clinton Administration has never intervened in such local decisions. We have attempted to take on certain state-like functions and give the District a sound basis for managing its own affairs.

In furtherance of the goal of continued and sustainable economic growth in the District, President Clinton's Fiscal Year 1999 budget contains a proposal for $100,000,000 in addition to the monies contemplated in the Revitalization Act . This money would spur economic development by funding a locally charted economic development corporation, provide monies to fund transit improvements at a new convention center site and further the work of the Authority and the District on management improvements. In addition the Department of Education is providing an additional $20,000,000 to help the District Schools implement reforms to improve student achievement.

Beyond these initiatives, the President's budget also contains increased funding for the cultural institutions that make the District uniquely attractive to tourists. As First Lady Hillary Rodham Clinton said recently, "Very few people leave or live in D.C. without paying a visit to our cultural and historical institutions. As we enter the millennium, they shed light on our

creativity and innovation, on who we are and who we want to be. To preserve and strengthen them for the ages, the President's budget includes $1.5 billion- - nine percent more than in 1998."

The President said in his recent State of the Union Address, "Last year, this Congress took strong action to help the District of Columbia. Let us renew our resolve to make our capital city a great city for all who live and visit here." OMB Director Frank Raines, D.C. Task Force Executive Director Carol Thompson-Cole, a dedicated OMB staff, and other Federal employees join me in pledging to work with you to see that the District continues to achieve the goal of greatness the President envisioned.

Mr. DAVIS. Thank you. I will start the questioning.

What do you think is the most important fiscal priority for the city today?

Mr. DESEVE. I had a sentence in my testimony that talked about balancing the desire to get the revenue structure right, revenue burden right, the desire to have spending priorities clearly established—and I can't tell you what those are, that is something the local officials have to work out—while at the same time being sure that economic growth in the District is promoted. It is a balancing act that all localities have to go through, and solving that and getting unanimous consent locally and then working with the Congress to enact that, I think is the first thing that has to be done. I think it is in the process of being done.

Mr. DAVIS. It is the same thing here in Congress. If we get a surplus, what do we do with the surplus here, put it to deficit reduction? Do you do the trust funds, Social Security, transportation? Do you do tax cuts? I think you are saying the city is going to struggle with the same thing.

Mr. DESEVE. That's right. I have not used any particular formulation.

Mr. DAVIS. We look forward to working with you all on that. We are certainly at a better juncture now. We have options that we didn't dream of at that point.

What do you think the significance is of the $185.9 million surplus?

Mr. DESEVE. I, like Ms. Norton, associated myself with a slightly different number. I look at the operating surplus revenues minus expenditures, because there are some accrual adjustments that are quite appropriate and fully in accordance with generally accepted accounting principles, but they don't add either to the city's cash position, nor do they provide a basis going forward for the kind of planning that one would want to do. So I think we focus on about a $108 million surplus when we think about that.

That is a tremendous achievement. It is an amazing achievement, and it is on both sides of the ledger. It is both expenditure control—and I was told, although I can't verify this that no single agency overspent its budget this year, others may testify to that—which is very, very, very positive, even in entitlement programs, where spending is very difficult to control because poor people are entitled to that money or that payment.

So I think that expenditure control being in place, a good economy—the forecasters of doom and gloom said that everybody was leaving the city. Well, they are not. Somebody is here and somebody is paying the income tax. I am very happy to see that.

Mr. DAVIS. I heard on the radio coming up this morning, driving in from Williamsburg, where we have a Republican retreat, that in point of fact home buying has increased with that first-time home buyers credit; that in fact the exits out of the city, we won't see the statistics yet——

Mr. DESEVE. I have to say this to you, that we are also seeing, in addition to people taking advantage of the credit, we are seeing a very active real estate market at the upper end as empty nesters are beginning to move back into Washington, DC. Folks who are not quite as worried about education for their children, which has

always been a problem, are moving back, and they are bringing their incomes with them, God bless them.

Mr. DAVIS. I think the zero cap gains, all of this is I think starting to take effect. The first step was to stabilize the budgetary, fiscal situation, and were it not for the increased scrutiny and oversight, not just from Congress but from the White House, and the assistance we have given the city leaders it appears to me that together we have arrested that trend.

Mr. DESEVE. We have to give the city leaders credit, too, Mr. Chairman. They have acted very responsibly, working with the Financial Responsibility Authority, to try to—and it has been very hard—to try to manage the expenditures and take advantage of the opportunity to get some of their house's elements in order.

Mr. DAVIS. We do have representatives from the city here today and we will have an opportunity to hear from them, but this is a partnership and sooner, hopefully, rather than later they will have almost the exclusive responsibility.

We have tried to work together with them to try to bring up the systems and the structures and know-how, where we are in a position to see the path clear for a long, long time, where Congress will literally have oversight and will not be coming in with a heavy hand. I think the fact that we have worked together well here, particularly in the last year but for 3 years now to bring this together, is of significance.

Ms. Norton, I just think it is important to say that we always seem to be leaning on the city, saying gee, the Control Board may not go away, but in point of fact my goal and your goal, and I think a lot of us have the same goal, is to get rid of this as quickly as we can. But we want to continue to not just keep the pressure on but act as a partner so we can continue to move ahead on these items, and we have to face a larger constituency in Congress that we have to answer to. To the extent that we have news like this, I think it helps us over the long term.

Let me just ask, Mr. DeSeve, your feeling of the significance of the change from a qualified to an unqualified, in the management letter.

Mr. DESEVE. I am spending the bulk of my life right now moving Federal agencies from qualified opinions to unqualified opinions. It is a multiyear project. We think it is incredibly important to restoring financial confidence in the District that qualifications be removed.

It doesn't mean that everything is right. Peat Marwick issued an internal control report as a companion to the audit, and there are items in there that the District will need to work very hard on, but it means that an independent accounting firm can look at the books and records, the systems underneath those books and records, and be satisfied that they have a basis for rendering a clean financial opinion. That is the sine qua non. That is the place where you start in Wall Street in analyzing things.

One of the reasons we have these opinions at all, these letters of financial statement at all, was in 1979 Congress did significant oversight of the city of New York and its troubles. And immediately following that, Wall Street investment banks and rating agencies

said, don't even bother coming up here unless you have a clean opinion.

I got the first clean opinion for Philadelphia in 1980. It was our first year out of the box. Price Waterhouse did our financials, because we were told you have to do this or we are not going to rate your bonds anymore. So this is a very important first step, and again, there is a lot more work to do.

Mr. DAVIS. All right. Thank you very much. I yield to our ranking member, Ms. Norton.

Ms. NORTON. Thank you, Mr. Chairman. Of course, we will be hearing from the chair of the City Council, but I want to note that Council Member David Catenya is going to arrive as well.

Mr. Chairman, I appreciate and want to associate myself right now with the remarks you made in your opening statement, that the Control Board's most important job is to work itself out of a job, with periodic discussions over how long the Control Board is to remain in existence simply emphasizing the fact that the law itself was designed to deal with an emergency situation for a relatively short period of time.

To its credit, the chairman has always in fact held to that understanding and protected Home Rule. I want to say to him right here and now that I appreciate it, and look forward to joining him in partnership as we wave bye-bye to the Control Board.

I particularly have to thank this witness, Mr. DeSeve, because of the enormous help he has been to the District. I can only say that if I was in his shoes, or anybody in the District, he would have been given more help, because he would have had a hard time continuing to work for OMB. He has the most valuable knowledge perhaps in the city.

Mr. DESEVE. Mr. Horn requires me to stay here. We will find that out tomorrow.

Ms. NORTON. There is nobody who has better knowledge and understanding of all the factors necessary to put the city back together. He was there in Philadelphia, they did it, they were back and running, and the city has underused them. I know the OMB would have pulled back, but I wouldn't have been riding that tug-of-war, and I hope you will remain available to the District as it goes into this closing stretch.

Let me just say for the record that the legacy of the President's rescue package, on which you worked so diligently, is going to be noted in history right up there with his major reform in Reinventing Government, for example, and other such major reforms. The District would have blown up, imploded and exploded at the same time, in 2004, without the pension reform.

No one in the District expected this to take off. It was going to be basically a campaign issue, a rhetorical issue. The fact that this President did it is one of the two or three most historic actions by anybody in the whole 20th century for the District. I want to say once again how important it was for the—to the District and how much I appreciate your efforts, as well as that of the President.

At a recent hearing Dr. Brimmer testified and we have since confirmed that the administration is not covering its fair share of costs of incarcerating these prisoners. He testified that there is a $30 million shortfall in the current fiscal year and a $40 million short-

fall predicted for fiscal year 1999, so then we got him and the committee believing that those are the figures.

We can understand how that mistake could have been made. When mistakes are made like that by the administration, what happens is a supplemental, so I will put you on notice that I will be asking the administration for a supplemental. I understand there is a difference between you and the Federal Bureau of Prisons, the Federal Bureau of Prisons and CFO, on how this shortfall is calculated. I wonder if OMB is involved in this dispute at all, or if it is up to you to resolve just how much this shortfall is in this fiscal year, already into this year, and the next fiscal year.

Mr. DESEVE. I will be happy to try to help as much as I can, Ms. Norton. I believe what we are trying to do is fully fund the requests the trustee makes, as I understand it. I will be happy to give you the detailed information on that so that you can continue to do your oversight.

Ms. NORTON. You don't know if the trustee has made the request for a supplemental?

Mr. DESEVE. I do not know that, but I will certainly examine that and find out.

Ms. NORTON. Thank you. A privatization study was required by the Revitalization Act. Could you tell us the status of the prison privatization study that was required?

Mr. DESEVE. I don't know the answer to that. I believe it is underway, but let me again find that out and get you that information for the record. At OMB I have other people who actually work on that one. I will find that out.

Ms. NORTON. Thank you. Now, as you know, Mr. DeSeve, one of the things we had the most difficulty with in the last days of the Revitalization Act as it was going through was whether we could get pensions through, and they literally slipped through our fingers hundreds of times. The Senate was just not going to go there. It is another miracle that this passed. Only with the unwillingness of the administration to trade it off for anything could this possibly have taken place. It was very hard to keep it there.

What we are confronted with now is that the Federal Government is not about to spend the kind of money that the budget bill requires, because of the configuration of that bill, not because this is what pensions ought to cost the Federal Government. I will have to, working with the chairman, draw a bill soon. The Treasury Department was to study alternative ways for Treasury to finance the unfunded pension liability that was required.

Could you tell us the status of that very important study before the Senate jumps up and down and tries to do its own?

Mr. DESEVE. I talked to Treasury within the last week and I will be meeting with them again next week on this. They have the Request for Proposal rating and they have the people identified who will be doing the study. They have the scope of work outlined in that study. I anticipate that going forward very shortly and being done in a timely manner.

Ms. NORTON. Thank you.

Mr. Chairman, I have one more question. It is about this matter that caused so much trouble during the appropriation period last time. That was the differences between the District and the appro-

priations subcommittee on a financial management system. It was one of the factors that held up the appropriation and was the most stormy. GAO in fact has looked at this matter and has been critical.

We sided with the District, of course. We don't see how we could go forward without a new financial management operation. But the GAO said that the District had not fully developed the concept and that the requirement definitions were incomplete. Therefore, the GAO never said we needed or did not need a new financial management system. It simply said it couldn't tell because the work was incomplete.

I wonder if you have a comment on the position taken by GAO and the progress, if any, that the District has made in meeting these requirements.

Mr. DESEVE. I am very sympathetic to GAO's position, and again, in Federal agencies, as Mr. Horn knows, we are very careful and meticulous about how we do some of these things. One of the reasons for that is that commercial off-the-shelf software has not been long developed. There is not a long history of it in the Federal Government. Alternatively, in State and local governments there have for a very long period of time been commercial off-the-shelf packages.

What I was able to do, working with District officials, involving our colleagues in House Appropriations, involving the GAO, is try to last year set up a process by which the request for proposal and then the award of the contract would be accommodated within a schedule. We started last February, looking at the broad criteria for analyzing the District's position at that moment, that is, what their existing system looked like, and I think we got some agreement on alternatives at that point.

That was then put out for bid, I believe last August. An award of contract was made on schedule in August. The firm of Peat Marwick Mitchell—KPMG—was awarded the contract. It is my understanding there are two pilots currently operational on a parallel basis in the education area and in the police area. I want to ask District officials that. But they have begun the operational testing of pilots in those areas.

They are putting in a system that I put in in Philadelphia, again, in 1980. It was at that time called FAMOUS. I believe the version they are putting in here is called STARS, because it is a State-level system they are using as opposed to a purely local system. I have not done the research, but it is used in many, many, agencies. NASA just awarded a contract to KPMG. There are vendors out there. I'm just saying it is used in the Federal Government as well, a modified STAR system will be used. I guess it is probably appropriate for there to be a STAR system at NASA, but they will be installing that as well. So I think they made a very good choice of going with the commercial off-the-shelf products.

There are other vendors they could have chosen; other vendors competed. I had no involvement in the choice of vendor A versus vendor B versus vendor C. I fully expect we will have an operational system on schedule. So far everything has been on schedule. I don't monitor it continuously, but I have heard nothing to the contrary.

Ms. NORTON. You do believe the District is on the right track as it goes toward a new financial management system?

Mr. DESEVE. Yes. I think the decisionmaking process was a good one. What GAO was saying is they would have liked more definition, more front-end planning and so on. That is really quite appropriate of Federal agencies.

If you look at what NASA did over probably almost a 2-year period, they spent about 2 years planning the system, planning the procurement, setting up the selection criteria, because there really wasn't a good prototype for them. There have been lots of prototypes out there in State and local governments, in State governments, so I think the level of planning in the city was quite appropriate.

Ms. NORTON. Thank you very much, Mr. DeSeve. Again, thank you for all your hard work for the District.

Thank you Mr. Chairman.

Mr. DAVIS. Thank you.

The gentleman from California, Mr. Horn.

Mr. HORN. Thank you very much, Mr. Chairman.

You obviously have been a key player in this. We appreciate the hard work you have done to help reform the District. You mentioned some aspects of the reform of the financial management system just now. What are some of the other aspects that you think need to be done to really get a proper financial management system, and how far along do you think the District is, and where else do we have to go?

Mr. DESEVE. Again, I want to indicate that I don't have the same level of oversight of the District that I might have of the other Federal agencies that you are familiar with. I do have some good information and experience watching the Chief Financial Officer take on a very activist role by going into the agencies and putting in place controllers in each of the agencies who have a direct reporting relationship, not a dotted line reporting relationship but a direct reporting relationship to him. Thus, the process for feeding the central system the data is also in place.

I think the continuation and strengthening of controllerships in each of the departments—a young man who used to work for me, who is temporarily the controller in the police department, he developed a very strong budget this year. The police department developed a very strong budget this year and made some tough choices along the way, so I think strengthening that controllership is a very important step.

Within the internal control report there are a series of weaknesses that are identified. I think going down the list of those weaknesses and assuring themselves that next year there will be—it will be a much shorter report; for instance, there are some cash control items, some voucher control items that need to be taken on.

Beyond that, and I said this before, I think that the District needs to think about how best to rationalize its tax system. I think that there are a lot of different ways to do that. There have been a lot of different recommendations. I don't have any particular recommendations, but that is certainly an area to work in.

Mr. HORN. Besides the auditor's recommendations, is there anything that you or your staff at OMB feel should be added to what

is being done by the Chief Financial Officer and the various controllers?

Mr. DESEVE. We have tried to work with them over the last 3 years in several areas. We have helped them again in procurement. GSA has taken a very active role in both helping them design procurement systems, as well as in helping them to actually in a sense outsource to GSA's schedules procurement activities like the police department. I think they buy all of the fire trucks, all of the—they buy all of the fire trucks, all of the police cars, I believe bulletproof vests, off GSA schedules, which is a very efficient way to do it.

So except for the things here, and strengthening of the controllership function, I don't have anything in particular. But again, I am not there on a day-to-day basis the way the CFO is in the Federal Government's.

Mr. HORN. Two questions. One is the year 2000 aspect. I will be asking about that. Does OMB have any aspect on how they come near to solving that problem?

Mr. DESEVE. Again, I hate to keep standing by this, but I think this is a very strong portrayal of some of the problems they are going to have in the year 2000. Like other entities, we will need to think seriously about contingency planning in addition to correction. I think that is a theme you will hear from me as we talk about the year 2000 going forward.

We will also make our year 2000 office eventually, with John Koskinen—and we appreciate your work in thinking this through with us, this sort of thing. We will reach out—the Council, the President's Year 2000 Conversion Council—we will reach out to the District and offer whatever assistance we have. To the extent that Federal agencies have been solving some of their problems or can be a source of contingency for the District, we will make that available to them as well.

Mr. HORN. You mentioned the better revenue system which would bring in more revenue and be more efficient about who has paid and who hasn't. How about parking meters? Has OMB ever gotten into that, to make you feel like a city manager?

Mr. DESEVE. All parking meters are local, Mr. Chairman.

Mr. HORN. OMB doesn't have—the problem is, meters are disappearing. I see them chopped off all over town. I don't know if that is the business that is near the parking meter that does that, or whether the city is doing it, or whether they contract it. We will be asking them that. But I just wondered if you had any thoughts on that.

Mr. DESEVE. No, sir. I know when to stay out of a subject.

Mr. HORN. OK. Thank you, Mr. Chairman.

Mr. DAVIS. That is wise.

You have been involved in the 1999 budget process for the District. Can you help assure that there will be a consensus budget, and with the abbreviated process we put in the Revitalization Act, that will be used to get the budget up before the deadline?

Mr. DESEVE. I believe so. I think all of the parties are committed to that, but I think they are a better source of that information than I am. It is certainly greatly to be desired.

Mr. DAVIS. I see the gentleman from Maine has just come in, Representative Allen. I recognize him.

Mr. ALLEN. Thank you very much, Mr. Chairman. It is nice to be at hearings which are by and large good news hearings. Not all the ones we do on the Hill are of that character.

Mr. DESEVE. I am very much aware of that, Mr. Allen.

Mr. ALLEN. In your testimony you indicated that the audit report shows on a GAAP basis that the District posted a fiscal 1997 surplus of $185 million. That is the number that has been in the press. You say on a budgetary basis, annual revenues minus annual expenditures, that the surplus was $108 million.

Mr. DESEVE. Correct.

Mr. ALLEN. You suggest using that number or focusing on that number. I wondered if you could talk about the difference between, you know, the calculation based on generally accepted accounting principles as compared to the budget, and why the latter is the basis for performing your next budget.

Mr. DESEVE. Sure. I am almost inclined to commit heresy. I actively opposed the use of GAAP in its current form back in the late seventies and early eighties. It recognizes changes to the balance sheet position of the city and certain changes to the cash position of the city that are, in essence, one-time changes.

For example, here there was a $94,272,000 change net to the Medicaid accruals. These are payments that at one time were estimated to be needed to pay Medicaid vendors. Once cost settlements were done, once proper recognition of revenue occurred, they were able to reduce that number; in other words, to admit that there wasn't really a need to make those payments. It has no effect going forward because those were accumulated payments over time.

It is really restating history to some extent, and I would have made those direct changes to fund balance rather than an element of surplus. The accounting is absolutely correct. There is nothing wrong with the accounting at all. It is perfectly correct. But again, as Ms. Norton said, she focused on the difference in revenue, which is about $110 million, another good piece of information.

It is important to focus down and say it is great that they don't have this liability, if you will, for those payments, but it is not something that will be recurring in the future. So we look at the recurring situation and use that.

Mr. ALLEN. Do you have any basis for expecting any one-time events to affect your—the upcoming budget? Are there any similar factors on the horizon that might affect the upcoming budget?

Mr. DESEVE. I actually don't work with the District in the preparation of its budget, but I know of none. There are none that have shown themselves to me. Again, you may want to ask the CFO or the Financial Responsibility Officer about that.

Mr. ALLEN. One final question. You indicated the Treasury has provided short-term advances to the District of $749 million since 1995.

Mr. DESEVE. Correct.

Mr. ALLEN. Have all of those funds been repaid?

Mr. DESEVE. I believe there may be some outstanding, which are appropriate. They have all been repaid on time. Whenever they were due they have been repaid.

Mr. ALLEN. Do you have any reason to expect there will be any need for further short-term advances in the future?

Mr. DESEVE. We meet with the city about every quarter. At our quarterly meeting at this time the city indicated as long as the economy continued, and assuming that they do a deficit borrowing in August, which is something that the committee had authorized previously, that they don't see any need for temporary cash borrowings from the Treasury. And they also have market access. They have continuing market access for their short-term borrowings at this point. There is nothing on the horizon that would need a backstop of the Treasury for liquidity.

Mr. ALLEN. Good. Thank you very much. Thank you, Mr. Chairman.

Mr. DAVIS. Mr. DeSeve, thank you very much for being here. Thank you for all the help, support and leadership you have shown in this. I look forward to continuing to work with you and with Mr. Raines.

Mr. DESEVE. Thank you, Mr. Chairman.

Mr. DAVIS. Now for our next and final panel to testify we have John Farrell, who is the partner at KPMG Peat Marwick. He will be accompanied by John Reagan and Ronald Saluzzo.

We have Mayor Marion Barry, Council Chairman Linda Cropp, Control Board Chairman Andrew Brimmer, and Mr. Anthony Williams, Chief Financial Officer for the District of Columbia, and I understand Mr. Williams will be accompanied by Mr. Natwar Gandhi, the Deputy CFO.

As you all know, it is the policy for all witnesses to be sworn before they may testify, so if you would come up here and raise your right hands.

[Witnesses sworn.]

Mr. DAVIS. Please be seated. I will ask that any written statements be made part of the permanent record. As I mentioned before, please limit your oral statements to no more than 5 minutes, so there will be ample time for questions. The committee has read your statements in advance.

Try to confine yourselves to the issues that are involved in the audit. We will begin with Mr. Farrell, who will set the tone here with his audit, and then he will be followed by Mayor Barry, Council Chairman Cropp, Dr. Brimmer, and Tony Williams.

Let me also congratulate Earl Cabbell, the D.C. Controller, who is has been chiefly responsible for this being a clean, unqualified opinion, and a gentleman who has worked in the office involved in collecting revenues owed in the District and moving toward an integrated tax system that will greatly improve the revenue collection.

Mr. Farrell, thank you, sir for being with us this morning.

STATEMENTS OF JOHN A. FARRELL, PARTNER, KPMG PEAT MARWICK LLP, ACCOMPANIED BY JOHN REAGAN AND RONALD SALUZZO; MARION BARRY, JR., MAYOR OF THE DISTRICT OF COLUMBIA; LINDA CROPP, CHAIR, DISTRICT OF COLUMBIA CITY COUNCIL; ANDREW BRIMMER, CHAIRMAN, D.C. FINANCIAL RESPONSIBILITY AND MANAGEMENT ASSISTANCE AUTHORITY, ACCOMPANIED BY DANIEL A. REZNECK, GENERAL COUNSEL; AND ANTHONY WILLIAMS, CHIEF FINANCIAL OFFICER, DISTRICT OF COLUMBIA

Mr. FARRELL. Thank you. Good morning. Good morning also to members of the committee. I am pleased to be here today on behalf of my firm, KPMG Peat Marwick, to provide information that may be helpful to the committee in reviewing the operations and the financial position of the District of Columbia.

I am the partner responsible for the audit of the District's 1997 General Purpose Financial Statements presented in its 1997 Comprehensive Annual Financial Report. My personal experience includes more than 26 years of auditing financial statements of governmental entities, both local and Federal.

We have issued two reports as a result of our 1997 audit, the Independent Auditors' Report on the General Purpose Financial Statements, and the Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards. We will also issue a letter to the District in March 1998, which discusses other internal control matters of lesser significance.

KPMG has audited the District for the past 3 years. In 1995–1996 the District's financial statements were qualified due to the District's inability to provide sufficient evidence on tax balances. Other reports we issued in those years highlighted material weaknesses in internal controls, including violations of the District's procurement processes and a lack of controls over reporting obligations.

For the first time in 3 years KPMG has issued an unqualified independent auditors' report on the District's 1997 financial statements. Late in fiscal year 1997 the District's Office of Tax and Revenues devoted significant staff resources to researching thousands of tax balances which have previously been unsupportable. Their efforts allowed the District to record correcting entries and to provide us, the auditors, with sufficient audit evidence on the tax balances which was not possible during the prior two audits.

Our controls report, however, for 1997 still refers to tax system weaknesses. The required adjustments as a result of the correcting entries had the effect of restating the beginning general fund balance, a fund deficit in this case, to be $518 million, an increase in the deficit of $64 million.

Our report highlights several matters for the readers. They are not qualifications but significant matters regarding the financial statements. They are the District's continuing liquidity concerns, a sale-leaseback transaction of the District's Correctional Treatment Facility, and the development of the budget matters.

Additionally, our report identifies new accounting standards that the District was required to adopt in 1997. Our Report on Compli-

ance and Internal Control Over Financial Reporting, which Ed DeSeve was referring to, describes material weaknesses in internal control over financial reporting and material noncompliance with laws and regulations. A material weakness is

> a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our report addresses 11 matters that existed during the fiscal year under audit that meet that definition. Our report does not extend beyond September 30, 1997.

The more significant material weaknesses in internal control over financial reporting relate to pervasive internal control weaknesses in the electronic data processing systems environment, reconciliations of many of the accounts on a detailed basis being delayed until fiscal year end, weaknesses allowing several instances of noncompliance with laws and regulations in the procurement area, and weaknesses of financial management activities at several District agencies, including the Department of Housing and Community Development, the D.C. Lottery and Charitable Games Control Board, the Water and Sewer Authority, and the Unemployment Compensation Trust.

These items, as well as other matters that have been reported to the District that are not considered material weaknesses, may indicate possible instances or opportunities for fraudulent financial reporting or fraudulent misappropriation of assets. We have communicated these items to District management as required under generally accepted auditing standards and Government Auditing Standards.

Clearly, much remains to be done in the District. However, the efforts of the D.C. Financial Responsibility and Management Assistance Authority and the Chief Financial Officer have improved the financial management operations of the District over the past 3 years. Weaknesses associated with identifying and reporting accounts payable have largely been corrected, as has the inaccuracy in the reported tax balances.

The number of procurement-related exceptions we have noted in 1997 have decreased over the past 3 audits. Several material weaknesses or reportable conditions that have previously been reported have been eliminated by the city implementing additional controls. The CFO has established chief financial officer positions at most agencies, enhancing the overall financial management capabilities of the District. Finally, stringent expenditure budgetary controls and revenue-enhancement initiatives monitored by the CFO and the Authority were integral components of the District's improved financial results for 1997.

In closing, we acknowledge the courtesy and cooperation extended us by District employees during the course of our audit. We appreciate the opportunity to appear before you today, and we will be pleased to answer any questions you have.

[NOTE.—The report entitled, "Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed," may be found in subcommittee files.]

[The prepared statement of Mr. Farrell and the Independent Auditors' Report follow:]

TESTIMONY TO THE
DISTRICT OF COLUMBIA SUBCOMMITTEE OF THE
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
February 11, 1998

John A. Farrell
Partner, KPMG Peat Marwick LLP

Good morning, Mr. Chairman and Members of the Committee. I am pleased to be here today on behalf of my firm, KPMG Peat Marwick LLP (KPMG), to provide information that may be helpful to the Committee in reviewing the operations and financial position of the District of Columbia (District). I am the partner responsible for the audit of the District's 1997 General Purpose Financial Statements as presented in its 1997 Comprehensive Annual Financial Report. My personal experience includes more than 26 years of auditing financial statements of governmental entities, both local and federal.

KPMG has issued two reports in accordance with generally accepted auditing standards and standards promulgated by the General Accounting Office (GAO). The reports we issued are the *Independent Auditors' Report* on the General Purpose Financial Statements and the *Report On Compliance And On Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*. We will issue a letter to the District in March 1998 which discusses other internal control matters of lesser significance.

KPMG has audited the District for the past three years. Our 1995 and 1996 reports on the District's financial statements were qualified due to the District's inability to provide sufficient evidence on tax balances. Other reports we issued highlighted material weaknesses in internal controls, including violations of the District's procurement processes and a lack of controls over recording obligations.

The 1997 Independent Auditors' Report

For the first time in three years, KPMG has issued an unqualified independent auditors' report on the District's financial statements. Late in fiscal year 1997, the District's Office of Tax and Revenue devoted significant staff resources to researching thousands of tax balances which had previously been unsupportable. Their efforts allowed the District to record correcting entries to the financial records; thus, they were able to provide us with sufficient audit evidence on the tax balances which was not possible during the past two audits. Our controls report, however, still refers to tax system weaknesses. The required adjustments had the effect of restating the beginning General Fund fund deficit to be $518 million, an increase in the deficit of $64 million.

The KPMG report highlights several matters for the reader. These are **not** qualifications but significant matters regarding the financial statements we believe require emphasis to aid the reader's understanding. They are as follows:

- The District's General Fund reflects an accumulated fund deficit at September 30, 1997 of $332 million. Additionally, the District projects a pooled cash shortfall in fiscal 1998, necessitating short and intermediate term borrowing. The District believes its liquidity position is improving, but that it may continue to experience cash shortfalls as the accumulated fund deficit is eliminated.

- During 1997, the District completed a one-time transaction which enhanced its liquidity position. The District completed a sale-leaseback of its Correctional Treatment Facility (CTF). The result of the transaction is that the District effectively borrowed $55,850,000. This transaction resulted in an immediate improvement in the fund deficit of the District's General Fund which will reverse over 20 years as the District makes payments on the CTF lease, which obligation is recorded in the General Long Term Liabilities Account Group.

- The legally adopted budget enacted by Congress authorizes expenditures at the function level. A revision that exceeds the total expenditures authorized for any function must be enacted by Congress unless otherwise authorized by an act of Congress. In order to reach certain Congressionally mandated deficit reduction targets, the District of Columbia Financial Responsibility and Management Assistance Authority (the Authority) approved certain budget revisions which altered expenditures, as authorized in the District of Columbia Financial Responsibility and Management Assistance Authority Act (Public Law 104-8) and the 1997 District of Columbia Appropriations Act (Public Law 104-194). The Authority, acting on the advice of counsel, and counsel for the Authority have represented that the Authority may legally approve such budget revisions.

Additionally our report identifies new accounting standards that the District was required to adopt in 1997. The District adopted Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans;* No. 28, *Accounting and Financial Reporting for Securities Lending Transactions;* and Interpretation No. 2, *Disclosure of Conduit Debt Obligations*, in 1997. The implementation of these newly effective Statements resulted in additional disclosures in the footnotes to the financial statements.

Report On Compliance And On Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

KPMG's *Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards* describes material weaknesses in internal control over financial reporting and material noncompliance with laws and regulations. This report reflects the new reporting format that became effective in 1997.

A material weakness is defined by the American Institute of Certified Public Accountants as, "a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions." Our report addresses 11 matters that existed during the year being audited and does not extend beyond September 30, 1997. The more significant material weaknesses in internal control over financial reporting are as follows:

- A pervasive internal control weakness of the District is in the electronic data processing systems environment. The District has a wide-spread and complex data processing environment operating in a myriad of organizations and functions. There are multiple major data centers located throughout the District, each serving different groups of users, running multiple applications, and using various types of computer platforms and systems. EDP efficiencies between agencies and functions require enhancement. Underutilized systems and poor integration of functions and operations exist. Staffing and budget cuts have left many agencies with minimal staffing and resources to accomplish their missions. Existing staffs do not always have the necessary training or experience to perform their duties effectively. As a result, user confidence in agency departments has eroded. The District also appears to be vulnerable to the Year 2000 conversion issues. Failure to address these issues could severely impact District operations in a variety of critical service delivery and support areas.

- The District reconciles many of its accounts on a detailed basis only at the end of the fiscal year This is a time consuming process, requiring agency personnel to review a full year of transactions, and adjust records to facilitate the preparation of year-end financial statements. This process required over four months of effort and diverted resources from current activities. An analysis of the year-end closing process indicates that agencies are not entering the required financial transactions into FMS in a timely manner throughout the year. Since FMS is not updated in a timely manner, reports the District utilizes to manage District operations, such as budget to actual analyses and reports to Congress, are of limited use during the year. Improvements are required in interagency/department cooperation and procedures, timely resolution of policy questions that result in out of balance conditions not being resolved in a timely fashion, and periodic reconciliation procedures to address these weaknesses.

- There are several district agencies where there were material weaknesses in financial management activities. Loan administration control weaknesses at the Department of Housing and Community Development led the U.S. Department of Housing and Urban Development (HUD) to suspend the District's ability to participate in certain HUD sponsored lending programs which benefit District residents. The DC Lottery and Charitable Games Control Board was without five of six financial positions during the year which resulted in a failure to record certain financial activity in the general ledger throughout the year. Both the Water and Sewer Authority and the Unemployment Compensation Trust Fund did not

perform timely reconciliations between subsidiary ledgers and the general ledger for significant accounts.

- Our compliance tests identified several instances of noncompliance with laws and regulations in the procurement area. The District has identified over 150 lawsuits with claims amounting to approximately $20 million, where the vendor provided services at the District's request before there was a valid contract in force, in violation of District procurement regulations. We identified several instances of successive emergency procurements, as well as splitting of invoices to avoid requisite management approval. Finally, we observed that the District failed to pay numerous invoices within the 30 days required by law.

The items described in certain of the above areas, as well as other matters that have been reported to the District that are not considered material weaknesses, may indicate possible instances of fraudulent financial reporting or fraudulent misappropriation of assets. We have communicated these items to District management as required under generally accepted auditing standards and *Government Auditing Standards*.

A Three-Year View on the Financial Management Systems of the District

Clearly, much remains to be done at the District; however, the efforts of the DC Financial Responsibility and Management Authority and the Chief Financial Officer (CFO) have improved the financial management operations of the District over the past three years. Weaknesses associated with identifying and reporting accounts payable have been largely corrected, as has the inaccuracy in the reported tax balances. The number of procurement related exceptions we have noted have decreased over the past three audits. Several material weaknesses and reportable conditions previously reported have been eliminated by implementing additional controls. The CFO has established chief financial officer positions at most agencies, enhancing the overall financial management capabilities of the District. Finally, stringent expenditure budgetary controls and revenue enhancement initiatives monitored by the CFO and the Authority were integral components of the District's general fund excess of revenue and other sources over expenditures and other uses for 1997.

In Closing

We would like to acknowledge the courtesy and cooperation extended by District employees during the course of our audit. We appreciate the opportunity to appear before you today and would be pleased to address any questions you may have.

KPMG Peat Marwick LLP

2001 M Street, N.W.
Washington, DC 20036

Independent Auditors' Report

District of Columbia Financial Responsibility
and Management Assistance Authority:

Inspector General of the District of Columbia:

Mayor and Council of the District of Columbia:

We have audited the general purpose financial statements of the District of Columbia (the District), as of and for the year ended September 30, 1997, as listed in the accompanying table of contents. These general purpose financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, except as discussed in this paragraph. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the District of Columbia Retirement Board, the Pension Trust Funds within the Fiduciary Fund Type, were audited by other auditors in accordance with generally accepted auditing standards, but not in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall general purpose financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1(A), Public Law 104-8 created the Authority, defined a "control period" and deemed a control period to exist. The District is still in this control period. The District's General Fund reflects an accumulated fund deficit at September 30, 1997 of approximately $332,000,000. Further, as discussed in Note 1(Q), the District projects a pooled cash shortfall of approximately $300,000,000 in fiscal 1998, necessitating short and intermediate term borrowing. Note 1(P) discusses the National Capital Revitalization and Self-Government Improvement Act of 1997 which made significant changes to the District's Charter, its structure, and the services it provides with the objective of improving the District's financial condition. However, the District continues to face significant unresolved future funding issues, the outcome of which may result in additional changes to the District's structure and level of services.

During 1997, the District completed a one-time transaction to enhance its liquidity position. As discussed in Note 9, the District completed a sale-leaseback of its Correctional Treatment Facility (CTF). The result of the transaction is that the District effectively borrowed $55,850,000, of which $52,000,000 is for operations and $3,850,000 is for improvements to the CTF. This transaction resulted in an immediate improvement in the fund deficit of the District's General Fund which will reverse over 20 years as the District makes payments on the CTF lease.

As discussed in note 1(E), the legally adopted budget enacted by Congress authorizes expenditures at the function level. A revision that exceeds the total expenditures authorized for any function must be enacted by Congress unless otherwise authorized by an act of Congress. In order to reach certain Congressionally mandated deficit reduction targets, the District of Columbia Financial Responsibility and Management Assistance Authority (the Authority) approved certain budget revisions which altered expenditures as authorized in the District of Columbia Financial Responsibility and Management Assistance Authority Act (Public Law 104-8) and the 1997 District of Columbia Appropriations Act (Public Law 104-194). The Authority, acting on the advice of counsel, and counsel for the Authority have represented that the Authority may legally approve such budget revisions.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the District of Columbia, as of September 30, 1997, and the results of its operations, changes in plan net assets of the pension trust funds, and the cash flows of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 1(O), the District adopted Governmental Accounting Standards Board (GASB) Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* and No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, and Interpretation No. 2, *Disclosure of Conduit Debt Obligations*, in 1997. As discussed in Note 1(B), the Water and Sewer Authority Establishment and Department of Public Works Reorganization Act, established the Water and Sewer Authority (WASA) effective October 1, 1996 and, accordingly, the District has presented the former Water and Sewer Utility Administration enterprise fund as a discretely presented component unit. Additionally, as discussed in Note 1(O), WASA changed its valuation methodology for construction contributions received from other jurisdictions.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 5, 1998, on our consideration of the District's compliance with certain provisions of laws, regulations, contracts, and grants and the District's internal control over financial reporting. Our report identifies potential material noncompliance related to:

- the District of Columbia Procurement Practices Act of 1985
- the Anti-Deficiency and Home Rule Acts
- the Quick Payment Provision of the District of Columbia Code
- the Depository Act of 1977
- lawsuits and court orders
- federal grant requirements
- the District of Columbia Financial Responsibility and Management Assistance Authority Act

Our report also identifies material weaknesses in internal control over financial reporting related to:

- the District of Columbia Procurement Practices Act of 1985
- the Anti-Deficiency and Home Rule Acts
- the Quick Payment Provision of the District of Columbia Code
- electronic data processing
- business tax information system processing
- monitoring of Department of Housing and Community Development loan activity
- DC Lottery and Charitable Games Control Board financial management
- bank reconciliation controls
- controls over transactions involving the Authority
- lack of timely entry of transactions into FMS
- other reconciliation and management items

Our audit was performed for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The information in the accompanying schedules identified as Exhibits A-1 through G-6 in the table of contents is presented for purposes of additional analysis and is not a required part of the general purpose financial statements of the District of Columbia. Such information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements, and, in our opinion, is fairly stated, in all material respects, in relation to the general purpose financial statements taken as a whole.

We did not audit the data included in the introductory section and the statistical section of the report, and accordingly, express no opinion thereon.

KPMG Peat Marwick LLP

February 5, 1998

Mr. DAVIS. We will have some questions. Thank you, Mr. Farrell. Mayor Barry.

Mayor BARRY. Thank you, Mr. Chairman and members of the subcommittee. I want to thank you for the opportunity to testify on the 1997 audit report and the Office of Chief Financial Officer for the District of Columbia. I would like to ask that my entire statement, over 20 pages, be entered into the record.

Mr. DAVIS. Without objection, so ordered.

Mayor BARRY. In every situation there is a pretext, a context and a post-text. Again, just for the record, the pretext began with the passage of the Home Rule Act of 1973, which provided for an elected Mayor and city council. However well-intentioned this act was, it gave the District a management structure that was doomed for failure. There were structural problems that were there. The budget included State functions, county and city functions, a management structure that is uncontrollable.

Moreover, Mr. Chairman, when we took office in 1979 the financial conditions were in total disarray. There had not been an audit of District finances in over 100 years. In fact, in 1976 Arthur Andersen indicated that the District's books could not be audited because we had been treated as a Federal agency, and Federal agencies don't use the generally accepted accounting principles.

We were finally audited in the 1980's and we found that the Federal Government had a deficit of $284 million, so one thing that was committed to do was to get the Federal Government to pay its debt.

Also, Mr. Chairman, there has been a view that the District government over the years has not been concerned about balancing the budget, that we were just spending money and not worrying about whether or not we had the revenues to account for that budget. I have in my statement on page 3, a chart which demonstrates clearly from 1980 to 1990 there were 11 audits done by independent certified auditors, various firms who had the contract, and that in 8 of those 11 years, you could see it started in 1981, $6 to $8 million; they were small, we were not into the red; then a $14 million deficit in 1988, and in 1990, $18 million.

That was a very unique situation because of my own difficulties, and the council was reluctant to raise taxes or cut expenditures. Again, I think for the record we ought to just say that the District has always been interested in trying to do all we could to balance our budget and not just spend recklessly because we wanted to do so.

Also, Mr. Chairman, we find that the—all of us know this—that in terms of the structural difficulties that we were facing and still are facing—and I'm sure Mr. Williams and others will testify later that even though we have good news in 1997, we still have some structural imbalances here. What I mean by that, there are some revenue and expenditure drivers—expenditures far greater than the rate of revenues. Medicaid is one of those. Our debt service is one of those. There are several other areas which do that.

So there are court orders and mandatory expenditures that we have no control over, temporary receiverships, several receiverships, where these receivers can just make up a budget and spend

without regard to whether or not the revenues are available. Those are structural deficiencies that we still have to deal with.

Also, Mr. Chairman, we know with the turbulent years of 1991 to 1994, there were a number of hearings about the District's finances, and they were in total disarray. That brings us to the context of now.

In 1997 I came back into office. I came before the committee on February 22 and pointed out that the District was facing a potential deficit of $722 million. Nobody questioned those numbers. They thought they were good numbers, but we worked awfully hard that year, even before the Control Board, even before the independent CFO, to reduce that deficit from a potential of $722 million to $54 million, as certified by an independent audit. That means we had done spending reductions and potential reductions of $668 million, a deficit reduction of $335 million in 1994 to $54 million in 1997, a net reduction in expenditures of $151 million. This is work that has been done.

I put this in the context again to just say that the District government has always—not always met those, but we have been interested in trying to bring spending under control. On page 7 you see a number of things we did. The most significant, I think, is that in 1995 the District reduced agency spending by $229 million. Our citizens suffered the impact of that reduction, because when you cut money like that it has to impact on services somewhat. Our employees took a 12 percent wage reduction, and there are other things that we did, too.

We need to look at all of this in the three-pronged approach. One was to reduce the cost and growth of government. We have done that. The District has made tremendous sacrifices. I don't think they have been appreciated as much as it ought to be in terms of the kind of discipline we brought, the kind of sacrifice that our employees have made, and the sacrifices that our citizens have made in terms of some of the services that we have not had. We have reduced AFDC benefits, unemployment benefits, workers' compensation costs. Again, that was a very difficult area to deal with because of the unions, et cetera.

There has been tremendous progress made in our Water and Sewer Authority, on which you worked with us, Mr. Chairman, to get going. It has worked very, very well in terms of that situation. The Water and Sewer Authority will raise their own funds and therefore take back $230 million from our books, which allows us to be more effective.

Also, we restructured the relationship with the Federal Government and the District, as you may recall. In 1995 I first suggested many of the reforms which became the Revitalization Act. Quite frankly, at that time some people laughed at that visionary direction or scoffed at it, thought it was not something that made any kind of sense. On the whole, 2 years later President Clinton and OMB and this committee adopted that approach.

As far as growth, I don't think anything that has been done has really stimulated economic growth the way I think we need to. I think jobs for D.C. residents are one way to stimulate the growth. Also the good news, and I intended to send this to Ms. Norton yesterday but I will do it today, in terms of the outflow from the Dis-

trict between 1980 and 1996, you will find over 40 percent or 40,000 of those persons who left were incomes of $15,000 and below. And between 1980 and 1996 the District has actually gained in population of people who are making between $25,000 and $50,000, some 13 percent for $25,000 to $35,000, and we have to find ways to continue to keep that population growth in Washington.

There was a notion that that population was leaving at a much greater rate than people who were coming in, so these numbers, which came from the Census Bureau, demonstrate that we have not lost the middle class population. In fact, we have gained that population as we go forward. Nobody knows where the under $15,000 went. They didn't go to Prince George's County, so they don't know what happened to them.

So in 1995, that was when the Authority was created. I had an opportunity and responsibility to recommend a Chief Financial Officer. I interviewed a whole bunch of people and came to the conclusion that Anthony Williams was the best among those persons. That is a decision that I don't regret. I think he has demonstrated his ability. He has worked tirelessly within my administration to execute my financial plans.

Obviously in every new system there are some bumps and grinds. There were a few in the very beginning. I think if you look at the relationship between the Mayor's Office and the Chief Financial Officer, you will find that we are working very well together, and his office is now working hard to prepare the 1999 budget using some performance measures, as opposed to the other way of just filling out our budget based on last year's base.

Now I want to commend the CFO and his staff, and particularly we mention Mr. Cabbell. He is the one who really brought this in in terms of the daily work of bringing some discipline to spending and some controls to the situation. And also $53.6 million of the $185 million has to be taken in the context that some of it was a one-time income from the CTF sale. We argued that position for 1996 but the auditor said we couldn't do it. But now we can do it, it is legitimate.

The good news, though, is the improved tax collection, $110 million, which means that this ought to be basically recurrent for 1999 and 2000 in terms of the kind of income that we are getting.

Mr. Chairman, I am near the end here. I still think we need to walk an extra mile to look at what we need to do as a Congress, as an executive branch of government, to complete this picture. If we don't continue to transfer some of these State functions, such as mental health, and we don't—the Federal Government does not pick up the full cost of Medicaid, which is $262 million for 1999, and unless there is still a Federal contribution of at least $328 million, no matter how disciplined we become, regardless of how stringent we make ourselves, I predict in another couple of years we will be out of balance again, in the sense that there are only so many places you can cut this budget with these court orders and mandatory kind of expenditures.

So I would urge Congress to adopt Revitalization II, which is another vision of mine. I hope it won't be looked upon as it was in 1995; that the Congress should bite the bullet now, take that ini-

tiative, and then we won't be back up here talking about structural deficits anymore. People have to make tough decisions.

I want to thank the committee for allowing me to participate in this good news situation.

I am glad to hear Ms. Norton indicate, she said this before, so we are going to do it, that she would go to the floor of the Congress and talk with her colleagues about the tremendous amount of progress we have made. That service delivery is improving.

Finally, Mr. Chairman, I really think it is a mistake to try to continue to tie service delivery to our freedom. The Financial Assistance Act is very clear. You can measure whether or not you have a balanced budget, whether or not you have a surplus or a deficit. But when it comes to service delivery, that becomes subjective to some extent. Let's not have subjective kinds of discussions tied to our continuing this Control Board. We need to move from 1997, 1998, 1999 and 2000 and as access to Control Board be deactivated. This is an institutional position. We need to get rid of this Control Board quickly so democracy can be restored to the District and local officials can do that which we were elected to do: Manage the service delivery and the financing of the District.

Thank you.

[The prepared statement of Mayor Barry follows:]

GOOD MORNING MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE. THANK YOU FOR THE OPPORTUNITY TO TESTIFY ON THE FY 1997 AUDIT REPORT AND THE OFFICE OF THE CHIEF FINANCIAL OFFICER FOR THE DISTRICT OF COLUMBIA.

IN EVERY SITUATION THERE IS A PRETEXT, A CONTEXT AND A POST TEXT. THE PRETEXT BEGINS WITH THE PASSAGE OF THE HOME RULE ACT IN 1973. THE PROVISIONS FOR AN ELECTED MAYOR AND DISTRICT COUNCIL WERE WELL INTENTIONED. HOWEVER, THE GOVERNMENT ESTABLISHED WAS NOT ALL IT COULD BE. IT INCLUDED A DIFFICULT MANAGEMENT STRUCTURE WHICH WAS DOOMED TO FAIL.

IN 1979, WHEN I FIRST TOOK OFFICE, THE FINANCES OF THE DISTRICT OF COLUMBIA WERE IN TOTAL DISARRAY. THEY HAD NOT BEEN AUDITED IN 100 YEARS. IN 1976 ARTHUR ANDERSON HAD CALLED THE DISTRICT'S FINANCIAL MANAGEMENT SYSTEM UNAUDITABLE. IN FY 1979, FOR THE FIRST TIME SINCE THE ENACTMENT OF THE HOME RULE ACT, AN INDEPENDENT AUDIT WAS CONDUCTED OF THE DISTRICT'S BOOKS. THIS AUDIT REVEALED THAT THE DISTRICT HAD AN ACCUMULATED DEFICIT OF $284 MILLION. THROUGH THE EFFORTS OF MY ADMINISTRATION, FINANCIAL DISCIPLINE WAS INTRODUCED TO THE DISTRICT GOVERNMENT. THE DISTRICT ACHIEVED A BALANCED BUDGET BY FY 1981.

FROM FY 1981 THROUGH FY 1990, THE BUDGET OF THE DISTRICT OF COLUMBIA WAS BALANCED IN EVERY YEAR BUT TWO, AS THE FOLLOWING TABLE DEMONSTRATES:

SUMMARY OF GENERAL FUND RESULTS
($ MILLIONS)

FISCAL YEAR	REVENUES	EXPEND	BOND SALES & TRANSFERS NET	SURPLUS (DEFICIT)
9/30/79	N/A	N/A	N/A	N/A
1980	1,732	(1,735)	(102)	(105)
1981	1,908	(1,733)	(107)	68
1982	2,000	(1,875)	(112)	13
1983	2,208	(2,078)	(117)	13
1984	2,402	(2,289)	(96)	17
1985	2,635	(2,775)	165	25
1986	2,815	(2,706)	(89)	20
1987	3,055	(2,941)	(94)	20
1988	3,364	(3,302)	(76)	(14)
1989	3,489	(3,420)	(64)	5
1990	3,680	(3,703)	(95)	(118)

DURING THIS TIME, FINANCIAL DISCIPLINE WAS MAINTAINED AND THE DISTRICT RECEIVED A SERIES OF CLEAN AUDITS. THE DISTRICT REALIGNED ITSELF STRUCTURALLY, IMPROVED ITS MANAGEMENT CAPACITY AND REAPED THE BENEFITS OF AN ECONOMIC BOOM.

NONETHELESS, THE DISTRICT'S STRUCTURAL IMBALANCE BUILT INTO THE HOME RULE ACT BEGAN TO SHOW ITS EFFECTS. IT COMBINED A FULL-SERVICE CITY AND A FULL-SERVICE STATE INTO A SINGLE GOVERNMENTAL ENTITY THAT HAS NO COUNTERPART IN THE UNITED STATES.

THIS GOVERNMENT DESIGN SADDLED THE DISTRICT WITH A FULL RANGE OF NON-MUNICIPAL RESPONSIBILITIES, ESPECIALLY THOSE TYPICALLY ASSIGNED TO STATES, WHICH HAVE PRODUCED SOME OF THE MOST VOLATILE COST PRESSURES IN THE PUBLIC SECTOR TODAY. WHILE THE DESIGN PROVIDED A RANGE OF STATE AND LOCAL TAXING CAPABILITIES, IT LEFT OUT PERHAPS THE MOST PIVOTAL ONE - THE ABILITY TO TAX INCOME AT ITS SOURCE.

DURING THIS PERIOD, COURT ORDERS AND MANDATORY EXPENDITURES WERE GROWING AT A RATE THAT FAR OUT-STRIPPED REVENUES. EXPENDITURES SUCH AS THE PENSION LIABILITY, DEBT SERVICE, MEDICAID AND AFDC COULD NOT BE CUT. TAX REVENUES DECLINED AS THE DISTRICT LOST POPULATION TO THE SUBURBS. MEANWHILE, THE FEDERAL PAYMENT ROUTINELY FELL SHORT OF COMPENSATING THE DISTRICT FOR THE NET IMPACT OF THE FEDERAL PRESENCE. YET, THE DISTRICT'S DISCRETIONARY SPENDING WAS UNDER CONTROL AND FINANCIAL DISCIPLINE WAS STRICTLY ENFORCED.

DURING THE SUCCEEDING YEARS, FROM FISCAL YEAR 1991 THROUGH FISCAL YEAR 1994, FINANCIAL MANAGEMENT WAS ALMOST NON-EXISTENT IN THE DISTRICT GOVERNMENT. SPENDING WAS, FOR THE MOST PART, OUT OF CONTROL. MANAGERS SHOWED NO FISCAL DISCIPLINE OR FINANCIAL INTEGRITY AS THEY ROUTINELY OVERSPENT THEIR BUDGETS. ACCOUNTING PRINCIPLES WERE COMPROMISED. AT THE SAME TIME, MANDATORY SPENDING REMAINED OUT OF CONTROL, WITH THE IMPOSITION OF ADDITIONAL COURT ORDERS, A FAILING ECONOMY LEADING TO HIGHER WELFARE SPENDING AND AN EVER-INCREASING PENSION LIABILITY. THE DEFICIT BALLOONED TO $335 MILLION BY THE END OF FY 1994.

WE NOW MOVE TO THE CONTEXT OF THE CURRENT FINANCIAL SITUATION. WHEN I RETURNED TO OFFICE IN JANUARY OF 1995, I DISCOVERED AND ANNOUNCED TO THE CITIZENS THE DESPERATE AND SORRY STATE OF THE DISTRICT'S FINANCES: THE PREVIOUS ADMINISTRATION HAD OVERSPENT BY $335 MILLION, AN AMOUNT THAT IF LEFT UNCHECKED, WOULD HAVE SPIRALED INTO A $722 MILLION SHORTFALL. GETTING OUR FINANCES IN ORDER WAS ONE OF THE HIGHEST PRIORITIES OF MY ADMINISTRATION. TO AVOID THIS DEFICIT THAT WOULD AMOUNT TO 26 PERCENT OF THE GENERAL FUND, SEVERAL DRASTIC MEASURES AND STRATEGIES WERE EMPLOYED. THESE INCLUDED:

1. REDUCING AGENCY SPENDING BY $229 MILLION – WHICH INCLUDED THE REDUCTION OF PERSONAL SERVICES EXPENDITURES BY $79 MILLION BY ROLLING BACK EMPLOYEE WAGES BY 12 PERCENT, AND IMPLEMENTING FURLOUGHS, VOLUNTARY SEPARATION PROGRAMS AND MASSIVE REDUCTIONS IN FORCE;

2. RESTRUCTURING THE DEBT FOR A $70 MILLION SAVINGS; AND

3. MOST IMPORTANTLY, A CALL TO THE PRESIDENT AND THE CONGRESS TO ASSUME SOME OF THE NON-MUNICIPAL SERVICES THAT WERE INHERITED BY THE DISTRICT AT HOME RULE.

THE FY 1995 EXPENDITURE REDUCTION PLAN WAS LARGELY SUCCESSFUL IN THAT THE FISCAL YEAR ENDED WITH A $54 MILLION DEFICIT. THE ANNUAL INDEPENDENT FINANCIAL AUDIT CONFIRMED A NET REDUCTION IN EXPENDITURES OF $151

MILLION FROM THE PREVIOUS FISCAL YEAR.

THIS REDUCTION REPRESENTED THE FIRST TIME THAT EXPENDITURES IN A FISCAL YEAR WERE LOWER THAN THOSE OF A PREVIOUS FISCAL YEAR. BUT FOR AN OVER EXPENDITURE IN MEDICAID AND A DECISION NOT TO RAISE PROPERTY TAXES, THE FY 1995 BUDGET WOULD HAVE BEEN BALANCED.

TO CREATE A FRAMEWORK FOR STABILITY AND PROSPERITY I DEVELOPED A THREE PRONGED LONG-TERM RECOVERY STRATEGY.

THE FIRST PRONG WAS TO REDUCE THE COST AND GROWTH OF GOVERNMENT. THIS APPROACH IS REFLECTED IN MY TRANSFORMATION PLAN. ONE YEAR AFTER UNVEILING THE TRANSFORMATION PLAN, THE FOLLOWING INITIATIVES HAD BEEN INITIALIZED AND COMPLETED:

- REDUCING THE SIZE OF GOVERNMENT BY MORE THAN 7,500 FTEs FOR A SAVINGS OF $165 MILLION, WHICH REPRESENTS A 27 PERCENT REDUCTION IN THE SIZE OF THE WORKFORCE OVER A PERIOD OF TWO AND A HALF YEARS;

- OUTSOURCING CITY SERVICES, ESPECIALLY THE CORRECTIONAL TREATMENT FACILITY;

- REDUCING AFDC BENEFITS, UNEMPLOYMENT BENEFITS AND WORKERS COMPENSATION COSTS TO BE MORE IN LINE WITH THOSE OF NEIGHBORING JURISDICTIONS;

- CREATING A DEPARTMENT OF HEALTH AND A PUBLIC BENEFITS CORPORATION THAT DRAMATICALLY IMPROVED

HEALTH CARE IN THE DISTRICT AT A LOWER COST;

- IMPROVING PUBLIC PROTECTION BY ADOPTING A COMMUNITY POLICING MODEL, EVEN BEFORE THE INITIATION OF THE MEMORANDUM OF UNDERSTANDING (MOU) PROCESS;

- ESTABLISHING A "WARD-BASED" SANITATION SYSTEM AND INCREASED THE NUMBER OF SOLID WASTE INSPECTORS;

- CREATING AN INDEPENDENT, REGIONAL WATER AND SEWER AUTHORITY WITH THE ABILITY TO RAISE THE NECESSARY REVENUES THROUGH A MUCH NEEDED RATE INCREASE AND, MORE IMPORTANTLY, ENHANCED BORROWING AUTHORITY, RESULTING IN MUCH NEEDED REPAIRS TO OUR DRINKING WATER SYSTEM; AND

- FOCUSING ON THE DISTRICT'S FINANCES, GOING FROM "JUNK" BOND STATUS TO THE ABILITY TO SELL MORE THAN $230 MILLION IN GENERAL OBLIGATION BONDS AT A VERY COMPETITIVE RATE.

THE SECOND PRONG IS TO RESTRUCTURE THE RELATIONSHIP BETWEEN THE DISTRICT AND THE FEDERAL GOVERNMENT. IN 1995, I FIRST SUGGESTED MANY OF THE REFORMS WHICH EVENTUALLY RESULTED IN THE REVITALIZATION ACT. MANY PEOPLE RIDICULED MY PLAN FOR THE DISTRICT. YET, TWO YEARS LATER, PRESIDENT CLINTON ADOPTED MY FISCAL APPROACH TO REVITALIZING THE DISTRICT. I HAVE RECENTLY PROPOSED REVITALIZATION TWO. LET US HOPE THAT THIS LESSON DOES NOT FALL ON DEAF EARS.

THE THIRD PRONG INVOLVES ECONOMIC GROWTH. A COMPREHENSIVE AND EFFECTIVE ECONOMIC GROWTH STRATEGY IS BEING DEVELOPED. IT RELIES ON GROWTH INCENTIVES AND THE CONTINUATION OF COMMUNITY POLICING, IMPROVEMENTS TO PUBLIC WORKS AND IMPROVED PUBLIC HEALTH INITIATIVES, SUCH AS PREVENTION AND WELLNESS PROGRAMS AND A COMPREHENSIVE PRIMARY HEALTH CARE SYSTEM.

IN APRIL 1995, THE POSITION OF CHIEF FINANCIAL OFFICER WAS CREATED AS PART OF THE DISTRICT OF COLUMBIA FINANCIAL RESPONSIBILITY AND MANAGEMENT ASSISTANCE ACT (FRMAA). THIS ACT VESTED THE APPOINTMENT OF THE CHIEF FINANCIAL OFFICER IN THE MAYOR. AFTER AN EXHAUSTIVE SEARCH OF WELL QUALIFIED CANDIDATES, I APPOINTED ANTHONY WILLIAMS AS CHIEF FINANCIAL OFFICER.

MR. WILLIAMS HAS WORKED TIRELESSLY WITHIN MY ADMINISTRATION TO EXECUTE MY FINANCIAL PLAN AND BRING FISCAL DISCIPLINE BACK TO THE DISTRICT GOVERNMENT. HIS EFFORTS AND THOSE OF THE MANAGERS WITHIN MY ADMINISTRATION HAVE RESULTED IN THE GOOD TIDINGS WE BRING TODAY.

THIS BRINGS US TO THE PRESENT. THE FY 1997 AUDIT RESULTS ARE IN. THE DISTRICT HAD A BALANCED BUDGET FOR FISCAL YEAR 1997. WE TURNED AROUND AN ANTICIPATED $74 MILLION DEFICIT INTO A SURPLUS OF $185.9 MILLION. FOR 1997 OPERATING REVENUES EXCEEDED OPERATING COSTS SIGNIFICANTLY.

MR. CHAIRMAN, THIS OCCURRED BECAUSE EXPENDITURES WERE CLOSELY MONITORED TO ENSURE THAT EVERYONE STAYED WITHIN THEIR BUDGET OR BELOW; BECAUSE OF CONSERVATIVE REVENUE ESTIMATES, IMPROVED TAX COLLECTIONS OF $110.9 MILLION, MEDICAID SAVINGS OF $53.6 MILLION, THE SALE OF THE CORRECTION TREATMENT FACILITY RESULTING IN $53.6 MILLION...AND THE DISCIPLINE AND HARD WORK OF THE ADMINISTRATION AND EMPLOYEES WHICH CONTRIBUTED $41.5 MILLION TO THE SURPLUS. AS IMPORTANT, THE FINANCIAL MANAGEMENT PROBLEMS WHICH CAUSED THE FAILURE OF THE FY 1996 AUDIT ARE BEING CORRECTED, RESULTING IN A "CLEAN AUDIT" FOR FY 1997.

AS I HAVE STATED ON PREVIOUS OCCASIONS, I WANT TO CONGRATULATE THE CHIEF FINANCIAL MANAGER, ANTHONY WILLIAMS, HIS STAFF AND THE FINANCIAL AND PROGRAM MANAGERS FROM ACROSS THE DISTRICT OF COLUMBIA GOVERNMENT FOR BALANCING THE DISTRICT BUDGET TWO YEARS AHEAD OF SCHEDULE. EARL CABELL, DEPUTY CFO FOR FINANCIAL OPERATIONS AND SYSTEMS IS TO BE PARTICULARLY CONGRATULATED FOR ADDRESSING THOSE FINANCIAL MATTERS WHICH RESULTED IN AN UNQUALIFIED OPINION ON THE 1997 AUDIT.

BY BRINGING IN A BALANCED BUDGET FOR FY 1997, WE WILL RETURN DEMOCRACY TO DISTRICT CITIZENS ONE YEAR EARLIER. THIS IS TRULY GOOD NEWS. THIS BRINGS US TO THE POST TEXT.

RECENTLY, THERE HAS BEEN DISCUSSION OF LINKING THE TERMINATION OF THE FINANCIAL AUTHORITY TO SERVICE DELIVERY. THIS WAS NOT THE INTENTION OF THE FRMAA ACT,

WHICH REQUIRED ONLY FINANCIAL CONTROL AND FOUR YEARS OF BALANCED BUDGETS FOR THIS TO OCCUR.

AS I HAVE STATED BEFORE, MOST SERVICE DELIVERY ISSUES ARE THE RESULT OF A LACK OF RESOURCES. TO HOLD DEMOCRACY IN THE DISTRICT HOSTAGE ANY LONGER IN THE ABSENCE OF ADEQUATE FEDERAL REVENUES WOULD BE THE ULTIMATE INSULT.

AS I MENTIONED ABOVE, I HAVE PROPOSED A PLAN CALLED REVITALIZATION PART II, WHICH SHOULD BOTH EXPAND OUR ECONOMIC BASE AND RESTORE OUR DEMOCRATIC RIGHTS.

AS YOU KNOW, WE LOSE $1.5 BILLION A YEAR IN TAX REVENUES AND WE LOST AN ADDITIONAL $660 MILLION A YEAR WHEN THE FEDERAL PAYMENT WAS CUT OUT. THIS $2 BILLION OBLIGATION IS NOT A SUBSIDY OR A BAILOUT, BUT WHAT IS LEGITIMATELY OWED TO D.C. CITIZENS. WITH THIS TREMENDOUS LOSS IN REVENUES LET US SAY THE CITY IS BEING LAND-LOCKED, OUR ECONOMIC BASE CANNOT EXPAND.

THE CONGRESS HAS THE OPPORTUNITY TO CORRECT THIS FLAW IN THE FY 1999 BUDGET CYCLE BY TRANSFERRING COSTS BORNE BY THE DISTRICT TO THE FEDERAL GOVERNMENT FOR MENTAL HEALTH SERVICES ($140 MILLION), AND BY FULLY FUNDING MEDICAID ($262 MILLION). WE ALSO REQUEST A CONTINUED FEDERAL CONTRIBUTION OF $328 MILLION FOR PAYMENT IN LIEU OF TAXES. FINALLY, WE RENEW OUR CALL FOR AN ECONOMIC DEVELOPMENT CORPORATION.

BY TRANSFERRING THESE STATE COSTS TO THE FEDERAL GOVERNMENT AND RECEIVING AN EQUITABLE FEDERAL CONTRIBUTION, WE CAN COMPETE MORE EFFECTIVELY WITH OUR REGIONAL NEIGHBORS AND ATTRACT AND RETAIN MORE RESIDENTS AND BUSINESSES.

ADDITIONALLY, THE 270 PROJECTS IDENTIFIED BY THE MANAGEMENT REFORM TEAMS WILL COST $183 MILLION. MANY OF THESE PROJECTS MIRROR PROPOSALS ORIGINALLY MADE WITHIN MY TRANSFORMATION PLAN. AS I HAVE STATED BEFORE, ADDITIONAL RESOURCES ARE NEEDED IN THE FY 1999 BUDGET TO FULLY FUND THESE PROJECTS. IF THIS COMMITTEE IS CONCERNED ABOUT SERVICE DELIVERY, IT SHOULD BEGIN BY PROVIDING ADEQUATE FUNDING FOR THESE PROJECTS.

FINALLY, LET ME REITERATE, IT IS TIME TO MAKE THE DISTRICT WHOLE. LET US CELEBRATE THE SUCCESS OF THE CHIEF FINANCIAL OFFICER, HIS STAFF, AND FINANCIAL AND PROGRAM MANAGERS THROUGHOUT THE DISTRICT.

LET US FURTHER HONOR THEIR EFFORTS BY CONTINUING THE REVITALIZATION PROCESS BY

- ESTABLISHING A PERMANENT $328 MILLION PAYMENT IN LIEU OF TAXES;

- INCREASING THE FEDERAL CONTRIBUTION FOR THE CURRENT YEAR TO THE SAME LEVEL TO FULLY FUND MANAGEMENT REFORM;

- TRANSFERRING ALL MEDICAID COSTS TO THE FEDERAL

LEVEL; AND

TAKING BACK THE FUNDING OF REGIONAL MENTAL HEALTH SERVICES AT ST. ELIZABETH'S HOSPITAL AND IN THE COMMUNITY.

THANK YOU FOR THE OPPORTUNITY TO ADDRESS YOU TODAY. I WILL NOW ANSWER ANY QUESTIONS YOU MAY HAVE.

Mr. DAVIS. Thank you very much. Ms. Cropp, thank you for being here.

Ms. CROPP. Thank you very much, Chairman Davis. I would say good morning to the chairman and other members of the House Government Reform and Oversight Subcommittee on the District of Columbia. I welcome the opportunity to appear before you today on behalf of the Council of the District of Columbia regarding the fiscal year 1997 comprehensive annual financial report for the District of Columbia. I join with the members of the committee as they thanked Mr. DeSeve, Frank Raines and the executive branch for their work in this effort. We appreciate their ongoing working relationship that we have developed and it has been exceptionally helpful.

The audit is a milestone in the financial recovery of the District, an important step in our effort to reform this government into an efficient and effective service provider. The good news is obvious. The city went from an expected operating deficit of $74 million to an operating surplus of $185.9 million. The accumulated deficit, the result of previous years overspending, went from $518 million to $332 million, representing a decrease in red ink of 36 percent. That is not a small figure. The deficit reduction appears to give the city the option of financing the cash deficit without borrowing, thus saving as much as $15 million a year in debt service; in a layperson's term, as I like to look at it, interest payments. That is an awful lot of money. As you may know, our fiscal year 1998 budget had anticipated that we would borrow $110 million for deficit reduction. We may not have to do that now.

The operating surplus we had in fiscal year 1997 opens up the possibility that we may eliminate the entire accumulated deficit by the end of fiscal year 1999. Collections of economically sensitive revenues such as personal income and corporate franchise taxes exceeded expectations by 10 percent and 19 percent respectively. This good news represents a monumental effort by the Chief Financial Officer, who put spending controls in place and who generated the necessary information for the decisionmakers to tackle the difficult budget reductions necessary and also improve the collection of revenue. On behalf of the Council, the Mayor and the Financial Authority, I want to say that we all deserve our fair share of credit. But I do not hesitate in expressing the thanks I believe we all owe to the Chief Financial Officer and his staff and his hardworking office.

Having discussed the good news, however, I must report that all is not well but it can be with certain understandings. Let me repeat, all is not well but it can be with certain understanding. While I pointed out some of the revenues outpaced our expectations, overall local revenue grew by just 2.6 percent from fiscal year 1996. We just barely beat inflation. Since inflation is a measurement of what things cost, any pickup at all in inflation without a corresponding revenue increase may leave us falling short in the future. Agency underspending of local funds of $41 million, while good news financially, may represent a failure to perform crucial functions. My concern with the programmatic impact of underspending is that we collected money from our taxpayers, budgeted funds for areas such as pothole repair, substance abuse programs, police and fire protec-

tion, and then we did not spend it all while the need was still there in many of those areas.

If we find a way to budget funds in these and other areas, we could establish quality of life improvements that are necessary. These could be coupled with the financial improvements and the financial progress that the city has made. That is the approach that we must take. While we are looking at cost containment, we must also look at improvement in those quality of life areas. Federal grants were $54.9 million less in fiscal year 1997 than they were in fiscal year 1996 and came in a shocking $141 million less than we expected. Last, though I expressed an expectation that we can pay off our deficit by the end of fiscal year 1999, the fact still is that we have an accumulated deficit of $332 million. We should never lose sight of that fact and understand that an accumulated deficit means that at the end of the year, our assets were insufficient to meet our liabilities. We have stopped the hemorrhaging, and that is an important factor, on the financial side, but we still have more work to do and we must succeed, because it is the rehabilitation of our financial position which becomes the underpinning for our service delivery efforts and then the service delivery efforts provide the basis for fostering economic growth. Economic growth will then be the engine that carries our financial health into the future.

This positive cycle, and it is a cycle, this continuum requires that we plow our surplus back into the infrastructure of further deficit reduction and economic development. This must be done because a surplus does not mean much to a mother and a father who are sending their child to a school which is in need of repair. It does not materially affect neighborhoods where crime is going on and equipment could not be purchased to help the reduction of crime, the trash is not picked up and the streets are unpassable because of potholes. Unless the good financial news is translated into improved services, it is just something on paper to citizens and we must make it more real to the citizens. But without this good financial news, we could not even start that step along the way to improve those quality of life issues for our citizens. Our overburdened taxpayers, businesses and residents, do not immediately feel the good news from a surplus unless we can turn that positive into the kind of service delivery that reduces the difficulty and expenses of living and doing business in the District. Our workers, who labored to produce this surplus and contributed directly with layoffs and benefit reductions, cannot see the rewards of our improved financial picture until we can go to the bargaining table with appropriate compensation.

All of these things cost money. We must have the money, combined with effective management to finance service improvements and to pay for economically stimulative tax reductions. The Council is committed to review our tax structure. In the fiscal year 1999 budget, we will be looking for funding for a new economic development corporation, for tax increment financing recently approved by Congress and other programs. With dollars in the President's budget requested in fiscal year 1999, we hope to grow our economy so that we may have gains which significantly beat the inflation rather than just being barely ahead, as I noted earlier. Wage increases

must be backed by dependable revenue sources so that they can be permanent rewards for our workers, most of whom have not seen an increase since 1994. During that time their wages were reduced for a temporary period, their benefits cut and they were asked to do more to cover the workload of those being laid off. Similarly, infrastructure improvements are expensive and require ongoing funding for maintenance. But without those investments, we cannot have a city that works.

Looking to the future, eventually we must find the resources to establish an accumulated surplus to provide a cushion against our next economic downturn. Today's news regarding the surplus is excellent. This is a fantastic step toward total financial stability. We have arrived where we are today with the help of this Congress, this subcommittee in particular. I want to thank you for your support. I look forward to continuing to work with you as we have more years of fiscal solvency so that we could see the Financial Authority move out. I join with the Mayor that we must have measurable means in deciding when the city has been successful. I look forward to all of us continuing to work together so we can continue along this good path of success. Thank you very much.

Mr. DAVIS. Chairman Cropp, thank you very much. Mr. Brimmer.

[The prepared statement of Ms. Cropp follows:]

Good morning Chairman Davis and other members of the House Government Reform and Oversight Subcommittee on the District of Columbia. I welcome the opportunity to appear before you today to testify regarding the Fiscal Year 1997 Comprehensive Annual Financial Report for the District of Columbia Government.

The Audit is a milestone in the financial recovery of the District and an important step in our efforts to reform this government into an efficient and effective service provider. The good news is obvious:

1. The city went from an expected operating deficit of $74 million to an operating surplus of $185.9 million;

2. The accumulated defict, the result of previous years overspending, went from $518 million to $332 million representing a decrease of red ink of 36%;

3. The deficit reduction appears to give the city the option of financing the cash deficit without borrowing thus saving as much as $15 million a year in debt service. As you may know, our Fiscal Year 1998 Budget had anticipated that we would borrow $110 million for deficit reduction - we may not have to do that now;

NAIWAR M GANDHI
DANIEL A [illegible]

4. The operating surplus we had in FY97 opens up the possibility that we may eliminate the entire accumulated deficit by the end of Fiscal Year 1999;

5. Collections of economically sensitive revenues such as personal income and corporate franchise taxes exceeded expectations by 10% and 19% respectively.

This good news represents a monumental effort by the Chief Financial Officer who put spending controls in place and who generated the necessary information for the decision makers to tackle the difficult budget reductions necessary. On behalf of the Council, the Mayor and the Financial Authority I want to say that we all deserve our fair share of the credit but I do not hesitate in expressing the thanks I believe we all owe our Chief Financial Officer and his hard working staff.

Having discussed the good news, however, I must report that all is not well, but it can be, with certain understandings:

1. While I pointed out that some revenues outpaced our expectations, overall, local revenues grew by just 2.6% from Fiscal Year 1996. We just barely beat inflation and since inflation is a measurement of what things cost, any pick-up in inflation without a corrosponding revenue increase may leave us falling short.

2. Agency underspending of local funds of $41 million, while good news financially, may represent a failure to perform crucial functions. My concern with the programmatic impact of underspending is that we collected money from our taxpayers, budgeted funds for areas such as pothole repair, substance abuse programs, police and fire protection and then we did not spend it all. If we find a way to budget funds in these and other areas we could establish quality of life improvements coupled with the financial progress.

3. Federal grants were $54.9 million less in Fiscal Year 1997 than they were in Fiscal Year 1996 and came in a shocking $141 million less than we expected;

4. Lastly, though I expressed an expectation that we can pay off our deficit by the end of Fiscal Year 1999, the fact still is that we have an accumulated deficit of $332 million. We should never lose sight of that fact and understand that an accumulated deficit means that at the end of the year our assets were insufficient to meet our liabilities.

We have stopped the hemorrhaging on the financial side, but, we still have more work to do and we must succeed because it is the rehabilitation of our financial position which becomes the underpinning for our service delivery efforts and then the service delivery efforts provide the base for fostering economic growth. Economic growth will then be the engine that carries our financial health in the future. This positive cycle, this continuum, requires that we plow our surplus back into our infrastructure, further deficit reduction, and economic development.

This must be done because a surplus does not mean much to a mother and father who are sending their child to a school which is in need of repair. It does not materially affect neighborhoods where crime is rampant and equipment could not help in its reduction, the trash is not picked up and the streets are unpassable because of potholes. Unless the good financial news is translated into improved services it is just something on paper to the citizen.

Our overburdened taxpayers, business and residents, do not immediately feel the good news from a surplus unless we can turn that positive into the kind of service delivery that reduces the difficulty and expenses of living and doing business in the District.

Our workers, who labored to produce this surplus and contributed directly with lay-offs and benefit reductions, can not see the rewards of our improved financial picture until we can go to the bargaining table with appropriate compensation

All of these things cost money. We must have the money, combined with effective management, to finance service improvements and to pay for economically stimulative tax reductions. In the Fiscal Year 1999 budget we will be looking for funding for a new economic development corporation, for Tax Increment Financing (recently approved by Congress) and other programs. With dollars in the President's budget request in Fiscal Year 1999, we hope to grow our economy so that we may have gains which significantly beat the inflation rate rather than being just barely ahead as I noted earlier in my testimony.

Wage increases must be backed up by dependable revenue sources so that they can be permanent rewards to our workers most of whom have not seen an increase since Fiscal Year 1994. During that time their wages were reduced for a temporary period, their benefits cut and they were asked to do more to cover the workload of those who had been laid off. Wage increases must also be accompanied by funded, ongoing, training programs so that as the work environment and systems change we keep the workforce trained to meet those new demands

Similarly, infrastructure improvements are expensive and require ongoing funding for maintenance. But without those investments we can not have a city that works.

Looking to the future, eventually, we must find the resources to establish an accumulated surplus to provide a cushion against the next economic downturn.

Todays news regarding the surplus is excellent. This is a fantastic step towards total stability.

We have arrived where we are today with the help of this Congress and this Subcommittee in particular and I want to thank you for your support. I look forward to continuing to work with you as we take the next, more substanitive, steps in the future and I will thank you now for the help I know you will offer the District.

Mr. BRIMMER. Thank you very much, Mr. Chairman, members of the committee. I am delighted to appear today. I would ask, Mr. Chairman, that my statement be put into the record and I will hit only a few highlights.

Mr. DAVIS. Without objection.

Mr. BRIMMER. Let me say quickly that I join with the Mayor, and the Chair of the Council in hoping that conditions will be achieved so that the Authority can disappear. I wish it had already done so and then I would not be here today. The legislation which established the Authority also created the Chief Financial Officer. One of the requests of me was to share with the committee a description of the way in which we work together in carrying out the joint functions in financial management in the District. I have described in my statement at some length how we carry out that collaboration, and I would call that to the committee's attention.

One of the things on which we worked most vigorously during the last year was the creation and introduction of the financial management system. This, too, is good news. The system that for many years was talked about is now being implemented.

Among the most difficult problems the District faces in addressing its fiscal condition is the replacement of its ineffective 20-year-old financial management system. As I have said, that is now under way. In August 1997, the Authority and CFO issued a contract to resolve the District's financial management inequities. We completely support the CFO with respect to the modernization program and we believe that the FMS system will have a positive impact on the city's future governance.

The committee has already focused on the audit for the year that passed, but what I would like to do for a moment is to talk about the financial plan and budget and the process under which we are now engaged to put forward the next budget. We talk about the form and improvement in financial management. The area of budget preparation, of planning and budget making is an area that shows substantial improvement. When we came into office in 1995, we found not only a budget in deficit but a budgeting process in disarray. It resulted in, under the act, a very cumbersome set of procedures whereby the Mayor, the Council and the Authority were required to bounce various drafts back and forward, to take public votes, and above all, that created a sense of disarray and conflict. Fortunately, we now have, because of the reform that took place, an opportunity to prepare the budget on the basis of a consensus process that is well underway, it is working well, and we will meet the deadline for putting a budget before the Authority. The Mayor will send a budget to the Council around March 1, the Council will send to the Authority a budget around April 15, and then collectively, after much consultation and working together, we will send a final budget for delivery to the Congress no later than June 15.

I have just a couple of comments I want to make about the annual audit. I too want to applaud the Chief Financial Officer and his staff for the splendid work that they did in producing the results reported in the audit. I would, however, want to stress a couple of components of that surplus which bear some closer analysis. First, I agree. This is a genuine surplus. The comments made by Mr. DeSeve should be taken seriously. But there was fundamen-

tally an underlying improvement in the city's financial condition. I want to applaud that.

However, there are one or two transitory components which should not lead us to conclude that the improvement is as great as it might appear. There is genuine improvement. I would mention first that there are one or two transitory, one-time elements. The Medicaid renegotiations, the corrections clearly are matters which won't be repeated. On the other hand, there is a genuine increase in tax collections. I was struck by the fact that as reported in the audit, individual income taxes were up by $69 million, far above what was expected. On the other hand real property taxes went down $11 million below the budget. With respect to the expenditure side, there was a hold-down in expenditures. I applaud that. But as was already mentioned, Ms. Norton mentioned it and others mentioned it as well, the hold-down on expenditures reflect the delivery of services that are gone. That was not a good thing. We need to make certain that the city's capacity to deliver services is improved. To do that, it would be necessary to spend the money.

There has also been improvement with respect to the city's access to the capital markets. One of the tasks included in the mandate to the Authority was to help the city regain access to the capital markets. The last year was remarkable. I remember one particular transaction where we wanted to sell somewhere in the neighborhood of somewhat less than $200 million but we ended up with over 40 bidders who pledged over $800 million for District credit. We do have access. It reflects the underlying improvement, the genuine improvement in the District's finances and the improved financial market's confidence that the District will continue to improve in the future.

Mr. Chairman, thank you very much for allowing me to make those comments. I would be delighted to respond to questions.

[The prepared statement of Mr. Brimmer follows:]

Mr. Chairman and Members of the Subcommittee:

Good morning. My name is Andrew F. Brimmer, and I am Chairman of the District of Columbia Financial Responsibility and Management Assistance Authority (Authority). I appreciate the opportunity to appear before the Subcommittee today to discuss financial management reform of the District of Columbia government. In my remarks this morning, I will discuss a number of issues, including the strategic direction of financial management in the District, the financial plan and budget process, the financial audit of the District, and oversight of the Office of the Chief Financial Officer by the Authority.

Introduction

Public Law 104-8, The District of Columbia Financial Responsibility and Management Assistance Act, created the Authority to eliminate the District's financial crisis and fundamentally to reform the delivery of public services. Along with the creation of the Authority, the Congress established also a more powerful Office of the Chief Financial Officer and an independent Office of the Inspector General, to assist in the financial and management reform of the Nation's Capital.

During a control year, the Mayor shall nominate and the Authority shall confirm the Chief Financial Officer (CFO) and the Inspector General (IG). During a control year, only the Authority has the ability to remove these officers, subject for cause.

With respect to the position of CFO, Mr. Anthony A. Williams became CFO of the District of Columbia effective October, 1995. Previously, Mr. Williams had been Chief Financial Officer of the U.S. Department of Agriculture, a position in which he focused considerable time and attention on payroll and other financial management systems.

The pattern of Congressional legislation on the CFO is clear. In a series of statutes, beginning with Public Law 104-8 and continuing to the present, Congress has created an office with broad powers and consistently enlarged them. The Congressional Committee which authored the Act establishing the Authority and the CFO emphasized the vital role of the CFO in the implementation of the legislation:

> "The Act would also amend the Home Rule Act to provide for the position of a CFO . . . . During a control period, the CFO supervises and performs all of the financial responsibilities of the Mayor as well as those duties normally assigned to the position. These duties include all tax collection and assessment, all bill paying, approving contracts, allocating available money in compliance with appropriations, and ensuring that the budget is

> adhered to." H. Rep. No. 104-96, 104th Cong., 1st Sess., at 48 (1995). (Emphasis supplied)

The sponsors of Public Law 104-8 all stressed the critical position of the CFO. At the time, Mr. Chairman, you stated:

> "In addition to the creation of the Authority, this legislation creates a permanent, statutory chief financial officer for the District of Columbia . . . . The Authority, the CFO, and the enhanced IG [Inspector General] form the nucleus of a more efficient, responsible, and responsive city government." (Cong. Rec. April 3, 1995, H4067) (Emphasis supplied)

The major responsibilities of the CFO are enumerated in Public Law 104-8 and its amendments. They include, but are not limited to, the following:

- preparing the financial plan and budget;
- assuring the accuracy and consistency of financial information;
- implementing procedures and systems to ensure the correctness and control of accounting, budgeting and personnel systems;
- preparing revenue estimates;
- implementing a program of effective internal controls;
- supervising and assuming responsibility for the assessment of District property, and for the levying and collection of taxes;
- maintaining custody of public funds and investment funds;
- apportioning appropriated and other funds to prevent deficiencies;
- certifying contracts, and certifying and paying bills and vouchers;
- performing internal audits in conjunction with the IG.

Additionally, Congress transferred to the Office of the CFO the functions and personnel of the District Controller, the Office of the Budget, the Office of Financial Information Services, and the Department of Finance and Revenue; and the Office of the Treasurer. Amendments to Public Law 104-8, also provided that the CFO oversees financial personnel throughout the District government.

CFO Performance and Strategic Plan

Mr. Chairman, let me now turn more specifically to the performance and operations of the CFO. First, the Authority is pleased that the CFO has made significant improvements in the District's financial situation. At the time that the Authority and the CFO were established, the District was in the depths of a financial crisis. While there remain considerable problems that demand our attention with respect to the City's fiscal condition, there is no question that the serious financial crisis the District faced three years ago has lessened. Improvements have occurred in many of the City's core finance areas, including in accounts receivable, in tax operations, in systems modernization, in budget formulation and implementation, in the District's cash situation, and in its ability

to finance operations. Mr. Williams and his staff deserve much of the credit for the District's financial turn around to date, and the Authority is pleased with their performance.

With respect to the CFO's strategic plan, the elements should include policy, strategy, operations, and service. Given the state of the District's finances when the Office of the CFO was instituted, it is not surprising that the focus of the CFO to date, and the 1997 Strategic Plan, have been on operations and service.

The operations of the CFO are spread among the statutory departments reporting to the CFO: Financial Operations and Systems (OFOS), Tax and Revenue (OTR), Finance and Treasury (OFT), and Budget and Planning (OBP); and, the financial officers in the line agencies of the District government. The strategic plans of the financial agencies reporting to the CFO also tend to focus on operational issues to address immediate needs.

The CFO's strategic plan goals for 1997 were:

1. An unqualified opinion on the FY1997 CAFR.
2. Implement pilots in two agencies for a new Financial Management System.
3. A more flexible budget formulation process.
4. Develop a pilot for monitoring budget execution to assure control over expenditures.
5. Improve efficiency of the District's financial organization (agencies and financial operations in line agencies).
6. Institute an administrative structure that supports employee performance and results.
7. Build a program to maximize District assets.
8. Develop a CFO Council to be accountable for establishing sound financial management practices.
9. Enhance revenues.
10. Create, document, and adopt financial management policies and procedures.
11. Establish customer service programs and customer service standards.
12. Evaluate and promote opportunities for economic development.

The Authority supported the CFO's issuance of a Strategic Plan and its vision for an effective, customer-driven operation for the City's finances and budget. The creation and dissemination of this plan is, itself, a laudable goal for the District. The process of establishing expectations, and measuring performance, is integral to the improvement of District services. The Authority is convinced that the Management Reform Program now underway will provide opportunities for all District agencies to vitalize strategic plans and measure the outcomes of their public service delivery.

Nevertheless, of the goals listed above, the unqualified opinion on the CAFR is unique. The CAFR is the only goal for which the CFO has committed to a specific outcome at a date certain. For all other goals discussed in the Strategic Plan, the CFO has not sufficiently established specific outcomes that will provide stakeholders with means to assess the nature of service improvements. I would note also that the CFO's Strategic Plan does not in all cases specifically tie the goals and objectives to the statutory base of the CFO's mission. Frankly, Mr. Chairman, this is not uncommon with respect to the operations of the District at this time. A greater reliance on such planning will be forthcoming as the District's agencies move from conditions marked more by management than by crisis.

During 1997, the Authority had a series of meetings with the CFO to discuss the goals, to help to quantify the ones that were vague, to examine the process of internal monitoring and tracking, and to propose the need for closer controls on the issues that cut across all of the financial agencies: data quality (past, present and future); staff quality, systems discipline and integrity; new technology; training; and the standardization of procedures. Based on our collaboration, future editions of the Strategic Plan are likely to show significant improvements.

With respect to the broader issues of policy and strategy, the long term future of the District's financial operation is not enunciated in the 1997 Strategic Plan document. Specifically, going forward, the Authority and the CFO need to determine the expected permanent size and staffing of the OCFO, the financial agencies and the financial functions in the line agencies. Clearly, this will be affected by the Management Reform Program in line agencies. Further, the Authority will need to work with the CFO better to determine the model and benchmarks for long-term viability and efficiency in financial programs and operations.

For example, in the longer term, the CFO should be in a position to determine the best, or highest, use of an additional financial person added to the District's payroll; assure taxpayers/residents that the standard in his operation is one of complete confidentiality with respect to individual financial information and complete integrity with respect to public assets; determine that residents/taxpayers asking questions of different staff in different parts of the organization are receiving the same, and correct, answers; and demonstrate to District residents/taxpayers that the costs of the financial operation are as low as they might be.

In the creation of the OCFO in 1995, there was an explicit recognition that the District's financial operations were in disarray and lacked, among other things, financial policy direction. A major focus of the CFO should be to establish a range of policy goals and a strategy for achieving them. The 1997 Strategic Plan did not address policy direction. In particular, the CFO should

develop explicit policies, with accompanying strategies for achievement, set out in the following areas:

- Structural budget balance;
- Expenditure containment, downsizing and personnel reduction;
- Cash management;
- Revenue and tax reform;
- Debt management;
- Budget discipline and integrity;
- Capital planning (treatment of capital assets: depreciation, preservation, enhancement and repair;)
- Corruption prevention and detection.

The Authority looks forward to working with the CFO in the months ahead to ensure that these important issues are completely integrated into the 1998 Strategic Plan, and that they are given priority in future endeavors of the Office of the CFO.

Financial Management System

Mr. Chairman, I will make just a brief mention of the Financial Management System (FMS). The reason for that is because, after many years of stop-and-go efforts, we are now moving forward. FMS is being implemented.

Among the most difficult problems the District faces in addressing its fiscal condition is the replacement of its ineffective 20-year old financial management system. In August, 1997, the Authority and the CFO issued a contract to resolve the District's financial management inadequacies. The CFO orchestrated extensive consultation with private and public sector organizations that culminated in a competitively-bid contract to acquire a new system that will utilize off-the-shelf software and eliminate many of the obstacles the existing system presents to effective financial management. Pilot implementation began last week in the Metropolitan Police Department, the D.C. Public Schools, and central agencies. The system is expected to be operational for fiscal year 1999.

We are completely supportive of the CFO with respect to the modernization program, and we believe that the FMS will have a positive impact on the City's future governance.

Financial Plan and Budget

Regarding the District's financial plan and budget, I think that it is important to note that we have achieved considerable progress – despite the unwieldy process that characterized the budget until this year. A more stable budgetary environment and improved financial conditions, combined with greater collaboration among all stakeholders, should continue to make the formulation

and implementation of the annual budget an increasingly effective tool in administering City operations.

Fiscal year 1996 marked the first full fiscal year under the Act and the first control year. However, the process surrounding the final approval of the fiscal year 1996 financial plan and budget became one of the most protracted in recent memory. The District submitted its budget request to the Congress on June 15, 1995. Congressional review was not complete at the beginning of the fiscal year, and in fact lasted over half of the fiscal year. On March 29, 1996, the Authority voted to allocate the fiscal year 1996 budget of the District in accordance with the $4.994 billion gross budget agreed upon by the Congressional conference committee.

Informally, the Authority continued working with the CFO to monitor spending throughout the fiscal year. As a result of the CFO's actions and more intensive monitoring of the spending, the deficit was limited to $60.7 million, as compared to the $116 million deficit authorized by the Appropriations Act for fiscal year 1996.

On June 14, 1996, the Authority, the Mayor, and the Council submitted a consensus financial plan and budget for fiscal year 1997. The budget submission included estimates for revenues of $5.03 billion, expenditures of $5.129 billion, and a resulting deficit of $98.9 million, down from the projected fiscal year 1996 deficit of $116 million. However, the Appropriations Act of 1997 established limits on the District's overall spending in two ways. First, the District was authorized to incur a deficit of not more that $74 million, almost $25 million less than the consensus budget estimated. Second, the District's total aggregate spending was limited to $5.109 billion or the total sum of revenues, whichever is less, including enterprise and other sources.

The fiscal year began with a requirement that the District make additional reductions of $25 million to compensate for the smaller deficit for the fiscal year. Additionally, in November, 1996, the CFO identified potential overspending of $60 million that required action to preclude exceeding the enacted limitations on spending and the deficit. On December 27, 1996, the Authority ordered budget reductions, adjustments, and other control actions to address the projected budget shortfall. The CFO and the Authority continued to monitor agency spending and deficit reduction action plans to ensure that the District met its budget goals. In this regard, I must note that the Authority is concerned that the estimates made at the time were not reflected in the significant surplus recently reported as part of the fiscal year 1997 financial audit. The considerable difference between the shortfall initially projected and the surplus ultimately reported highlight the need for further refinement in the District's ability to assess the budgetary implications of revenue analysis.

The fiscal year 1998 budget development process was more effective because key stakeholders, including the District Council, Mayor, and the Authority, early in the cycle jointly reviewed goals, priorities, and options. The approach for fiscal year 1998's budget focused on priorities rather the approach used in prior years, where budget marks were provided to agencies and agencies were then required to formulate a budget that fell within those marks.

The final budget submitted to the Congress on June 15, 1997, included minor variances between the Authority's proposed budget and the District Council and Mayor's proposed budget. These minor variances were subsequently eliminated in a consensus budget presented to the Congress, based on enactment of the National Capital Revitalization and Self Government Improvement Act. It is important to note that one major consensus objective established and met by the stakeholders was a balanced budget for fiscal year 1998--one year earlier than required.

In accordance with the Revitalization Act, and based on suggestions to the Congress by the Authority last year, a new budget process will allow us to work with the Mayor and the Council on a consensus basis, streamlining the cumbersome process in the original Authority Act. The revised process will enable us to deliver a consensus budget to the Congress as required no later than June 15. It *will also* enable us to focus on developing better budget estimates with respect to policy choices. The Mayor will deliver an initial budget to the Council about March 1; the Council will deliver a budget to the Authority about April 15. And the Authority—after consultation with the Council and the Mayor--will finalize a budget for delivery to the Congress no later than June 15.

Comprehensive Annual Financial Reports

Mr. Chairman, the fiscal year 1994 financial audit reported a deficit of $335 million. However, the audit was completed under a cloud of uncertainties, including questions about the extent of the deficit and how much the District owed to vendors. As a result, one of the first tasks undertaken by the Authority was to contract for and supervise the fiscal year 1995 financial audit for the District. Extraordinary efforts initiated by the CFO to reduce spending resulted in the fiscal year 1995 audit showing a deficiency that was substantially less than the prior year.

The fiscal year 1995 financial audit resulted in a qualified opinion on the District's financial statements. Despite the challenges resulting from the delayed appropriations for fiscal year 1996, which I mentioned previously, the CFO still made some progress in addressing the District's financial operations and management. The District's spending for the year was again substantially less than originally projected for the year. While the District did spend less in aggregate, overspending did occur within some agencies--mainly because of the

poor financial systems, questionable contracting practices, and inadequate procedures to control staffing levels.

The fiscal year 1996 financial statements were again qualified because of insufficient evidence to support the receivables for business taxes stated at $39,267,000. The internal control weaknesses reported by the auditor's reports on internal controls continued to show widespread problems. However, the auditor's reports on internal controls acknowledged that the CFO had initiated some actions to address the reported problems, and some improvements were noted.

The best measure of the City's improved situation is seen through the results of the fiscal year 1997 audit. While the reports still indicate many widespread internal control weaknesses, the reports also acknowledge that the CFO took many interim actions to compensate for the lack of good internal controls and the inadequacies of the financial systems that preclude timely reporting on the status of funds. Each month, the Budget Office conducts an extraordinary manual effort to develop a funds status report. Also, each agency is required to report on its budget execution and project funding needs for the remainder of the fiscal year. Each quarter, this same process is used to develop comprehensive financial data for the District to use in its reports to the Congress on the District's financial status.

Most importantly, the District received an unqualified opinion for fiscal year 1997, and it was able to report a surplus in the general fund of $185 million. It is the first surplus for the City since 1993. A significant reason for the surplus is the result of $110 million in increased revenue from taxes. Net Medicaid savings represent $53.9 million of the surplus, the sale of the Corrections Treatment Facility produced $53.6 million, and savings in a number of agency and program related areas were responsible for $41.5 million. I would also note that the CFO, as mentioned earlier, has made improvements in a number of areas that are also addressed in the financial audit, including business tax collection, fixed asset management, procurement, and accounting operations.

There is no question that the financial audit results represent true progress in our efforts to revitalize the District's financial and management condition. But let us not be too quick to celebrate. We all still have much work to do-- not only to address the long-term fiscal stability of the District, but also to improve the delivery of services. We can not let this success cloud our mission or cause us to lose momentum in pursuing effective, long-lasting improvement to the District and its operations.

Tax and Revenue

Mr. Chairman, let me briefly turn to issues of taxes and revenue. I have already mentioned that increased tax revenue has helped to produce the first

surplus since the fiscal crisis began. Additional improvements are likely in the future, but it will take sustained efforts to ensure revenue growth. The Authority continues to support substantial change in systems and process within the Office of Tax and Revenue (OTR) to achieve revenue goals.

At the core of the OTR's operations are the automated data systems that contain all pertinent tax records. Problems of managing these systems throughout the agency are endemic, and negatively affect every aspect of its operations. This is especially true of the operations and processes surrounding the agency's data system administration, the core functional area charged with ensuring the efficient collection, manipulation, processing, and storage of tax and taxpayer information.

The Chief Financial Officer has begun to implement solutions to strengthen the District's revenue management function, and transforming and reconfiguring its processes and policies. Some of these processes are either underway, or have been completed. The Integrated Tax System, and the concurrent realignment and reengineering of the agency, are expected to be fully developed and implemented by the year 2003. Mr. Williams will provide additional information on this subject in his testimony.

Financing Issues

Turning now to financing issues, we have also seen significant improvements in the District's access to the credit markets. In fiscal year 1997, the Authority, working with the CFO, engaged Disclosure counsel on market borrowings undertaken by the District. Improvements also were made to ensure that the District's disclosures to the marketplace met the requirements of the Municipal Securities Rulemaking Board. Additionally, improvements in the accuracy and quality of the information being disclosed helped bolster the confidence of market participants, thereby enhancing investor interest. Also, the District procured new financial advisors through a competitive process. The results of this procurement led to the signing of three separate contracts to help strengthen discrete operations of the CFO at more competitive hourly costs.

With disclosure counsel and new financial advisors in place, the District proceeded with its scheduled issuance of market borrowings for both capital and cash flow purposes. During fiscal year 1997, the District successfully issued and sold $408,390,000 of long-term General Obligation Bonds, $264,800,00 of short-term General Obligation Notes, and $223,100,000 of borrowings through the U.S. Treasury (Treasury Advances). I would also note that the Authority has seen the level of investor interest in

District obligations steadily improve, and the spread above comparable market based borrowings narrowed considerably,--thereby lowering the overall cost of funds to the District. I am certain that the recent financial audit results will also boost the District's credibility in the markets, as it shows that the City is better able to manage its financial affairs.

In sum, the District's position and access to the credit markets are significantly improved because of the joint efforts and actions of the CFO and the Authority.

Financial Oversight

Finally, Mr. Chairman, let me mention our direction with regard to oversight of financial management in the District. The Revitalization Act provides the Authority with a unique opportunity to strengthen its oversight of District agencies. By utilizing the Chief Management Officer to oversee the day-to-day operations of the agencies and government functions that we now directly manage, Authority Members can spend more of their time engaged in long-term oversight and strategic planning related to the District's broad-based recovery. The Authority will, of course, retain direct oversight over the Public Schools, in conformance with its November, 1996, Order, and of the Metropolitan Police Department, through the Memorandum of Understanding agreement.

Now that the Management Reform Program is in place, and the Chief Management Officer, in conjunction with the Management Reform Teams, is engaged in implementing specific agency-level plans, the Authority can shift its course to the provision of City-wide oversight. Utilizing the Chief Management Officer, the Chief Financial Officer, and the Inspector General to leverage programmatic and operational change, the Authority will in the months ahead chart a specific approach to financial and management improvements in the District.

All efforts to improve the government and its operations will require coordination in the development of appropriate strategies for their successful formulation and implementation. There can be no effective management reform program, for example, without knowledge of budgetary implications and financial accountability overall. Sequenced work plans throughout the government will require unparalleled cooperation to leverage maximum reform. Performance management will necessarily rely on outcomes verified through an independent quality assurance program. And improvement goals throughout the government necessitate integrated strategic plans which articulate missions supported by stakeholders.

The Authority will continue to work closely with the CFO and others to achieve these results. Using the budget and financial audit process, systems improvement plans, and the refinement of the CFO's Strategic Plan, we believe that the District can take the next steps to financial health. The Authority will maintain its close ties with the CFO and facilitate improved results in financial programs in order to ensure an effective, long-term recovery for the District and its citizens.

Mr. Chairman, that concludes my prepared testimony. I would be happy to respond to any questions that you or other members of the Subcommittee have at this time.

# # #

Mr. DAVIS. Dr. Brimmer, thank you very much. Now the Chief Financial Officer, Mr. Williams. Thank you for being with us.

Mr. WILLIAMS. Mr. Chairman and Members of the committee, I would like to thank not only the committee but the president, Frank Raines and Ed DeSeve, as people have mentioned. Personally I have worked with Ed DeSeve on a CFO consult back in a previous job, and we have worked closely with him as we went through this financial recovery. He has been enormously helpful to us and we are appreciative of that. I would like to make that thanks. I would also like to thank not only the Mayor and the Council but the Authority, and especially the Authority staff, who have been enormously helpful to us every step of the way.

If it would please the committee, I would just like to go through a couple of charts by way of my testimony. My written testimony has been submitted for the record, so if we could just start with the first chart. I will try to do this in 3 or 4 minutes, very briefly.

Of course one of the highlights for this year's audit, as has been mentioned before, is that we now have a clean opinion. This is good for the District because it represents the fact that we have made improvements in our underlying processes. As Mr. DeSeve has mentioned and others have testified here, we have a long way to go but we are basically telling our citizens and investors now that we are fairly stating our financial results. That is a good thing. A general fund surplus of $185 million. I agree with Ed DeSeve. This is basically looking globally with all the accounting adjustments on where we stand, $185 million, but as Dr. Brimmer has stated, we have an actual real surplus here in the District of around $108 million, which I will go into in a second.

Increased revenue from taxes of $110 million, improvements resulting not only from improvements in the economy but very especially from improvements in tax collection and administration. Because of an improved tax collection administration we are seeing improved voluntary compliance by taxpayers. This surplus is broken down in the following ways. I mentioned the increased revenue primarily from income tax, improved economy, voluntary compliance, improved collection. Mr. DeSeve talked about the Medicaid adjustments; that is, looking at long-term liabilities in terms of Medicaid and bringing those down as we scrub our books and get our books in order. This is a one-time thing. We cannot rely on this on a recurring basis. It really doesn't represent our position going forward, as he stated.

Sale of the Correctional Treatment Facility, representing a one time benefit to the District of $53 million. A local surplus which I will go into in a second of $41 million. Essentially underspending or positive benefits by the agencies in a number of different areas, representing a total variance again on a GAAP basis of $259 million; in other words, a swing of a projected $74 million deficit to a $186 million surplus.

Continuing on briefly, this local surplus combines the following things. First of all, it combines a benefit we realize by lower interest. We save $8.6 million on interest costs. This is a positive thing for the District government.

The Department of Corrections was unable to spend $8.7 million. Late in the year they received a waiver from the trustee for the

Federal Government resulting in a benefit that we could not expend by the end of the year. Yes, we have congestion in the system, but we received that benefit late in the year.

Economic development is a matter of concern, as Dr. Brimmer and Chairman Cropp have mentioned. In that we received funds for hiring personnel in economic development work, we were unable to do that during the year. That is obviously something we need to fix next year.

In human services there was underspending by $7.8 million. That is bad because that is a service that is not getting to needy citizens. On the other hand, this represents about 1 percent of their overall budget. Given the state of systems in the District payroll over there in terms of processes, it is actually a minor miracle. Across the District government we realize underspending of around $11 million. These are largely training funds that were not actually put out into the system where folks were actually trained. This is going to be corrected this year as part of a management reform program.

Just continuing on quickly, we gave ourselves a progress report comparing last year and this year. As Mr. Farrell has mentioned, as Ed DeSeve has mentioned, yes, we have an unqualified opinion, yes, we have made major improvements in a number of management letter concerns. I believe we have put in a tracking system to reliably now attack lingering outstanding management letter comments and remove them from the audit. We go through an annual process now of lessons learned from the audit. We have now set up a tracking system for all the audit findings in the District government, and we now undergo a yearly risk assessment to look at long-term early warning signs. I am confident that now on a recurring basis we can begin to, as we have this year, see a consistent reduction and hopeful, as soon as possible, elimination in these management letter concerns.

So overall in business taxes we started with an F in 1996. We heard about the Himalaya Mountains and file room and all that. We are going from an F in 1996 to I think a C now in 1997. In other words, I believe that we have now put our business tax operation on a very fragile but pretty much an average basis. We want to continue that improvement with the integrated tax system we now have under way. In fixed assets, we started with an F in 1996, no idea where we stood with our fixed assets, no inventory, no tabulation. We did a massive effort this year to begin a tabulation of fixed assets in the District. We continue that effort with the overall asset management program under my auspices and that of the Chief Management Officer, give ourselves a B now.

Policies and procedures. Last year we had no policies and procedures in the District government. This was not only a management letter concern but just an overall management concern. I would use the analogy of a minivan. There are about 10 or 11 people in the District government who know how these systems work. If this minivan were hit by a truck, without policies and procedures, we have no way of replicating that knowledge. We now do and we now have in 1997, I think, the grade of a C-plus.

Finally, in technology we start off with an F, but we are beginning initial tentative efforts in terms of the financial management

system, the payroll personnel system, and the integrated tax system. The new chief technology officer for the District is getting under way now. And we are going to begin making headway but we are starting off way behind. We are only realizing the initial steps. So there is urge for caution there.

I would wrap up by saying I believe our single most important initiative for this coming year is seeing that our systems initiatives are brought in on time and under budget, the financial management system, the beginning of the integrated tax system and the payroll personnel system. With that, Mr. Chairman, I would be happy to answer any questions you may have.

[The prepared statement of Mr. Williams follows:]

TESTIMONY OF THE DISTRICT OF COLUMBIA CHIEF FINANCIAL OFFICER ANTHONY A. WILLIAMS

Chairman Davis, members of the Committee, my name is Anthony A. Williams and I am the Chief Financial Officer of the District of Columbia. I am extremely pleased to be here to share with the Committee the results of the District of Columbia's Fiscal Year 1997 Comprehensive Annual Financial Report. This report indicates that we have made substantial improvements in the District's financial position while at the same time bringing integrity and accountability to the financial management of the government of the District of Columbia. Let me say at the outset that credit for this turnaround belongs to all of the decision makers in the District: the Council, the Authority, and the Mayor. I want to also thank you Chairman Davis and Representative Norton, for your efforts in securing passage of the Revitalization Act for the District which paves the way for further improvements in the District's financial position and for supporting the reforms that are now bearing fruit. Also I want to thank the President and the Office of Management and Budget for developing and assisting in the passage of the Revitalization Act. Last but not least, I want to thank the folks who work for me and made this unqualified opinion and increase in revenue possible. That includes Earl Cabbell, our Deputy Chief Financial Officer for Financial Operations and Systems, for his leadership in ensuring an unqualified opinion and Natwar Gandhi, Deputy Chief Financial Officer for Tax and Revenue for his efforts in our tax department.

Audit Results: Unqualified Opinion

For the first time since 1994, the District received an unqualified opinion on its financial statements. We have made tremendous strides in cleaning up the business tax files in our tax department. To achieve this unqualified opinion, the financial management organization of the District has undergone a massive effort to resolve the problems documented in Fiscal Years 1995 and 1996. By strengthening internal controls, examining all accounts payable, cataloging the District's fixed assets, developing policies and procedures for all financial operations, and ensuring that every transaction in our Byzantine budget process can bear scrutiny, we have begun to address many of the serious issues that have undermined the District's financial stability for many years.

Audit Results: Budget Surplus

The audit indicates that we ended 1997 with an operating surplus of $185.9 million, which far exceeds our initial budget target of a $74 million deficit. While some of the surplus is due to an unexpectedly strong economy and one-time revenues - such as the sale of the Correctional Treatment Facility for $56 million – much of the surplus resulted from improved management of the basic financial functions of a city: collecting taxes, holding the line on expenditures, and planning for future contingencies.

Although there is still an accumulated deficit of $332.3 million that remains to be retired, the District has demonstrated that it can eliminate budget deficits and cash shortages through comprehensive financial planning, sound budgeting, accurate revenue forecasts and careful spending as called for in the Control Act.

Much work still remains, however. Let me now discuss some of the initiatives we are implementing that will not only improve the District's financial position, but will also lead directly to improvements in customer service, both internal and external.

Fiscal Year 1998 Systems Improvements

The Office of the Chief Financial Officer is in the middle of several important systems improvements that will have a salutary effect on the delivery of financial services to the rest of the government, and most importantly to the taxpayers of the District.

Financial Management System

Let me start with the new financial management system (FMS) currently being installed. There are two pieces to the FMS: Hardware/Software and reengineering of process/training of personnel. With the help of this Committee and the Authority we secured funding for and selected a vendor to implement the first piece, a new system. Just last week we installed, on a pilot basis, the new system at the Metropolitan Police Department, D.C. Public Schools and the Office of the Chief Financial Officer, among others. Over the next few months, we will include the Office of Grants Management and procurement and personnel functions. The system will be fully operational by October 1, 1998.

The new FMS will allow agency heads and others to access financial information in real time: that is, instantaneously. Currently, financial information is usually 60-90 days old by the time it is compiled into a report for officials. And some information is never available. Agency heads will be able to access financial information at their desktops with the click of a

mouse button. Having timely information readily available will allow managers to make informed decisions regarding departmental priorities.

The new FMS will dramatically improve the ability of District officials to make the important budgetary and programmatic decisions necessary to streamline and improve agency operations while at the same time ensure that spending caps are not exceeded. The feedback from out pilot agencies has been extremely positive.

Another major component of the FMS installation includes an intensive, ongoing training program and reengineering of our financial processes. These elements of the implementation are critical to success of the overall project and ones that we take very seriously. All users will be fully trained in the operation of the new system. This training has already begun. Additionally, we are undertaking a reengineering of our financial process in order to ensure that our systems and processes are synchronized for maximum efficiency and performance.

I want to thank the Committee for their support of this critically important system and will continue to meet with you and your staff as we make progress towards completion.

Integrated Tax System

The other major systems implementation we are undertaking is linked directly to improvements in our level of customer service. This is the Integrated Tax System, or ITS. The contract for this system will be signed soon and is part of the District's overall management reform process. The bulk of the system will be phased in over 3 years.

Currently, the computers in our tax department do not interact with each other. That is, if a citizen calls and asks questions about their property tax they cannot get an answer to a

question about their income tax. Thus, the customer has to call another customer service representative and only maybe will that employee have the information that the customer needs. The ITS will change all that.

When operational in 1999, a customer can call the tax department and get useful information regarding any of their taxes from one central source, much like when we call Visa or American Express and ask about our credit card bill: prompt service with accurate information. That is our vision and I am committed to achieving that vision.

The other important feature of the ITS is that it will be linked with the computers of the District of Columbia's Consumer and Regulatory Affairs office. This will allow the cross-checking of businesses who may have business licenses that are not filing taxes or vice-versa. This will greatly increase both voluntary tax compliance and enforcement of business taxes.

The Comprehensive Automated Personnel / Payroll System (CAPPS)

The District of Columbia currently uses an antiquated personnel and payroll system (UPPS) to support the Department of Personnel and the Office of Financial Operation and Systems to process personnel and payroll transactions. This system was a "gift" from the federal government in the 1970s and adapted for use in District. Because of the limited automation, volume of transactions, and long transaction times, this system leaves much to be desired. Additionally, because the system was designed as a federal system, it was not well suited to perform the necessary functions of a state/local entity..

From a functional vantage point, CAPPS will improve our data stewardship and data management through a single comprehensive data warehouse, online transaction processing and

query capabilities. It will carry history forward, include online help, and contain multiple levels of security.

CAPPS includes a flexible reporting tool to enable managers to analyze trends of the past, and accurately predict future trends. Managers throughout the District will now have proper access to data to improve program management.

In short, CAPPS will:

- Enable the District to pre-budget positions before they are filled;
- Control overtime;
- Improve the speed of personnel changes;
- Streamline the labor intensive time and attendance process; and
- Improve the payroll process by ensuring the right people are paid the right amount, while preserving the District's on-time payment record

After defining requirements that best met the city's needs, the District procured software that form the underpinnings of CAPPS. In 1994, the city sought vendors to provide business process re-engineering and system integration services. After procurement delays and a freeze in funding beginning in 1994, the District resumed its developmental activities in late 1996. Now in early 1998, we are on the verge of implementing this system. Roll-out will commence in April 1998 and is expected to be completed during the summer months.

This project had been stalled when I became CFO. I am proud to say that we now have it on track.

Highlights of Operational Accomplishments

From an operational perspective, we have made tremendous progress since 1996. Let me just highlight a few of the accomplishments in my office and in the financial operations of the agencies:

Tax Department

- Improved collections of tax receivables
- Improved rates for voluntary compliance
- Clean-up of our business tax receivables database
- Same day deposit of checks
- Homestead audit which brought in over $15 million
- Tax sales which brought in about $25 million

Treasury

- Reduced cost of borrowing saving the District roughly $9.5 million
- Improved dishonored check collection
- Increased revenue generated from Unclaimed Property unit
- Passage of the Depository Act which will result in increased revenue of nearly $1 million

Agency Operations

Another key accomplishment has been the hiring of Chief Financial Officers in all of the major agencies of the District of Columbia. These CFOs played a pivotal role in the Fiscal Year 1997 audit. Moreover, the CFOs have instituted policies and procedures ensuring that the

financial operations of the agencies are continually improving. By establishing a Chief Financial Officers Council similar to that of the Federal government we are allowing agency financial managers to develop government-wide solutions to agency problems. This Council continues to make improvements in budget development and execution and accounts payable, to name a few.

Conclusion

In closing, Fiscal Year 1997 was a critical year for the District. And I am proud to say that we have had many accomplishments. However, much work remains. We must fully install the new Financial Management System, continue to make improvements in internal controls, and continue to make improvements in customer service. I am committed to achieving all these objectives.

Thank you for the opportunity to testify today and I am pleased to answer any questions you may have.

Mr. DAVIS. Thank you very much, Mr. Williams. I am going to ask Ms. Norton if she has any questions.

Ms. NORTON. Thank you very much, Mr. Chairman. While all of you are at the table, I have a question for all of you on short-term borrowings and on accumulated deficit borrowing. As I recall, Ms. Cropp indicated that we might be done with the accumulated deficit by the end of 1999. Mr. DeSeve testified that the District of Columbia would not need to do short-term borrowing if we do an accumulated deficit borrowing. In December, Dr. Brimmer was asked, off the top of his head I think, to simply estimate what the accumulated deficit was. At that time he thought it was about on the order of $500 million. I would like the opinions of each of you on, one, whether or not you think there will be a need for an accumulated deficit borrowing, particularly given Ms. Cropp's testimony, what you think the accumulated deficit is, and if the need for short-term borrowing depends upon our doing an accumulated deficit borrowing which would give us cash on hand.

Should we begin with Mr. Farrell?

Mr. FARRELL. Thank you, Ms. Norton. That is really looking at a prospective type of operation of the District. My audit was based on transactions that had taken place during—preceding the fiscal year. I don't really believe it appropriate for the auditor to be commenting on management's plans with respect to borrowings.

Ms. NORTON. I wasn't asking you about finance. I am trying to get based on what we know now. If you want to dodge it, that is fine with me. But I am trying to use existing information to discern whether or not the District will need to do short-term borrowings in this year, whether that is dependent upon having cash on hand that will come from accumulated deficit borrowing, therefore whether or not we need an accumulated deficit borrowing or whether, as Ms. Cropp predicts, we might not need one at all because we might be rid of the whole accumulated deficit by 1999. I would think in a real sense you might be in the best position to comment on that.

Mr. FARRELL. We are shortly into the new fiscal year, I believe Mr. Williams will be able to confirm this, that the city already did short-term borrowing.

Ms. NORTON. That was in part I think because of delay. I am asking another question. If you don't want to answer, Mr. Farrell, I won't insist.

Mr. FARRELL. I will pass for now.

Ms. NORTON. Dr. Brimmer, Mayor Barry, either of you.

Mr. BRIMMER. First with respect to the accumulated deficit, at the end of fiscal 1997 it was about $332 million. That is reflected in the records now. When the budget was approved for fiscal 1998, it was assumed that there would be—we have the authority to borrow, and we assume that there might be a need to borrow just over $100 million, around $110 million. The surplus in the budget which was then estimated around $200 million presupposed there would be a borrowing to reduce the accumulated deficit. But, Ms. Norton, whether that takes place or not is a policy question, not just a question of statistics but a policy question. My own view is that in the long run, because we are not likely to be able to generate enough operating surpluses year by year, that we would probably

have to borrow to reduce that accumulated deficit. We are now reexamining the question. But with the way revenues are flowing now and given the forecast for those revenues, it is clear that we probably will have to have very little short-term cash-flow borrowing this year, and I believe that we will be able to make some substantial reduction in the deficit. But if I had to guess right now, I would say there is some likelihood—a likelihood that we might do some deficit borrowing this year. How much, I don't know.

Mayor BARRY. Ms. Norton, we might discuss this in terms of Ms. Cropp or the CFO, but my own analysis is that we have a $332 million accumulated deficit as of September 30. We have revised revenue estimates of about $160 million. Some of that $160 million in my view may have to be used for some part of the management reform. I just told Ms. Cropp that just my analysis would not lead me to the same conclusion. I don't see how with the present revenue and the pressure on the budget, we can't eliminate $332 million by fiscal year 1999. We cannot do that. Even if we took all the $160 million and spent it there, adding that $60 million anticipated in 1999 over revenue estimates would not get us to $332. I would suggest we rely on Mr. Williams' analysis without getting into some of the policy decisions as to what might be the earliest. We can reduce the $332 million. Assuming we take $100 million, what we have now, and put it on the deficit, that is $232. We will reduce the need to borrow but the amount cannot be zero, not in 1999. It just mathematically won't work unless we are going to cut the budget by $200 million. We ought to rely on Mr. Williams' advice in broad outlines of how we get there.

Ms. NORTON. Mr. Williams.

Mr. WILLIAMS. I would agree with Dr. Brimmer, Chairman Cropp, and the Mayor that ultimately what one decides to do in terms of borrowing or not borrowing in this context is a policy question. But in terms of the analysis I guess there are 3 things to look at. There is the short-term seasonal borrowing for cash, there is a borrowing for cash because of an actual cash deficiency, and then there is your attack on the overall accumulated deficit. Attacking the overall accumulated deficit is a policy question that is going to take a number of years. That is up to the policymakers. In terms of the underlying cash needed for the District, the surplus we are realizing this year and the increased revenues that we are projecting clearly lessen that issue. That is an issue. Although policymakers may still want to as a policy choice borrow to finance the cash deficit to leave options open in other areas. That is a policy choice. In terms of seasonal cash needs, this can happen in the best of operations with the best of resources. That is something we constantly have under analysis. We typically have borrowed over the summer for seasonal cash.

Ms. NORTON. I will get to Ms. Cropp as well. I think that the seasonal borrowing question came up in the way it did because Mr. DeSeve was trying to think of a circumstance in which one would have to do no short-term borrowings. I think the only circumstance he could think of was if you had the cash that would come out of an accumulated deficit borrowing.

Ms. Cropp.

Ms. CROPP. I just wanted to state that my testimony talked about cash, or cash borrowing; it also did not go further to say that it is a policy decision that we have to make. That is very clear. We just received the audit this year and we have not come together to make those decisions. But what my testimony was suggesting, that I still stand by and say it is extremely valid, that there are opportunities for us because of this surplus that we did not have before and we have to make those policy decisions as to which is the best direction for us to go in to continue financial stability, at the same time improve management and the services that we deliver to our citizens.

Ms. NORTON. It is clear you are going through a very thoughtful process. My first round is over. I guess I would pass to Mrs. Morella.

Mrs. MORELLA [presiding]. I would like to recognize now the gentleman from California for his questioning, Mr. Horn.

Mr. HORN. I thank the chair.

Mr. Williams, you will note on the audit, pages B–6 to B–10, the year 2000 problem. I just wonder who is going to be responsible for implementing the transition that is needed just 688 days from now. We are getting down to 7 quarters, 688 days. What is the strategy of the District government and who is responsible for the conversion?

Mr. WILLIAMS. Overall responsibility I guess would be vested with the Authority and Dr. Brimmer; the Chief Management Officer, Dr. Barnett; the Chief Technology Officer, Michael Herndon. All I can say is that as part of that overall effort, we have made every effort to ensure that in our system's implementation, the integrated tax system, payroll personnel system, financial management system, that those systems are 2000 ready or compliant. I could turn to Dr. Brimmer.

Mr. HORN. Dr. Brimmer, what is the plan? Have we got one? Are you getting weekly reports on testing? We need testing, we need to go through those lines of code and we need a strategy here, or you are all going to have mud on everybody's face around here.

Mr. BRIMMER. The responsibility for carrying that out is the responsibility of the Chief Technology Officer, Dr. Herndon. The responsibility and the funding have been recently transferred to his care and custody. He is developing the plan. I do not get weekly reports.

Mr. HORN. Will the Control Board review the plan?

Mr. BRIMMER. Yes, it will.

Mr. HORN. I will let it go at that. I have got a number of other questions. I just want to know where the responsibility is.

Mr. BRIMMER. With the Control Board, and we will be reviewing it.

Mr. HORN. Financial management systems. Mr. Williams, you heard my question to Mr. DeSeve at the OMB level. What are your plans in terms of implementation of additional financial management systems? Where are the real sore points that you see, that by getting a decent system we would at least know where we are on expenditures and we would at least know where we are on revenue. What are your thoughts on that?

Mr. WILLIAMS. Mr. Chairman, the financial management system that we have right now, you would loosely describe it as a financial management system because it doesn't have some of the key ingredients here. The hardware and software is out of date. Then as you know very well, when you talk about a system, you are not only talking about hardware and software, you are talking about operations, people and processes. Talk about operations, it is a system that is disconnected in many, many ways from your key components. For example, we don't really have tied to the system accounts payable, accounts receivable, real property, grants. So as you know, how in the world could a manager really manage his or her operation, for example, if they don't really have good balance sheet information in terms of what their payables and receivables are? How can we as a District, for example, timely pay the people we owe and timely manage our affairs to people who owe us without that kind of information?

Another problem with the system is it takes us right now to produce what we call our monthly and quarterly reports an enormous amount of manual intervention just to produce a comprehensive report for the decisionmakers that is 60 days old. In this day and age, producing a report that is 60 days old is like the kid coming home with a frog. They are proud of it, but it is really not getting the job done. We are very proud of these reports, but they are not really useful as they stand to managers.

Mr. HORN. Let me ask you on the budget to monitoring the Chief Management Officer would have to do, and you and others. It seems to me as a former executive, the simple way to do that is have the budget account, how much is expended on a monthly basis, what percent of the budget has been expended, assuming a steady stream because we are labor intensive and presumably if you have got the 70 percent mark you are roughly two-thirds of the way through the budget. Do you have that kind of monitoring tool which really ought to come to your desk every week, or every month for sure, to know where you are on the budget expenditures?

Mr. WILLIAMS. Our monitoring right now is basically a matter of us working closely with the agency CFOs with whom we have a direct relationship. We have given them the authority and responsibility to manage their budget. They report to us again on a manual basis. With a new financial management system, and we already have pilots under way as we speak with the police, education, public works in my office and this summer with all the agencies, it will actually be real-time reporting. The transaction can be put in in the morning and there will actually be real-time information to all the decisionmakers, agency managers and financial people in minutes.

Mr. HORN. How long will that take?

Mr. WILLIAMS. We expect to have the system fully implemented and operate as a system of record October 1, 1998.

Mr. HORN. One last question. Parking meter contract. What has happened on that in terms—and what are we doing with parking meters? I see them chopped down around town. Is that the District government just chopping them down because they don't want to dig them out or are they going to have lower level parking meters for those of us that are rather small, or what?

Mr. WILLIAMS. Dr. Barnett, the Chief Management Officer, has made this her top priority. The Council has passed a resolution approving the contract. It is now before the Authority. We expect to work with her in maximizing that source of revenue now for the District government.

Mayor BARRY. Congressman Horn, the meters are being taken out by other people. The District is not doing that. We finally have gotten that contract approved by the City Council. It involves state-of-the-art meters, 15,000 meters. They are almost tamperproof, vandalism proof.

Mr. HORN. Are they metal saw proof?

Mayor BARRY. Yes, sir. If you pick up one, it would take steel as hard as the steel they make to try to saw them off.

Mr. HORN. Someone has obviously made a great fortune.

Mayor BARRY. It is easy to knock their heads off. You can take a hammer and just knock them off. We found a ring of people going around town. It is hard to prosecute because people do it quickly and disappear. We have broken up that ring of people who were deliberately taking these meters off, that is where the money is, and busting them up to get the money out of it. That has decreased. I am anxiously awaiting this contract to be implemented so we can get the meters back on the streets. And also it has affected income by $4 or $5 million, too.

Mr. HORN. Let me make one more suggestion. All I can say, Dr. Brimmer, is that if we had a decent public works operation where they striped the streets so you knew what your space of parking was, you would add many more parking places in residential areas, everything else. I live up here on D Street. It is just silly the way you lose 5 parking spaces in a block because it is just, you know, haphazard. You can park any which way you want, 3 inches from the person in back of you, assuming they have pretty good steering, and 1 foot from the person in front of you. Or you can have two cars take up 4 spaces, just by the way they are sprawled around there. Why can't we get some sort of pilot program to improve the actual parking in this city? It is nonexistent.

Mr. BRIMMER. Mr. Congressman, the parking meter contract is also one area for good news. I signed the contract last week. It is now being implemented. I was asked by the Chief Management Officer to stand by. She plans to have a ceremony down in the street below our building when there will be the actual installation of the first meters. So that one is under way. The planning question which you mentioned is under way. That is also one of her principal tasks. She is working closely with Public Works to do precisely what you have just described.

Mr. HORN. Thank you, sir. Thank you, Mr. Chairman.

Mr. DAVIS. Thank you. Now if I could, I will recognize the former mayor of Portland, OR, the gentleman from Maine.

Mr. ALLEN. Portland, ME.

Mr. DAVIS. Portland, ME. Excuse me. I don't know why I was thinking that.

Mr. ALLEN. You caught it quickly. It sure would be a long commute.

Thank you again, Mr. Chairman. I have a comment and then a question. It is possible, as everyone knows, to have a balanced

budget for any government body and have a totally ineffective government. And so it seems to me that the comments that Ms. Cropp made are right on point. That what we are trying to do here is establish the management—first, the financial base and, second, the operational management, so that you reach the goal which is a very effective delivery of services to the public, because government exists for all sorts of reasons but it doesn't exist just to have a balanced budget. It exists for a purpose, to provide certain services to the people who live there. That is why I do believe it is important for the District. We want this to be a great city, a great American city, not just a city that has a balanced budget. I hope that in this coming year we really make the second step. The second step of progress is to say things in this District are getting better, services are better, the schools are better. I really hope that we hear that. But I do believe that you want to get back to self-government as soon as possible.

In that connection, I understand, though I am no expert, that there are a number of requirements in the law for repayment of obligations, both those issued by the Control Board and those issued by the city, before you can regain full Home Rule. I am wondering if there is any plan to make sure that we have met those requirements of the law after we have had 4 years of a balanced budget as well.

I suspect that is more for Mr. Williams and Mr. Brimmer, but I am not sure.

Mr. BRIMMER. Congressman Allen, it is my understanding that the reference in the statute to repayment of debt obligations refers to obligations issued by the Control Board on behalf of the city. So that the debt that is issued by the city for its own account, without reference to us, does not have to be repaid during the life of the Authority. Again it is my understanding that if we were to issue debt, which we have the authority to do on behalf of the city, then that would be our pledge to the investors in the capital markets, and thus the Authority would have to be in being during that period, since that would constitute a new control period. That is my understanding of it.

Ms. CROPP. Congressman Allen, at this point there has been no debt in the name of the Financial Authority at this point.

Mr. ALLEN. I don't want to argue the law. I am sure you people know it better than I do. The statute does refer to all borrowings by or on behalf of the District of Columbia. I just hope someone other than me takes a good, close look at it.

Ms. NORTON. If the gentleman would yield, we looked into this matter. It is a very important matter the gentleman has raised. It does mean that the accumulated deficit—we believe here in the Congress that it means the accumulated deficit and all the borrowings are eliminated and that there is a clean——

Mayor BARRY. Congresswoman, what did you say about that?

Ms. NORTON. That the section which the gentleman from Maine spoke of means that the District shall have eliminated accumulated deficit as well as its operating deficit. We had this matter researched ourselves last year. That is why it has been a matter of continuing concern to me about the accumulated deficit, because we

could still be left without meeting the terms of the statute in the way that the gentleman has indicated.

Ms. CROPP. Congresswoman Norton, that is not our understanding. I would hope that we could all look at that a bit more, because that is not the understanding that we have.

Ms. NORTON. The language could not be clearer. I hope that nobody here is on a wing and a prayer. The gentleman read the language correctly, we had it researched and we wrote this law. It says that all borrowings by or on behalf of the District of Columbia. So it is a matter that you will want to look into. I appreciate that the gentleman has raised it, so that you can look more closely at it.

Mayor BARRY. Ms. Norton, I would look at the legislative intent. I don't think anybody on this subcommittee intended for this Control Board to be around 20 or 25 years, which is the life of our borrowings.

Ms. NORTON. No, we are talking about the accumulated operating deficit, which is what took the District down in the first place.

Mr. DAVIS. Not general obligation bonds.

Ms. NORTON. Not general obligation bonds.

Ms. CROPP. That is where we were misunderstanding.

Mr. DAVIS. Not GO bonds.

Ms. NORTON. In other words, if what you were left with was part of the deficit that took the District down, you would be in violation of the Control Board statute. So we are talking about annual deficit and accumulated deficit. Part of that was what Mayor Barry found when he came in. It is going down. You are doing very well. But you wouldn't want to be left with annual surpluses, but an accumulated deficit, or an operating deficit.

Ms. CROPP. That is that $500 and something million that this $185 million has gone to reduce down to the $332 million. One of the reasons why my testimony was moving toward we could continue to reduce that deficit.

Ms. NORTON. Exactly.

Mr. ALLEN. My only point is it would be good to resolve this issue, figure out, come to agreement on what that language means now rather than 3 years from now.

Mayor BARRY. I think we agree. Also, Congresswoman Norton, let me point out that we have met every debt repayment, even during the tough years of 1995 and 1996. We have always repaid our borrowings, whether short-term or long-term, on time.

Mr. DAVIS. Let me thank my friend from Portland, ME. They are spelled the same.

It is important that we understand what the rules are and that we can agree together how we are going to pay it back. If we can understand that and have a strategy, I think this city is going to be on much firmer ground. I am going to recognize the gentlelady from Maryland at this point.

Mrs. MORELLA. Thank you, Mr. Chairman. The gentleman from Portland, ME represents two of my children. I wondered about whether he was involved in the power outage and its final reinstatement. That doesn't come from my time.

Mr. DAVIS. He was opposed to the power outage. He just wanted to go on record.

Mrs. MORELLA. I am sure he was. Thank you.

I wanted to congratulate you, particularly Mr. Williams on the CAFR, and all of you for being here. It is a very important hearing. My questions are going to be directed to personnel issues. First of all, I understand, and perhaps Mr. Williams would be best at addressing it and maybe Mr. Brimmer wants to comment. I understand there is a collective bargaining agreement with D.C. workers that has been pending for about 6 or 7 months. Would you tell me what steps have been taken to ensure that the collective bargaining agreements are signed and implemented quickly?

Mayor BARRY. Congresswoman, I think I can answer that question.

Mrs. MORELLA. All right, Mr. Mayor.

Mayor BARRY. Last spring, last summer, we had the 8 unions representing almost 10,000 workers ratify a 3-year agreement. But prior to that being sent to the Council, funds had to be identified. Quite frankly, last summer and last fall, Mr. Williams and I had been talking about sources of funding but we couldn't come up with a definite source. My own view, I have not even talked to Dr. Brimmer about this, but I have just said publicly, is that since we now have revenue estimates over the originals, something about $10.5 million, I intend to send that over to the City Council for their ratification.

Mrs. MORELLA. Can you give me some time?

Mayor BARRY. Early next week.

Mrs. MORELLA. Tomorrow?

Mayor BARRY. Early next week.

Mrs. MORELLA. The first of next week?

Mayor BARRY. Yes.

Mrs. MORELLA. How long is it delayed after that? Is there a delay?

Mayor BARRY. The Council has 60 days. I would certainly urge the Council to act affirmatively on that. These workers are long overdue. On the other hand, I am developing and will send to the Council and the Authority an overall wage policy for the District, because right now we don't have an overall wage policy. Police gets 5 percent, fire gets this amount, other workers get this amount. It is not a good system. The problem was money; not having an identifiable funding source was the problem up until now.

Mrs. MORELLA. You are saying that you think there is going to be smooth sailing? You couldn't find the money before but now——

Mayor BARRY. There is money in the 1998 budget sufficient to cover them, $10.5 million.

Mr. BRIMMER. May I comment on that?

Mrs. MORELLA. Yes, indeed.

Mr. BRIMMER. Because we at the Authority are at the tail end of the process. Once the contracts have been dealt with by the Mayor and the Council, they come to the Authority. Under the statute, the Authority is mandated to review and approve labor contracts. In making that decision, we have to weigh the contract provisions to determine whether they are compatible with the financial planning budget. We do that only when the contracts come to us. However, in anticipation of the need to coordinate a citywide policy with respect to contracts, we did give to the Mayor last year

some guidelines and urged the Mayor to take these into account when the negotiations got under way. My understanding is that that was done, the negotiations have produced the results the Mayor just described. When they come to us, we will review them as required by statute.

Mrs. MORELLA. What timeframe, Dr. Brimmer?

Mr. BRIMMER. We will review them promptly.

Mrs. MORELLA. Promptly is like, within that week?

Mr. BRIMMER. I believe that—we don't have a time limit for contracts. We have a time limit for legislation. What we have, 7 days, we can extend it for something like that. But I assure you, we will not be a bottleneck in the consideration of these once they come to us with the required information, because one thing the Mayor will have to do and the Council will have to see that it is done is an economic impact statement.

Mrs. MORELLA. But it sounds like this is going to move beautifully. That is exactly what I wanted to hear. If the Mayor is ready to send it to the Council, the Council is going to send it to you, you are going to act promptly, it is a small increase, they need it, great. Let us go into another area.

Mr. BRIMMER. I am sorry, I want to be clear. We will examine those, we will review them. But we must have the economic impact statement, I want to stress that, because if it comes without it, we will simply have to ask—send it back, put it on hold and ask that the information be supplied.

Mayor BARRY. Congresswoman, it will have—as I said, compensation unit one and two will cost the city about $10.5 million in 1998. We will have that as part of the transmittal.

Mrs. MORELLA. You will have the economic impact statement, which we have just heard a little bit of now.

Mayor BARRY. Absolutely.

Mrs. MORELLA. If I might ask another salary question, that has to do with my friends the firefighters. They have been waiting for their 5 percent pay raise. The appropriations bill provided that increase. There is another 4½ percent that the firefighters have earned and have been promised. They put their lives on the line. Hey, what is happening? I wondered if you could get—I would like to ask you if you can get it all in order by Friday, the 13th of this month.

Mayor BARRY. Congresswoman, it was an unfunded mandate to 5 percent. It was not in our budget. It is my understanding we have now identified the money for that, $2.6 million, and the other 4½ percent was supposedly gained from the savings from the fire department. I think just day before yesterday they identified that. That should be moving rather rapidly.

Ms. CROPP. The fire department had agreed that they would find the money from within their budget, that 4 percent.

Mr. BRIMMER. I understand that the budget office indicated they sent it over to us the last day or so, maybe yesterday. As of today, the counsel at our office who handle this has not seen it as yet, but I am told it is in the pipeline. It is somewhere between the budget office and our office, and may even be in our office by this time.

Mrs. MORELLA. Maybe we need a roto-rooter to get through that pipe, because my understanding is that this was actually appropriated.

Mayor BARRY. It was not. It was in the report from the Appropriations Committee but there were no funds allocated, either Federal or local, for that. It was one of those unfunded mandates where the Congress had paid in a 5 percent but did not include one nickel to do so. What we have done is reprogram money, I think from the interest payments, to put it over there because we feel some obligation to do so. But it was not in the budget. We couldn't do that until we identified a source of reprogramming.

Mrs. MORELLA. I guess the implication was that it was in the report language.

Ms. CROPP. The other part was that they were supposed to have identified the 4 percent from within their budget. We had agreed that there would be an increase. The mechanism was for the fire department to look within their budget and to come back to us with recommendations. Let me also state that I am not aware of anything coming to the Council yet. So if it has not come to the Council yet, I don't know—the Authority would not be able to take action, and we have not received it.

Mrs. MORELLA. What can I do to move this ahead?

Mayor BARRY. It is already moving.

Mrs. MORELLA. Is it from the Mayor, then to you?

Mayor BARRY. Congresswoman, as I said earlier, the reprogramming has been identified by the CFO's office. The necessary documents have been drawn up. My understanding is they have been sent to the Control Board.

That will be as soon as the Control Board examines and approves that. Also, the Fire Department just 2 days ago identified within its own budget the 4½ percent. So once these two get approved, then the money will be forthcoming.

Mrs. MORELLA. So it is in your court then, Dr. Brimmer?

Mr. BRIMMER. Again, Mrs. Morella, this is a case where the complexities of the financial procedure entrap all of us.

Mrs. MORELLA. You sound like a politician.

Mr. BRIMMER. Reprogramming comes from the Mayor to the Authority to us. We have not gotten that as yet. Then if we approve it, we then send it to the Council. That is why Mrs. Cropp hasn't gotten it, because it hasn't come from us. But these are the mechanics.

The point is that the policy is clear. The increases that take place, if the funds can be found, I am told that the budget office has identified those sources and it is in the process. When it gets to us we will dispose of it very, very quickly. If it is there today it will be out of our shop very, very quickly.

Mrs. MORELLA. Let me just state for the record that I hope that we can fulfill this commitment that has been made. I am happy to work with you, because I know my time has expired, to push this forward. Thank you.

Mayor BARRY. Congresswoman, it seems to me that you and the other Congressmen, you have the responsibility to ensure if these mandates are put in, you have the responsibility to fund it, so we don't find ourselves next year with the same problem.

Mrs. MORELLA. It is nice that we have the same problem. I'm not going to ask you now, but remember, Medicaid, Medicaid, Medicaid, contract.

Mr. DAVIS. I will move to the other side, to Ms. Norton for 5 minutes, and then I will have some questions.

Ms. NORTON. Thank you Mr. Chairman.

Just to further clarify, it was precisely because of that possibility that the District would have done its homework on the annual deficit, and could be left with its accumulated deficit. And the Congress hasn't been altogether clear, so I can understand why the Control Board, for example, wasn't exactly sure whether or not Congress intended such a borrowing to occur.

It is for that reason that we worked with the administration to put a provision in the rescue package which explicitly authorizes, if necessary, a borrowing to get rid of the accumulated deficit. We did this because we are fully aware of what that section means. It means that at the end, somebody could pop up and say, no, they really are not clean. So one way or the other—and I think you all are handling it very well. You now have the flexibility to decide what you want to do. I congratulate you for it.

In the rescue package I put a section in the law, an amendment, that I really regarded as unnecessary. But I did so because I thought that the way in which the financial authority statute was worded may have caused some confusion; in order to make sure Home Rule got preserved, that the Council's prerogative, the Mayor's prerogatives, that the Control Board's prerogatives got preserved, we really speak sequentially. You go to this one, back to that one, you go to this one, and you can really play ping-pong on the budget.

So Congress may have been responsible for this. Although it has been my position all along that all of this could have been waived, just to make sure, I put a provision in the rescue package, "notwithstanding any other provision", the Mayor, Council, and the Authority—"if the Mayor, Council and Authority jointly develop a financial plan and budget for the fiscal year." This is the so-called streamlining provision that allows you to do essentially whatever you want to do.

When we were able to say, when we had this horrendous battle on the appropriation last year, that there was a consensus budget, we got a great distance against those who wanted to derail your budget.

I would like to know what specifically is being done to make this a joint enterprise, or are you going to still be into sequential formulation of the budget; this one, then you wait, and then that one goes back? Are you taking steps to implement the streamlining provision that would actually put everybody at the table at one point early in the process, so that we could get through the process much earlier, even given the differences which emerged anyway? So they are going to emerge anyway, with sequential handling of the budget. What is to be lost in letting them emerge with everybody sitting around the table and taking care of them?

Mr. BRIMMER. I would speak to that, Ms. Norton. We are in the process of implementing a consensus procedure. Earlier in the year, late in 1997 calendar year, Mr. Williams set out guidelines which

were discussed with the principals involved, and departments are now drawing together budget information and making preliminary analyses within that framework. That is being done.

The Mayor and the Chair of the Council and I have talked about the need for an early meeting to start discussing assumptions. Long before we get to actual numbers, we need assumptions and a policy framework. We have been trying to raise that meeting. I understand that at this moment an effort is being made to raise that meeting for tomorrow, in which that will be taken. That will include the Council, the Mayor, and the Authority. So that is a step that is already underway.

The objective is that the Mayor would draw up and submit a first draft, and I will stand by and let the Mayor describe what it is he plans to do. It is my understanding that he will do that by March 1, and it is my understanding also that the Council will have worked its will and will submit something to us, hand something to us by the 15th. But we will be working side-by-side, and we are already doing so. So I do not anticipate a repetition of what I described earlier as a ping-pong game, where it came to us, we bounced it back, and so on. So I believe a consensus process is underway.

The Mayor.

Mayor BARRY. The process that was outlined was unworkable. It created all kinds of problems, you know, that went back and forth. I got tired of it, the public got tired of it, everybody got tired of it. We have been working on a different process.

The Chief Management Officer is involved with this process now. We started yesterday a series of hearings, internal hearings, with the department heads. The budget office has done the analysis. We will have a document where the Council and the Authority can look at it before I formally submit it on March 1. If there are any numbers concerned we will know what they are. We may end up with one or two disagreements, but it won't be the same kind as last year. They will just be the philosophical program problems, that we know up front what they are. This process is working far better than the other one.

Also, Congresswoman Norton, the budget office has done an incredible job of developing a performance-based budget with outcomes and inputs, all this kind of technical language that people use. It just means that we know what we are getting for our dollars and we will make decisions based on priorities, as well as whether or not they come forward with those performance measures. It will not be a budget where you start with last year's budget and buildupon it. You have to start with zero and build a budget unit-by-unit, so it is a much better process.

I feel very comfortable that we won't have this ping-pong. If there is a difference, we will know what it is early and try to resolve it before it gets to that final stage.

Ms. CROPP. Another important step in this process, Congresswoman, has been that the budget staffs from the Council, the budget office, the Authority, the CFO's office, they have all come together continuously, and they have been working together on issues and briefing the respective individuals with regard to the budget process. Also, it is important that all of the principals,

whether it is the Mayor, the Authority, or the Council—we have agreed to work together to develop the consensus process.

The Council through the Management Accountability Act did require performance objectives and measures, and as we speak now the Council is holding public hearings based on performance measures and outputs that we expect to get from the government. We strongly believe that you will see a great turnaround based on those performance measures that have been developed by the agencies, and as the Council is dealing with strong oversight, to see whether or not those measures were achieved. So we are looking forward to a consensus budget. As Dr. Brimmer stated, we hope to come together tomorrow to deal with our assumptions on that.

Ms. NORTON. Just let me congratulate all three of you on this process you are working out. The reason I do so in no small part is because the way in which the government works in the American system is built-in adversarial checks and balances, so in a real sense in normal times I recognize that you would be supposed to have this kind of process that you go at one another. But in times of emergency like this, to go at it the way you are going at it is very, very helpful, and I know it is difficult. I congratulate you on it.

I just assume that Mr. Williams is involved in this, and his staff, in all your meetings. Is that the case, sir? And the assumptions and all the rest of it?

Mr. WILLIAMS. Right. We got a charge from when the legislation was passed, to simplify and streamline the process. We got a charge from the Authority, and there was concurrence to the Mayor and Council to set forth and propose a process that would do all the things Dr. Brimmer, the Mayor and Chairman Cropp were talking about. As I have said, I believe we are on the way.

I would underscore this experience we have had, where the staffs of the Council, the Authority, the Mayor, and our staff all work jointly on information, and we really have become more and more now a data warehouse of information for all the decisionmakers. I personally believe that we are on the way toward creating one of the best budget offices in the country out of this experience, similar to what happened in Philadelphia and New York.

Ms. NORTON. Thank you very much. Thank you, Mr. Chairman.

Mr. DAVIS. Thank you. Let me say that it is critical to have the right information there to make decisions. In the past you could have the right decisionmakers, but with the wrong information coming forth you couldn't do it. I agree with you.

Chairman Cropp, it is good to see the Council actively involved in this. I think it has been very, very positive at this point. Keep your involvement. You are a very important part of this solution. Before long, the Control Board, sooner rather than later, folds out of existence, and it will be in your lap and the Mayor's lap again. Hopefully the city will be much stronger for what have been, I understand, some tough times for the city and democracy, but I feel a lot more optimistic with this. This is the best report we have had.

I am going to ask Mr. Farrell, who has been sitting here as we talked to some of the others, for just a couple observations on the history of this. I guess John Hummel had done this last year. I wonder if you could just—you hit a little bit in your testimony on

how the city's procedures have improved year to year, and how far we need to go.

Mr. FARRELL. Surely. Well, as you know, our report does contain a number of significant matters that we think the city continues to have to improve on. But what we can speak on is an experience of having performed 3 years' worth of audits and speaking on improvements within those 3 years.

Most notably, the improvements we have seen are in the area of accounts payable. When we arrived here on the scene in 1995, the city was having a very difficult time getting a handle on their accounts payable at that time and getting the right amounts recorded in the books. There was a requirement at that point in time to do a special accounts payable procedural issue to help the city determine what the 1995 year-end accounts payable were. Through the efforts of the chief financial officer's office and the controller's office and many others, I would say that that problem is largely behind the city at this point in time.

One of our audit procedures that we had performed based on what we had found in 1995 was to actually go around to employees' desks looking for invoices that had not been processed through the system, and therefore needed to be recorded in the system, and in 1995 we found many of those. Here this year, while we are still doing those same procedures in 1997, we are not finding that situation any longer. So I think a lot of credit has to be taken by the city for improving that situation.

You know, a city this vast is ordering goods from throughout the city, and there are many people who are processing purchase orders, et cetera, and requesting goods, and to get that under control I think was a giant step in the right direction.

Mr. DAVIS. It really would have been unrealistic to expect them to have gone from your first audits to basically a perfect audit overnight. Is that fair to say?

Mr. FARRELL. It takes a while. We held them to the fire this year on ensuring that the records indeed did deserve to have this unqualified opinion placed on them.

Mr. DAVIS. Can you just elaborate on that? Tell me what the significance is of an unqualified versus a qualified opinion to the decisionmakers, such as the Mayor, the Council, the Control Board, and Congress, to have an unqualified opinion?

Mayor BARRY. Pardon me. May I be excused? I have a very present appointment.

Mr. DAVIS. We would be happy to do that. Thank you for your being here, for your input in the process, and for your help. Thank you.

Excuse me, we have some constituents coming in.

Ms. NORTON. The young people coming in are part of a program I have called D.C. Students in the Capitol, to make sure that no youngster graduates from high school without coming to the Capitol, meeting with his Congressperson, having a tour of the Capitol, getting to sit in on a hearing, if at all possible. And I have told them that it gets boring so they don't have to stay. These are fifth grade students from Clark Elementary School. We are very pleased to welcome them and thank their teachers for seeing to it that so many of them got down here today.

Mr. DAVIS. Let me just say to the students that Mayor Barry is in the back, and the Council Chairman, Linda Cropp, is here too. Politicians have to look after each other.

Ms. CROPP. Mr. Chairman, since you are recognizing students, may I take this opportunity to recognize a student intern who is accompanying me today, Christopher Cramer, who is here.

Mr. DAVIS. Thank you very much. You are making a difference. Thank you all very much.

We were talking about the qualified versus unqualified opinion and what it means to the opinionmakers.

Mr. FARRELL. In a financial statement audit we perform a variety of procedures to form an opinion on whether the financial statements present fairly, in accordance with generally accepted accounting principles, the information contained therein. To the extent that our procedures indicate that we are not able to draw a conclusion on a particular aspect of the financial statements, we must note in our accountant's reports that it is qualified with respect to that aspect. So this year——

Mr. DAVIS. Being able to rely on it is kind of an asterisk, whether you can actually rely on it.

Mr. FARRELL. That is correct. It says, "These are OK, except." It does put a question mark out there. This year we were able to express an unqualified accountant's report. That is the highest form of assurance that auditors give on a financial statement. It is not that there was something better that the city could have received. This is the highest level of assurance.

Mr. DAVIS. KP Peat Marwick does not do that lightly; is that correct?

Mr. FARRELL. That is correct. We spend a lot of time making sure that conclusion is correct, sir.

Mr. DAVIS. OK. They still have some things they need to improve on. You noted those throughout the audit. What would be the most important areas that the city could improve upon if you looked at this next year?

Mr. FARRELL. To me, I believe the most important thing the city needs to concentrate on from a financial reporting perspective is its systems. They are doing much, as you have heard from the testimony of the other members of this panel today, but the systems we reviewed that were in place during the year end of 1997 were the old systems, and they need lots of repair for the city to be able to move forward.

Mr. Horn also mentioned the year 2000 issue, and that is also a big issue that the city needs to address. Thank you.

Mr. DAVIS. I agree. In fact, Congress I think previously has been part of the problem on that, and I think we are moving ahead with some of the systems now in terms of giving it the appropriate funding and maybe too much oversight.

Let me ask Tony Williams a question, and anyone else can chime in if they would like.

Tony, I would like you to describe the reasons behind the District's request for permission to conduct negotiated bond sales, and what benefits the city gets from that process while it has a less than investment-grade bond rating. As a matter of principle, should bond sales normally be done competitively, and do you in-

tend to move toward that process as the District's bond rating improves?

Mr. WILLIAMS. I think the Authority can speak to this as well, but at least we have found that in many jurisdictions across the country, these jurisdictions have the ability to do negotiated sales. They can achieve the most cost-effective transaction for the jurisdiction in question while at the same time having the flexibility to do transactions, especially in the kind of financial environment we are in, in the shortest possible time.

For example, a year ago, one of the problems we have found with the competitive sale process is that in a competitive sale you are making the assumption that people are lined up for a competition and, you know, if you don't really have, you know, goods that are not really bringing in that kind of demand, you are kind of begging the question. This would have given us flexibility that we otherwise would not have had.

I might also add, I think that there are protections that could be built into the system to ensure that you have the controls and the integrity and the proper oversight while still having a negotiated sale process.

Dr. Brimmer may want to speak to this, too.

Mr. BRIMMER. Yes, thank you very much. Mr. Chairman, you might recall, I have spent a good part of my life in the capital and financial markets. One of the things I have done is to approve bond sales and borrowings. Mr. Williams is absolutely right, under normal conditions competition is greatest when you have vigorous bidders, a good quality product but vigorous bidders for it. The problem with the District is that you have very few bidders. A few years ago when we came in, you had none.

So what you need is not an ironclad rule which says all bond sales must be negotiated, or all bond sales must be competitively bid. You need to choose the instrument best suited at the time. Until the District strengthened its financial underpinnings and created some confidence among investors, there was no way to get the large supplier bidders which Mr. Williams described as absolutely necessary for a successful competitive transaction.

So I am delighted that the Congress did not impose a prohibition on negotiation. If the issue comes up again, I would hope it would resist doing so and allow us to have the flexibility in our hands. This is one of the things to which I devote a good bit of my own time, and I assure you that in negotiations we would not allow the collusion, which is a real danger.

Mr. DAVIS. I think under the current situation, seeing how far we have come, seeing the successes we have had from what started as a very, very bad situation, I can't understand why anyone up here in Congress would try to come in and impose anything other. You have shown great results the way you have been doing this.

Ms. CROPP. Mr. Chairman.

Mr. DAVIS. Yes, Chairman Cropp.

Ms. CROPP. Let me say the Council has gone back and forth on that very issue, and I think our action would support the very position that Dr. Brimmer has just articulated. A few years ago when our bond rating was up, a good bond rating, the Council argued vigorously that we ought to deal with the competitive market, but

as we have had problems and our rating dropped somewhat, you then saw the Council support the idea of negotiated bond sales.

So I think the Council's action very much supports what Dr. Brimmer has articulated, and it seems to me that it would be the best of all worlds if Congress would allow the District to make whatever the appropriate decision is with regard to whether or not we go on the competitive market or whether or not we negotiate sales. It is quite possible that Congress could do one thing, and the action that Congress takes would not allow us to have success on the bond market.

Mr. DAVIS. Thank you. I am going to recognize Ms. Norton for 5 minutes. Let me just say, Chairman Cropp, just from my perspective sitting up here watching the Council now being very participatory in these decisions, sitting, rolling up your sleeves, working with the Control Board, the CFO, the Mayor, working together, from my vantage point and I think from other members up here it seems that the successes we are having—it restores some confidence in terms of looking over the long term when the Control Board goes away. It gives us some confidence in you being a participant at this point in the process, actively engaged. It gives us a good level of encouragement.

I would be remiss if I didn't say that, because sometimes the press will pick one thing out or another. We certainly have a ways to go. But it is good that instead of sitting on the sidelines or throwing bricks, you are working together and are fully engaged in this and adding value to the whole discussion. Thank you. You can share that with your fellow Council members.

Ms. CROPP. I certainly shall. They will love to hear that good news.

Mr. DAVIS. Ms. Norton.

Ms. NORTON. Thank you, Mr. Chairman. I want to associate myself with those remarks. Ever since this Control Board came, it seemed to me that the only way this system will work is close collaboration, particularly with the Council and Mayor, and that you are moving so well in that direction is very much to be noted and commended. That goes for all of you, and we are particularly pleased to see it in the Council because we know you have more players to work with, Ms. Cropp.

Mr. Williams, I really have to ask you about one continuing problem. I don't understand why it hasn't been solved. Do you know that Congress does not very much—I say this so the Control Board can hear this as well—we don't want to see litigation to resolve issues that arise. We believe that to go to court is to admit failure.

The kind of collaboration that we are saying works and is working so well will work with the school board, will work with personnel issues, will work with everything. If people have a problem-solving attitude, it will save the District court fees, and I can't tell you what it saves in terms of hard feelings and animosity.

Now, Mr. Williams, the committee has asked you to come and to have discussions with staff with respect to staff in the CFO's office. As you know, the Congress gave you special authority, authority that the Congress does not regret, with respect to termination, making certain employees at-will employees. Congress did that because it regarded the financial situation as an emergency situation,

and one thing that could not wait. At-will means that you can terminate people at will.

Your general counsel, as recently as January 15th, distributed a memo saying that Congress, in spite of meetings that Congress in effect has been having with you personally—that Congress didn't authorize the CFO to recognize and bargain with labor unions. Let me just tell you, as one Member of Congress, we could not have gotten this bill passed if there had been that kind of wholesale violation of labor rights. The whole Democratic side of the aisle would have—it would have been filibustered in the Senate, and I could not have voted for it. I could not have asked my colleagues to vote for it. I could not have asked all kinds of Black Caucus and other colleagues who went along with it, because they knew that we had left collective bargaining rights intact.

Now, you pass out a memo that says we didn't authorize you to recognize and bargain with labor unions over applicable terms and conditions of employment. Actually, in a meeting with staff and one in which I was present, we said we wished you would meet with and consult with members of the bargaining unit. Just as collaboration is working at the top, we don't see how you can get anything done without consulting with people over their terms and conditions of employment.

Now, just over a year ago the District Public Employee Relations Board issued a decision in which it concluded that none of our legislation pertaining to the CFO's office relieved you of any of the obligations of the Mayor with respect to collective bargaining.

I do not understand—and I speak for both sides of the committee, now, because the committee, minority and majority, have the same view here—we do not understand why you refuse to meet with union representatives to discuss their labor contracts, nor why a memo like this would be sent out, which we regard as simply inflammatory. We don't understand why one simply wouldn't sit down, the way you have said is working so well at the top of the government, with your own employees. We are not talking about termination, we are talking about simple consultation with people over their working conditions and over their labor contract.

At this point the only thing left to us, since we have had meetings with you personally, since we have had meetings with your staff, is to ask for an explanation of why you persist in interpreting the law contrary to what the committee—how the committee has told you we interpret the law.

Mr. WILLIAMS. So the question is, why do I interpret the law as I do?

Ms. NORTON. I want to know why—on what basis you believe that you do not have the authority, that you are not authorized to recognize and bargain with labor unions under the authority of your office. I want to know, what is the legal basis for that view, which is a view that your own counsel has expressed in writing?

Mr. WILLIAMS. I think because this is a matter of litigation, and rather than add additional material for the litigation, if I could say, because in responding to the general thrust of your question, I would say that I believe that one of the key objectives for our office—and I have talked to members of the Authority about this, specifically Connie Newman—that one of the key objectives for our

office as we move forward is to have all the collaboration that you are talking about with our employees that we have not had previously, No. 1; and No. 2, as we begin, and Dr. Brimmer refers to this in his testimony, a strategic plan for what the CFO operation will be through the control period and into a permanent state. Part of that has to be folding our existing personnel operation, such as it is, back into the reformed and improved District government operation. I have not had this as a top priority, but I agree with you, it should be a top priority.

Ms. NORTON. Mr. Williams, can you promise this committee that you will sit down with labor unions in your shop?

Mr. WILLIAMS. Yes. Unequivocally, yes.

Ms. NORTON. That is all I need. I appreciate that.

Could you tell me—I am interested in this—I understand that even with population loss, that our income tax has gone—I understand how that happens. You could have two people left in the District and still have that happen.

What bothers me is that real property taxes are going down. It bothers me because I have gotten—I know that it is certainly the case that people are buying property. Part of that was happening anyway. My $5,000 home buyer tax credit is helping that somewhat, we know, because people are calling in every day asking about it. I understand that probably includes a lot more than houses people buy, but could you explain why with a booming property, real property taxes would be going down?

Mr. WILLIAMS. I could ask Dr. Gandhi to amplify this, but essentially what is happening is that we have had a number of—if I understand it, part of the assessment process—we have inherited a bad system. There have been a number of appeals on commercial property where we have had an exposure and have had to record that in our books.

We are also in the process of putting in a new assessment system, and you may be seeing a temporary reduction in property tax revenue from that source. But in the long term you will begin to see a reflection on our records with what is happening in reality, which is an improvement in the real estate economy.

Dr. Gandhi, do you want to come forward and elaborate on that?

Mr. GANDHI. I think the basic point here is that there is about a 3-year lag between improved economy and catching up with the real problems in tax collections.

Ms. NORTON. I see. That is generally the case, you are saying?

Mr. GANDHI. Yes.

Ms. NORTON. This whole assessment process, what is the progress now on that very important process that your office has initiated?

Mr. GANDHI. We are right on the schedule on that, Ms. Norton. Basically, within the next 2 weeks the first assessment notices will go out, the first third of our triennial assessment.

Ms. NORTON. That is very good news. I'm sure home owners will think that is good news.

Mrs. MORELLA. This is again back to the Medicare contracts. We are still getting some complaints. There are some people who are suggesting that the procurement process must be thrown out because it is illegal.

I wonder if you could explain to me, Dr. Brimmer, how many managed care organizations are presently providing Medicaid services to the citizens of Washington, DC.

Mr. BRIMMER. I do not know how many, but the last briefing I had, which was last night on this question, focused on the divergence of views with respect to the four bidders as opposed to seven. It is my understanding that that has been resolved, that all of the seven will be able to receive business and to provide service, but the dates are still being worked out. But I was told that the general agreement has been reached.

Mrs. MORELLA. It has been reached.

There was a D.C. Superior Court Judge—that actually was Russell Canan—who said that the best option for the city would be to extend the contracts of the managed care organizations that were providing services as of July 1997, the date of the award.

Would you comment on that recommendation?

Mr. BRIMMER. No, I cannot comment on that. I was not briefed on the question of the status of the court proceedings, but I was talking about the operation and the implementation of the program by the chief management officer, now, who has oversight for that, and specifically, for the chief procurement officer.

Mrs. MORELLA. I think we have someone who would like to comment on it.

Mr. BRIMMER. General counsel from the Control Board, Mr. Reznick. May I ask him to come here?

Mrs. MORELLA. Yes, permission granted.

Mr. REZNICK. My understanding is that the existing contracts have been extended. I think you have six of them that are now providing the services. There are to be seven contracts under the new system. I think the issue right now relates primarily to when it goes into effect, the effort that is being made. It started as early as March 1. There may be an issue as to whether that date can be met. But there are going to be seven contracts that have been entered into, as I understand it. That is in accordance with what the Contract Appeals Board ruled, so that everything is being done in compliance with the law.

Mrs. MORELLA. Mr. Reznick, would you stand and raise your hand, since I understand that all witnesses are sworn in.

[Witness sworn.]

Mrs. MORELLA. My final comment is actually to thank Mr. Farrell for the work that he has done and also to pick up on that year 2000 computer glitch. We finally got the President federally to issue an Executive order and to establish somebody to be the so-called year 2000 czar.

We have for 2 years been working with the Federal agencies to come up with their national strategy, and we looked at the District of Columbia particularly to move forward on that, because it is an unrelenting deadline, and the big problem is interoperability if something goes awry.

What is your role in the computer glitch compliance problem?

Mr. FARRELL. Our role with respect to auditing is very limited, ma'am. We do have a role with respect to the FMS system that is being implemented in the city. That is a year 2000 compliance sys-

tem, as I understand are all the other new systems that the city is in the process of implementing at this exact moment.

But there are other systems throughout the city, and as you know, anything that has a chip in it that is measuring time could potentially have a year 2000 problem. You will see in our report here, the city has their plan laid out and we have indicated a number of things that we think the city should also consider in their plan to address year 2000 issues.

Mrs. MORELLA. Have we determined who the person is who is in charge? Maybe Mr. Williams.

Mr. WILLIAMS. The person responsible for that function in the District government is Michael Herndon, who comes to us from Boston. He is our chief technology officer and he reports to Dr. Barnett, and as one of the management reform projects that have been formulated by the management review teams, one of the key projects is addressing this year 2000 problem come hell or high water, because we know we have to do it.

Mrs. MORELLA. The problem also is that the microchips also in many instances are affected by it, too, and 1 year is needed for the testing, so that there are like 10½ months that are left actually to do it.

Will he be or will you have somebody to present to us kind of a status with respect to that?

Mr. WILLIAMS. I can't speak for the Authority, but I certainly will communicate with them about that.

Mrs. MORELLA. Good. If you would communicate with him, I'm sure—I know Congressman Horn and I have been doing some joint hearings on this, and trying to move State government, local government, and obviously the Federal Government and certainly the District of Columbia ahead. Good.

Ms. CROPP. As Mr. Williams said, that is one of the management reform functions we are about doing, and we will have continuous briefings with regard to the management reforms once we start moving back in that direction.

Mrs. MORELLA. It is just that we have to move ahead. There is just no delaying any of those deadlines.

Congresswoman Norton, did you have any questions you would like to pose?

Ms. NORTON. Congresswoman, I have just a couple more questions. One has to do with the good news and the effect it might have on our bond rating. It was when the two rating houses, in almost successive days in, withdrew the District's credit that it became clear the District had to have a Control Board, whatever else was needed. First, I need to know what is the District's current bond rating with Moody's and Standard & Poor's, and what effect do you expect this audit to have, and if so, by when?

Mr. WILLIAMS. Congresswoman Norton I can get you the exact ratings. We are still trading below investment grade, but I will say by way of a caveat, No. 1, as usually happens in these circumstances, we are trading ahead of our rating. In other words, the actual interest rates we are enjoying in our various bond sales exceed what one would expect given our rating, both on a short-term basis, long-term basis, and as Dexter, for example, Lockamy would tell you, an entity you are actually trading in—there is a lag be-

tween the rating agencies and actual experience, so the rating agencies will follow you down and then they will follow you back up.

We have a presentation actually to the rating agencies, a plan, within the next couple of weeks. We are pleased to have the participation not only from the Financial Authority but also from the Treasury, Assistant Secretary of the Treasury, and also from Mr. DeSeve, who will be making a personal pitch for reevaluation of the District's rating. We think we have an excellent chance to see an upgrade, and maybe even investment grade from one of the agencies, we hope.

Ms. NORTON. That is maybe the best news yet for every taxpayer in the District of Columbia.

Could I ask you all, finally, to help us out on a very hard problem that is not totally within your domain? I think it is the Mayor who testified as to something we have seen ourselves, that with respect to these receiverships, these judges have now almost open-ended spending.

We saw it when the prisons were—the authority of the prisons was transferred. We could not believe it, that apparently the judge was simply allowing the receiver to come in, name his figure, and more or less abiding by that figure. The figures were quite outrageous. They had doctors, according to the trustee, the prison trustee, they have doctors doing what nurse's aides do, and managed care long ago has left these people way behind. There is nobody doing the kind of oversight that you would do if you had control over this.

Part of it was the credibility of the District, because the Corporation Counsel would argue back, but since the District was in receivership, you know, they didn't want to believe them. I think contact was made with the Control Board, obviously, which does have credibility with the courts.

I wonder if there is, now that you have gotten hold of the things under your control, if there is some strategy being developed to get a hold of these receiverships so we can either get them back and get back control over the short term, or somehow have a strategy for keeping judges from keeping that part—and I understand it may be a very large part of the government—out of sync with the sacrifices you are making with the part of the government you control.

Is there any strategy for getting to these receiverships?

Mr. WILLIAMS. As part of the 1999 budget process, we are furnishing the Mayor and Council with the financial authority, we hope with a set of options that give them both short-term options on how to address these receiverships from a fiscal point of view, and long-term strategies wherein the District can sit down with the relevant court and hopefully reach an agreement on bringing the District out of the receivership into a normal state of operation, and what the budgeted cost for that would be. We have tried to do that initially now on a short-term basis, tried to build a long-term plan and get agreement from, I think it is Judge Robinson and the Dixon decree. We want to do this in other cases as well.

Ms. NORTON. Ms. Cropp?

Ms. CROPP. I am more familiar with the Human Services side, where quite frankly we have had quite a bit of problem with that. You were talking about physicians. For the Human Services side, it got to the level of things such as paper clips and how much money could be spent, whether or not you needed it or not, without any control whatsoever.

It really has to be a multipronged approach. No. 1, the problem rests with credibility with the courts. One of the things that we must do is establish credibility, that in fact we are going to do those things necessary to provide the services to our citizens. In doing that, it also means that we need to join hands with those individuals who we struck agreements with.

In the past the District made some very aggressive agreements with individuals that we can't keep, so these people in some instances have become the plaintiffs. We need to get back with them and talk with them, as part of our strategy that we move forward in making changes in how we deliver services.

I truly believe that it can be done, but it has to be done in conjunction with looking at the costs, the legal aspect. But it also means that we have to provide the services that we need to provide, and the courts have to be cognizant of the impact that they are having on our budget as a whole. Pretty soon they are going to be stepping on each other's toes in assigning dollars that cannot possibly be divided. So it has to be a multipronged approach.

Ms. NORTON. Mr. Reznick?

Mr. REZNICK. Yes. I just wanted to add that we had a very constructive meeting just this week with former Chief Judge Robinson who is administering the latest of these receiverships, the Dixon receivership, over mental health services, community mental health services. The District government was represented, Dr. Barnett was there, Mr. Hill was there, the receiver was there. It was an extremely good meeting, because I think it acquainted everyone with what everyone else's needs were.

I think it is important that the receivers and the courts receive that kind of information as to what they—as to how what they do on a particular matter affects the rest of the District government. I think Chief Judge Robinson, former Chief Judge Robinson, who is going to be administering this decree, is extremely interested in getting all that relevant information and wants the parties to work together.

This was the most hopeful sign that I have seen yet in terms of people being able to cooperate with the courts in the administration of these decrees. I hope it perhaps can become a model for some of the other decrees that we have, looking ultimately toward compliance by the District. Mr. Farren, the Corporation Counsel, has designated his deputy as a person to work on a very almost full-time basis on dealing with these decrees, and we intend to work with them in trying ultimately to relieve the District from the burden of these decrees once compliance has been achieved.

Ms. NORTON. You speak of the mental health decree, and of course we have accumulated a number of these decrees. I appreciate what you are doing in terms of a model. You have to first learn how to do it, because this is an unprecedented situation, and then try to apply it. I think Mr. Williams would have found more

of a surplus if in fact more of—he had been able to equivalently downsize more of the government.

It seems to me if one were plotting goals for this year, it would be to get control of each and every one of these. It would be harder or easier with some of them. The prison trustee will be a great help with that one.

Unfortunately, the District will probably be on its own with the others. The Control Board can be very helpful, because the Control Board was not part of the problem, has no reason to be suspected of covering up or not delivering services. The courts are really unaware, because the process has been joined only by the District, what they are doing to the District. It does show us that courts should not be in the business of budgeting other people's money.

Mr. WILLIAMS. Before you had a situation where the District was derelict and, you know, had been insufficient in meeting certain needs. Receiverships came in. Now you have a situation where a large part of the District government is in fix-up mode, and so the uniqueness of these receiverships it seems to me have changed, to say the least.

But we have a very hard time getting budgets from the receivers. They believe that they are acting under a spiritual mandate. We have a very difficult time getting them to live within any kind of budget constraints, because they say, well, we are solving problem one, problem two, or problem three.

Personally, I came here to solve problem, let's say five, but if I went to the Mayor and Council, Authority, and said I wanted to double my budget because financial management is important, they would laugh at me. I think everybody has to operate, no matter how severe their situation, how important their objective, they have to operate under some global budget constraint, or I agree with Chairman Cropp, we are in a bad way.

Ms. NORTON. When they say they are solving the problem, just let me make this clear, not only are they not solving the problem, they are making the problem worse. They are making these agencies dependent upon exorbitant expenditures, so that they have really become part of the problem.

Sure, they had a problem to begin with. People were being left out there. Now that they are telling people in prison that you deserve—that our jail, that you are going to get better medical care than anybody else in the whole United States, because you are going to have a doctor to come give you a thermometer when you need one. They are not only costing us, they are making it impossible to streamline, restructure and recover those agencies. The courts do not understand that because courts are single-dimensional here.

Could I ask, finally, what percentage of our budget would you—I know you may not have the figures before you right away, Mr. Williams—what percentage of our budget is still under the control of the courts in a receivership or some kind of court order or the other?

Mr. WILLIAMS. My understanding is it is between 10 and 15 percent. Not only that, but again, as the chairman mentioned, it is probably one of the biggest growth items right now in the budget, because in the interests of fixing whatever the problem, the atti-

tude is, we will just throw whatever resources we have available to solve that problem. And that may be fine in theory, but in practice it can be devastating.

Ms. NORTON. It is absolutely counterproductive to everything you are doing. You are going in the exact opposite direction.

Ms. CROPP. Congresswoman Norton, to show you how that situation can impact on the rest of the government, Human Services, when it was downsized significantly and it started looking at the programs on which we actually had the authority to make changes, it was such a small portion of the budget, because most of it was under court order, that it left programs such as day care, during a time when we are dealing with welfare reform, it left programs such as substance abuse as the only programs that could be cut.

When you look at the problems that we face in the District of Columbia, as in most urban centers, substance abuse treatment programs impact almost everything else. It impacts your criminal justice system, it impacts your education. Foster care, which is under a court order, many of the parents who have lost their children, they have lost them due to substance abuse problems.

So the predominant cause that needs to be treated for many of the other Human Services problems, we have to cut that out because it is the only budget that we can attack. So it is having such a negative impact on other programs that need to be supported and need to be funded.

Ms. NORTON. Ms. Cropp, you said that you believe that most of the budget of Human Services is under some form or other of court order?

Ms. CROPP. That's right. That's right. So when you looked at what was left, there was a very, very small part, which is why health issues, day care and substance abuse treatment, which would be a health issue, usually were the budgets that were constantly attacked when there had to be some type of reduction.

Ms. NORTON. Thank you very much, Ms. Cropp. May I thank all of the witnesses today for what has really been an extraordinarily good news hearing for the District that sends a sign throughout—the signs throughout the halls of the Congress that the District is getting there and getting there a whole lot faster than most Members ever thought it would. Congratulations to you all.

Mr. DAVIS. Thank you.

Mrs. Morella, do you have any additional questions?

Mrs. MORELLA. Yes. I just wanted to point out, Mr. Farrell, I look at your audit as a series of recommendations also by virtue of pointing out what the weaknesses are, and looking at the area of technology, which I think has been ranked a "D" by you, I notice that you say there is a pervasive internal control weakness in the District which is in the electronic data processing systems environment.

So with the widespread problem in that area, I guess then I would go to Mr. Williams and say, do you have a plan or a strategy with regard to the technology problems that have been pointed out in the audit?

Mr. WILLIAMS. First, again, the general technology problems are being addressed by the management reform process with a new technology director. Within the financial management sector of the

government we have a number of major projects that are underway as we speak.

We hope to come to agreement on a contract for a new integrated tax system any moment now that will actually combine all the different tax processes into one system, where a customer or a taxpayer will be able to call 24 hours a day and get their overall tax situation from the District government on a timely basis. We will do that tax by tax by tax until all the taxes are integrated.

Finally, and this has been like building the Suez Canal, but we will finally put in an integrated payroll personnel system, where we take time and attendance, budget data and payroll data, and have that synchronized once and for all. We hope to have that in place at the beginning of the next fiscal year, a new financial management system we hope to have in place. We have pilots underway as we speak, a new financial management system operating for all the agencies, and very, very importantly for all the decisionmakers who are sitting here and for the decisionmakers in Congress, providing timely, accurate, reliable information in place and running October 1 of this coming fiscal year, as well.

We believe that with those systems, and very, very importantly with what we call the business process reengineering that has to be a part of that systems development, we will have largely corrected a lot of the problems that Mr. Farell has referred to in this year's audit.

Mrs. MORELLA. Without micromanaging, we may want to in the future have Mr. Herndon come before us, Mr. Chairman, to talk about some of that.

Mr. DAVIS. Thank you.

Mrs. MORELLA. Mr. Williams, I think you have done a terrific job, and Councilwoman or Chairwoman Cropp, thank you for being here.

Mr. DAVIS. I think you have brought up something.

First of all, let me ask a question. There was an article today in one of the newspapers about payroll ghosts, about ghost employees. Have you ever encountered these in any other audits you have done?

Mr. FARRELL. Payroll ghosts? Possibly they will come up. What we are responsible for in performing an audit is determining if there is fraudulent financial reporting or fraudulent misappropriation of assets that would be material to the——

Mr. DAVIS. I appreciate that. You ended up going the extra mile on this audit.

Mr. FARRELL. Correct. We were looking for ghosts, and we didn't find any. That is the good news. We didn't find any.

Mr. DAVIS. OK. You found some people who were dead and getting retirement payments.

Mr. FARRELL. On the retirement system.

Mr. DAVIS. Which is understandable, I guess, if they were not getting the appropriate information.

Mr. FARRELL. That is correct. You have to make sure that you are getting the information to find out when people are deceased, and typically what happens is people match their files up against the Social Security files to find that.

Mr. DAVIS. Sometimes Social Security does not——

Mr. FARRELL. Which is what we did. Sometimes.

Mr. DAVIS. Sometimes Social Security does not get the word on time.

Mr. FARRELL. That's correct.

Mr. DAVIS. You will turn this over to the city and the city will have a couple of options. One, they could go back and collect that money back, should they choose to do that, depending on what the amounts were, from people who have cashed checks that were not intended to be cashed. Second, if there was any fraud they could always refer to the IG, who would decide if it would go forward.

Mr. FARRELL Correct. These have been referred to the city and the city has distributed them around the appropriate departments.

Mr. DAVIS. Do we know how much money was at issue?

Mr. FARRELL. No, I don't know the answer to that.

Mr. DAVIS. Mr. Williams, do you know? Does anyone know?

Mr. WILLIAMS. We are in the process of getting that figure, Mr. Chairman. We have don't have it right now.

Mr. DAVIS. One of my early cases as a young lawyer was one where a husband had died and the wife had continued to cash the checks for about 6 months, and it was an awkward case, but the government—the Federal Government got every penny back in that case, with interest.

And depending—in looking at this, this could be revenue; and to make a point, too, that we are going to go after people who don't make appropriate reporting or cash checks that are not intended. You don't have to make that determination, but this committee would be very interested in terms of how you handle it. If you could update that, let us know if it has been referred to the IG, if we are going after further collections, or if it is a de minimus amount, I think that would be of interest to us and to a lot of the reporters who have been following this to keep the public informed. I think those are the only questions I have at this point.

I appreciate all of you for the work you have been doing to help improve the city. This is, in terms of the types of hearings we have, a good news hearing. By and large we are moving in the right direction. We have all recognized and I think we can agree we have a ways to go. We will work together toward those goals. We don't want to be part of the problem up here, we want to continue to work with you. I just thank all of you.

Without objection, all written statements submitted by the witnesses will be made part of the permanent record. The record will remain open for 10 days.

I thank all who have helped us reach such a milestone. The subcommittee will continue to work with all interested parties to achieve our objectives.

These proceedings are closed.

[Whereupon, at 1:03 p.m., the subcommittee was adjourned.]