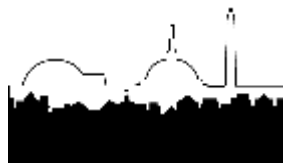

DC APPLESEED CENTER REPORT

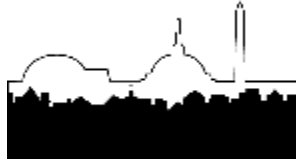
*AFTER THE CONTROL BOARD:
THE CHIEF FINANCIAL OFFICER AND
FINANCIAL MANAGEMENT OF
THE DISTRICT OF COLUMBIA*

June 2001



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DC APPLESEED CENTER

The DC Appleseed Center is an independent non-profit advocacy organization dedicated to making the District of Columbia and the Washington Metropolitan area a better place to live and work, focusing primarily on strengthening the financial health of the District and enhancing the performance of governmental institutions that affect the District. The solutions DC Appleseed presents to the public, civic leaders, and government representatives are based on nonpartisan analysis and include concrete proposals for change. DC Appleseed is one of a number of local centers across the country fostered by the Appleseed Foundation.

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INTRODUCTION AND EXECUTIVE SUMMARY

With the District of Columbia’s Financial Responsibility and Management Assistance Authority (“Control Board”) scheduled to become dormant on October 1, 2001, there are both hopes and concerns regarding the future financial management of the District of Columbia. The fiscal management systems and practices established over the past six years have provided a foundation upon which locally-controlled government can build. By eliminating the deficit and improving many aspects of financial management, the District government – during the Control Board’s tenure – has increased the likelihood that the District’s finances will be well-managed in the future.

At the same time, the District must guard carefully against the conditions that led to the creation of the Control Board in 1995. Before then, the District failed to manage its finances in a manner that ensured adequate budgetary and spending controls. While much progress has been made, problems with the District’s financial management remain, as reported in the Management Letter accompanying the District’s most recent annual audit and an April 2001 General Accounting Office report on the District’s financial management system.

Beginning in October 2001, the District’s finances will, under current law, be managed at the local level by the Mayor, the Council, and the District’s appointed Chief Financial Officer

(“CFO”).¹ The financial management responsibilities of the District’s elected leaders include enacting an annual budget, and implementing programs and enacting legislation consistent with the budget. The responsibilities of the CFO – the focus of this report – include developing estimates of revenues during the budget formulation process, controlling disbursements and monitoring spending to help ensure that expenditures are legal and consistent with the budget, and performing other typical financial management functions such as assessing and collecting taxes.

In political jurisdictions throughout the country, centralized financial professionals – like the District’s CFO – are expected to provide financial information and maintain expenditure control mechanisms that are essential to effective and efficient operations. These financial officers are to provide elected leaders and agency directors with the reliable financial information they need to develop policies, implement programs, and conduct oversight. For example, professional-level preparation of revenue and program cost estimates during the budget development process ensures the presence of critical guideposts for both agency expenditures and legislative oversight throughout the fiscal year. And, timely and accurate reports concerning a jurisdiction’s financial condition provide political leaders with the information they need to avoid deficits.

Over the past six years, the District’s CFO has increased the government’s capacity to fulfill those functions by developing within the government greater competence in several areas, including budgeting, accounting, assessing and collecting taxes, and preparing cost and revenue estimates. This trend has enabled better financial management in the District and has fostered greater confidence in the District’s finances within local and federal government and the financial markets.

This DC Appleseed Center report recommends a structure for the District government’s future financial management – including a strong role for the CFO – that builds on the District’s progress of the past six years in developing a government in which sound financial management effectively deters overspending and is integrated into program development and implementation. To meet these goals, this report seeks to answer the following general questions: (1) how much independence should the CFO have from the Mayor (and how should that independence be manifested); and (2) how should power over different components of the District’s financial operations be allocated among the CFO and other parts of the District government?

The formulation of these questions intentionally omits any reference to the prospect of continuing – through the ongoing presence of the Control Board or a similar entity – the level of federal control over the District’s financial management that has existed over the past six years. DC Appleseed strongly believes that District residents should regain at least the level of control that the Financial Responsibility and Management Assistance Act (the “FRMAA”) requires when the Control Board becomes dormant. The District has met the FRMAA’s terms for the

¹ Congress, of course, also plays a substantial role in the District’s financial management, most significantly through the process of appropriating the District’s annual budget. Pub. L. No. 93-198 § 446.

Control Board’s dormancy – four consecutive years without a deficit and access to financial markets at reasonable rates. Furthermore, basic principles underlying democratic government demand greater self-governance in the District than existed under the Control Board.

DC Appleseed also recommends that the District’s elected local government leaders play the lead role in developing the new financial management structure. While we understand that, under present law, Congress possesses ultimate power over the structure of District government, we believe that Congress should defer to locally elected leaders on this set of issues.

The report is divided into four sections. Section I provides background on financial management in the District. Section II recommends an allocation of responsibilities in specific areas of financial management, with a focus on the CFO’s role. Section III recommends continued independence of the CFO, including a substantial revision to the current mechanisms for ensuring that independence. Section IV examines the extent to which financial personnel in agencies should report to the central CFO as opposed to agency directors. A summary of each section follows.

Allocation of Financial Functions

DC Appleseed recommends that the CFO continue to have primary responsibility for financial management functions for the District government. Among District government entities, the CFO is best qualified to ensure that, for example, the District’s budget is built on sound revenue and budget estimates, taxes are assessed and collected in a non-political manner, fiscal impact statements (“FISs”) accompanying legislation are unbiased, and contracts are executed only when funds are available. The continued presence of professional competency in each of these areas is necessary for the District government to establish sound financial management practices over the long-term.

DC Appleseed also recognizes, however, that the District’s elected leaders must play a role in financial management if they are to have the information and support they need to serve the District and its residents. Structurally, elected officials’ input can be provided for through processes recommended elsewhere in this report, including by providing roles for the Mayor and the Council in the appointment and removal (for cause) of the CFO, and for agency directors in the appointment, evaluation, and removal of agency CFOs. However, it is also important that the CFO continue to work cooperatively with the Mayor, the Council, and agency directors if the District government is to deliver services to residents while maintaining sound financial management.

DC Appleseed recommends that:

- § the CFO fulfill the technical financial management functions typically fulfilled in other jurisdictions by central financial professionals, including retaining authority over the offices that handle treasury and controller functions, tax collection and assessment, and internal controls;
- § the CFO be responsible for issuing revenue estimates – a process that in recent years has

been viewed as producing credible forecasts – and that the process be made more transparent to allow for greater public input;

- § the Budget Director continue to report to the CFO, who will have the power to hire and fire the Budget Director after consulting with the Mayor;
- § Congress remove itself from, or significantly streamline, the processes by which the District’s annual budget and supplemental appropriations are approved;
- § the CFO be required to comment on the consistency with and fiscal impact on the budget and three-year financial plan of all legislation after it is passed by the Council;
- § the CFO be required to certify, before a contract is executed, that sufficient funds are available;
- § the requirement for Council review of contracts be eliminated; and
- § the Chief Procurement Officer continue to be required to certify that contracts have gone through proper contracting procedure before contracts are let.

Independence of the CFO

Over the past six years, the Control Board’s approval has been required to remove the CFO, giving the CFO a tremendous amount of independence from the Mayor and Council. DC Appleseed strongly supports continuing independence for the CFO after the Control Board becomes dormant in order to ensure that (1) the District’s fiscal management not return to its pre-1995 state, when financial officials in the District government were provided no structural independence, and (2) the CFO is able to continue building a strong professional staff to carry out essential financial management functions. However, DC Appleseed also recommends that the CFO be less independent in the future than has been the case during the Control Board’s tenure, primarily so that financial operations are well-integrated into the District government after the Control Board becomes dormant.

To achieve a balance between independence for the CFO and the integration of financial operations into government, DC Appleseed recommends that, beginning on October 1, 2001:

- § the Mayor may appoint the CFO to a fixed, renewable four-year term, coterminous with the Mayor’s term, subject to Council confirmation;
- § the Mayor may remove the CFO for cause, subject to a ten-day period within which the Council may prevent the removal (as opposed to the two-thirds Council approval requirement now in the law);
- § the requirement for a 30-day layover in Congress for appointment or removal of the CFO be eliminated;
- § the CFO retain separate and independent procurement, personnel, and legal counsel

authority for a two-year transition period, at the end of which these authorities will be subject to the Mayor's control; and

§ the budget for the Office of the CFO follow the same process as all other agency budgets, except that the Council receive the budget request originally made by the Office of the CFO to the Mayor, and the CFO continue to have an independent right to appear before the Council during the budget process.

Reporting Relationship of Agency CFOs

Many factors contributed to the District's most recent financial crisis – which came to a head in 1993 and 1994 – not the least of which were unmonitored and uncontrolled spending in District government agencies. To get spending under control during the Control Board's tenure, the central CFO was granted complete authority over the financial personnel in each agency. DC Appleseed suggests that – once the Control Board is dormant – agency directors be granted additional authority over agency financial personnel in order to increase collaboration between policy/program staff and financial personnel. However, given the continued need for central controls to resolve ongoing financial management problems, DC Appleseed recommends that the central CFO retain ultimate authority over agency CFOs and delegate only some of that authority to agency heads and agency CFOs as appropriate.

Specifically, DC Appleseed recommends that:

§ the central CFO establish criteria for selecting agency financial personnel, facilitate the recruitment of qualified candidates, select a pool of candidates for each agency, and delegate to the applicable agency director the authority to choose an agency CFO from that agency's pool;

§ the central CFO delegate certain financial management authority to agency CFOs, which can be withdrawn depending on the agency CFO's performance;

§ the central CFO delegate responsibility to agency directors for evaluating agency CFOs on the fulfillment of programmatic responsibilities, while retaining the authority to evaluate agency CFOs on financial management responsibilities;

§ the central CFO retain authority to remove an agency CFO, but only after consulting with the agency director; and

§ the budget for each agency's financial operations remain within the agency's budget, rather than being under the central CFO's control.

* * * * *

The recommendations in this report seek to establish financial operations for the District of Columbia that are independent, professional, transparent, and responsive to the policy and program goals of locally elected leaders. The attainment of those goals will depend not only on the structure of the government's financial operations but also on the dedication of the CFO and the District's elected leaders to work together to establish professional financial management for the District. We do not suppose that the recommendations made in this report are the only way to achieve these goals. Indeed, decisions regarding the future financial operations of the District will be products of a political process. It is important, however, that such decisions result in a financial management structure that represents a reasonable balance between independence and responsiveness of financial officials that underlies this report's recommendations.

I. BACKGROUND

A. Pre-Control Board Financial Management

A District of Columbia government, separate and distinct from the federal government, was established on January 2, 1975, pursuant to the District of Columbia Self-Government and Governmental Re-Organization Act ("Home Rule Act").² Under the Home Rule Act, the Mayor is the chief executive officer of the District, and, absent express delegation of powers to another officer or body, possesses all executive power. Under the original Home Rule Act, the District's financial operations were not expressly delegated to another entity, and were, therefore, under the Mayor's control.

At the time of transition to Home Rule, the Senate Committee on the District of Columbia commissioned Arthur Andersen & Co. in 1975 to conduct a study of the District's financial management and to write a report. The Andersen Report, presented to the Senate Committee at a public hearing on June 19, 1976, concluded that:

the financial information published by the District is not reliable. The District's [1975] annual report contains inaccurate and misleading numbers. Internal reporting, which is essential if the District's operations are to be managed on a sound financial basis, is not reliable, timely or consistent among agencies. This lack of reliable financial information results from weaknesses in financial controls which have evolved over a long period of time.³

One of the Andersen Report's principal recommendations for addressing these shortcomings was the creation of a single executive who would be solely responsible for managing (1) accounting operations, (2) treasury operations, (3) budget preparation, (4) tax and

² Pub. L. No. 93-198.

³ "Report on the Accounting and Financial Management Practices of the District of Columbia Government," Arthur Andersen & Co., prepared for the U.S. Senate Committee on the District of Columbia, June 1976, Volume 1 – Executive Summary, at 1. The report's director was Charles A. Bowsler, who was appointed in 1981 as U.S. Comptroller General.

revenue matters, and (5) financial data processing systems. This recommendation was implemented in 1982, when Mayor Barry created three Principal Deputy Mayors – Operations/City Administrator, Economic Development, and Financial Management.⁴ The Deputy Mayor for Finance was assigned the five key functions recommended in the 1976 Andersen Report, and the present CFO has essentially the same responsibilities.⁵ These functions are:

- § *accounting* – coordinating the annual audit, overseeing operation of the general ledger and supporting feeder (computer and other) systems, preparing periodic payroll and retiree disbursements, making vendor payments, and coordinating fringe benefit matters (*e.g.*, withholding income taxes, health and retirement deductions, federal and state withholding statements);
- § *treasury* – managing banking relationships, planning debt retirements and issuances, coordinating with municipal bond rating agencies, monitoring cash flows, *etc.*;
- § *budget* – preparing annual operating and capital budgets, monitoring budgetary oversight during the fiscal year, defending budget proposals on behalf of the Mayor and Council;
- § *tax and revenue* – administering the various tax systems (*e.g.*, income, sales, real estate, excise), including audit and enforcement activities, and assessment of real estate; and
- § *financial data processing systems* – assuring secure operation of financial systems to serve the foregoing activities.

Between 1975 and 1995, some political jurisdictions outside the District of Columbia insulated central government financial personnel – who handled functions similar to those of the District’s Deputy Mayor for Finance – from political pressures, either by granting them independent statutory authority for financial functions or by changing the manner in which they were selected. Nevertheless, until 1995, the District’s chief financial officials were – like other District agency heads – political appointees answerable directly to the Mayor and with no statutory protections against removal. These officials – including the Deputy Mayor for Finance – were employed at the pleasure of the Mayor, and had no independent statutory authority. In other words, they functioned under the control of, and with authority delegated by, the Mayor.⁶

⁴ “Barry Reshapes Government, Names Three Deputy Mayors,” *The Washington Post*, December 24, 1982, at A1.

⁵ Information about the Office of the Chief Financial Officer can be found on the OCFO website at <http://www.cfo.washingtondc.gov>.

⁶ The District’s need for a professional financial operation is no less, and perhaps more, than that of other jurisdictions. The District combines activities provided by three levels of government elsewhere throughout the United States – states, counties, and municipalities.

B. Financial Management During the Control Board's Tenure

Through the late 1980s and early 1990s, the District's financial condition worsened, and the District's inadequate fiscal management – including poor revenue estimates and poorly prepared budget documents – was a contributing factor.⁷ In fiscal years 1993 and 1994, the District incurred significant annual deficits and a growing accumulated deficit.⁸ In reaction, Congress enacted the FRMAA, creating the Control Board. Appointed by the President in consultation with members of Congress, the Control Board was granted broad financial management responsibilities for the District, including:

- § approval of the budget and financial plan adopted by the Mayor and the Council;
- § approval of all legislation enacted by the Council and signed by the Mayor for consistency with the budget and financial plan;
- § approval of all labor contracts for consistency with the budget and financial plan, as well as of any contracts and leases that the Control Board chooses, prior to those contracts being let or leases signed;
- § certifying all borrowings by the District as consistent with the budget and financial plan, as well as issuing bonds to borrow funds on behalf of the District; and
- § monitoring the District's spending and revenue collection throughout the fiscal year for consistency with the budget and financial plan.⁹

The FRMAA established the Office of the CFO and granted the CFO significant independence and authority. Although appointed by the Mayor and confirmed by the Council, the CFO was made independent from locally elected officials during the Control Board's tenure primarily by granting (1) the Control Board ultimate authority to remove the CFO, and (2) the

Thus, the District handles a range of functions that no other single jurisdiction handles. As a result, the District's finances are substantially larger than those of any surrounding county, and comparable to those of several federal agencies. *See Comparative Financial Data*, attached as Appendix B.

⁷ *See, e.g.*, "Financial Status: District of Columbia Finances," United States General Accounting Office, Report GAO/AIMD/GGD-94-172BR, June 1994; and "Avoiding a District of Columbia Financial Emergency," Greater Washington Research Center, December 1992.

⁸ *See* Greater Washington Society of CPAs, "2000 Audit Briefing," at 11, attached as Appendix C.

⁹ Pub. L. No. 104-8 § 201-204, 206, 211-214.

CFO independent control over the systems, budget, and staff for personnel and legal counsel for the CFO's Office.¹⁰

The CFO's financial management powers included:

- § hiring and firing CFOs who work in most District agencies;
- § estimating program expenditures and projecting financial conditions;
- § formulating revenue estimates;
- § preparing the budget and three-year financial plan;
- § certifying the availability of funds for contracts before they are let;
- § supervising and assuming responsibility for financial transactions;
- § maintaining systems of accounting and internal control;
- § assessing property for taxation;
- § collecting all taxes; and
- § maintaining custody of all public funds and investments of the District government.¹¹

For the first time, then, D.C. government financial professionals performed their functions independently from the political branches of the District government, using authority expressly granted under law.¹²

C. Post-Control Board Financial Management

Since establishment of the Control Board, the District's financial health has improved significantly. The District has achieved a substantial budget surplus in each of four consecutive fiscal years (1997-2000), and its bond rating, once considered non-investment grade, has been

¹⁰ Pub. L. No. 104-8 § 302, as amended by Pub. L. No. 104-192 § 142.

¹¹ Pub. L. No. 104-8 § 302.

¹² The FRMAA also increased the independence and responsibilities of the District's Office of the Inspector General, an office beyond the scope of this report. Pub. L. No. 104-8 § 303.

raised to investment grade by each of the three major rating agencies.¹³ As a result, the Control Board is scheduled to become dormant on September 30, 2001. The FRMAA provides that the Control Board will cease to have any decision-making authority when the District government has “adequate access to both short-term and long-term credit markets at reasonable interest rates” and has had four consecutive “fiscal years . . . [in which] the expenditures made by the District government during each of the years did not exceed the revenues of the District government during such years.”¹⁴ Because the Control Board has certified that the District has met these conditions, the statutory requirements triggering the Control Board’s dormancy have been met.¹⁵

The dormancy of the Control Board will, under existing law, be accompanied by several changes in the District’s financial operations. The law does not reassign to any other entity or entities the Control Board’s financial oversight responsibilities. The Control Board’s dormancy also triggers the removal from the CFO of certain responsibilities provided for in the FRMAA, including the power to prepare the annual budget.¹⁶

¹³ See “News Release,” District of Columbia Financial Responsibility and Management Assistance Authority, February 14, 2001. As a result, the District has repaid virtually all of its outstanding debt that carried higher interest rates than those the District could attract currently with its improved ratings.

¹⁴ Pub. L. No. 104-8 § 209. Specifically, once the District has met these conditions, the law suspends the Control Board’s activities at the end of a fiscal year for which the Control Board approved the budget.

¹⁵ See “News Release,” District of Columbia Financial Responsibility and Management Assistance Authority, February 14, 2001. Under the FRMAA, the Control Board will return if any of seven events occur: “(1) The requisitioning by the Mayor of advances from the Treasury of the United States under title VI of the District of Columbia Revenue Act of 1939 (sec. 47-3401, D.C. Code), or the existence of any unreimbursed amounts obtained pursuant to such authority. (2) The failure of the District government to provide sufficient revenue to a debt service reserve fund of the Authority under Subtitle B. (3) The default by the District government with respect to any loans, bonds, notes, or other form of borrowing. (4) The failure of the District government to meet its payroll for any pay period. (5) The existence of a cash deficit of the District government at the end of any quarter of the fiscal year in excess of the difference between the estimated revenues of the District government and the estimated expenditures of the District government (including repayments of temporary borrowings) during the remainder of the fiscal year or the remainder of the fiscal year together with the first 6 months of the succeeding fiscal year (as determined by the Authority in consultation with the Chief Financial Officer of the District of Columbia). (6) The failure of the District government to make required payments relating to pensions and benefits for current and former employees of the District government. (7) The failure of the District government to make required payments to any entity established under an interstate compact to which the District of Columbia is a signatory.” Pub. L. No. 104-8 § 209 (a).

¹⁶ Pub. L. No. 104-8 § 302, as amended by Pub. L. No. 104-192 § 142.

Additionally, in its FY 2001 appropriations act for the District, Congress altered the terms by which the CFO can be appointed or removed after September 30, 2001. Specifically, after the dormancy of the Control Board, the Mayor will have the power to appoint the CFO, subject to confirmation by the D.C. Council and a subsequent 30-day layover “for review and comment” by committees of both the Senate and the House of Representatives. The Mayor will also be able to remove the CFO, but only for cause, and subject to approval by a two-thirds majority of the Council as well as a 30-day layover for review and comment by the same committees in Congress.¹⁷

As stated earlier this year by the District’s external auditors, the impending suspension of the Control Board’s activities is “certainly cause for celebration over how much progress the District has made in improving its financial condition over the last four years.”¹⁸ Nonetheless, significant problems remain.¹⁹ In April 2001, the Management Letter that accompanied the most recent District audit identified several shortcomings, including the failure to monitor properly expenditures against open contracts and the existence of over 1,500 decentralized bank accounts throughout the District government.²⁰ An April 2001, General Accounting Office (“GAO”) report detailing substantial weaknesses in the District’s financial management system provides additional reasons for concern. According to the GAO report, these weaknesses prevent the District from being able to “reliably and regularly report on whether it has spent its budget as intended for targeted city services, such as trash collection, nor can it reliably report on the costs of those services.”²¹

¹⁷ Pub. L. No. 106-522 § 155(a)(1-2); D.C. Code § 47-317.2.

¹⁸ Management Letter from KPMG LLP to the District’s Mayor, Council, Inspector General, and Control Board, March 31, 2001, at 2 (the “KPMG Letter”).

¹⁹ However, the issuance of timely Comprehensive Annual Financial Reports has not been a problem. Except for fiscal year 1999, the District has issued its Comprehensive Annual Financial Report each year since 1979 within the 120-day provision of legislation. Further, the District has regularly been awarded the Government Finance Officers Association “Certificate of Achievement for Excellence in Financial Reporting.” The citation states “the Certificate ... is presented by GFOA to government units ... whose CAFRs achieve the highest standards in government accounting and financial reporting.” The District has also received an unqualified (“clean”) auditors’ report, the best possible outcome of an independent audit, for all years since 1979 except fiscal years 1995 and 1996, when the District faced its most severe financial difficulties. Greater Washington Society of CPAs, “2000 Audit Briefing,” at 4.

²⁰ KPMG Letter, at 3.

²¹ “District of Columbia: Weaknesses in Financial Management System Implementation,” United States General Accounting Office, Report GAO-01-489, April 2001, at 2.

Taking into account progress made and continuing challenges, this DC Appleseed report revisits the current law and considers the most appropriate financial management structure for the District in the future.

II. ALLOCATION OF FINANCIAL FUNCTIONS

A. Core Financial Functions Under the CFO

DC Appleaseed recommends that the CFO continue to have authority over the offices that handle accounting, treasury, tax and revenue, and financial systems functions, all of which are typically handled in other jurisdictions by central financial personnel – including CFOs, treasurers, and controllers.²² Because these are all technical aspects of financial management, they are best kept under the authority of an independent, appointed official with the expertise to hire qualified financial officials and to ensure that those officials remain focused on providing professional-quality work. Moreover, keeping these functions under a single, centralized financial officer in the District will allow the CFO to facilitate coordination among the offices within the financial cluster and produce timely reports of financial condition. DC Appleaseed sees no reason to remove any of these responsibilities from the CFO, and no such reform was suggested by anyone DC Appleaseed interviewed.

B. Estimating Revenue

1. Discussion

Before a government spends money, an annual budget or other spending plan must be approved, which requires that revenue for the ensuing year be estimated. High revenue estimates can be used to support political agendas, as they enable bigger budgets to be enacted and more funds to be spent on programs demanded by constituents. In the end, however, unjustified revenue estimates, designed to meet political goals, can eventually cause services to residents to be interrupted, deficits to be incurred, or both.

Over the two decades prior to the Control Board's tenure, District revenues were estimated by financial officials who reported directly to the Mayor. The FRMAA changed that, providing that the CFO has responsibility for preparing annual estimates of all revenues of the District, subject to approval by the Control Board.²³ The CFO's revenue estimates provide an absolute ceiling on the size of the budget the Council may enact (and the Mayor may sign) for the District, although the Mayor and the Council may prepare a budget based on revenue estimates that are lower than those projected by the CFO. In addition, during the fiscal year, as actual revenues are collected, the CFO is required to adjust the revenue estimates quarterly to reflect actual collections and projections for the remainder of the fiscal year. Such adjustments are required before a supplemental budget can be submitted by the District to Congress.²⁴

2. Recommendations

²² A summary of these functions is provided in section I.A. of this report.

²³ Pub. L. No. 104-8 § 302. Originally, this power was scheduled to expire with the Control Board's dormancy. However, in the FY2001 Appropriations Act, Congress granted the CFO this responsibility during the Control Board's dormancy as well. Pub. L. No. 106-522.

²⁴Pub. L. No. 104-8 § 302.

DC Appleseed recommends that the CFO continue its responsibility for estimating revenue. Although the CFO's revenue estimates appear to have been relatively conservative during the Control Board's tenure, the process has, by all accounts, worked relatively well. None of the individuals interviewed by DC Appleseed suggested that the District's revenue estimates were deliberately biased, or that those preparing the estimates did a poor job. Indeed, many spoke highly of the CFO's staff that estimates revenue and believe that it is important to ensure that the District continue to make such forecasts in an unbiased and professional manner.

That is not to say that the CFO should develop revenue estimates in isolation. Indeed, in recent years, staff in the CFO's Office of Research and Analysis who perform this function have consulted with independent economic advisors during the process of developing revenue estimates. Whether that process continues or not, DC Appleseed recommends that the ultimate authority to issue revenue estimates remain with the CFO.²⁵

In addition, the revenue estimation process should be changed to improve the public's ability to understand the basis for revenue estimates. Currently, the CFO is not required to provide to the public for review and comment information about the assumptions underlying revenue estimates or the actual estimates themselves. Thus, prior to the introduction of the annual budget and financial plan, it is very difficult for the public to provide meaningful input into the revenue estimation process.²⁶ Providing an opportunity for public comment on the estimates before they are finalized would improve confidence in and understanding of the system.²⁷

C. Preparing the Budget and Financial Plan²⁸

²⁵ An outside entity could be involved in the revenue estimation process either by (1) helping to prepare either the assumptions upon which revenue estimates are based or the estimates themselves, or (2) commenting on the validity of the assumptions and/or the estimates once prepared by the CFO. *The Washington Post* reported in May 2001 that the Mayor and Council Chair support creating a panel of economic analysts to review revenue estimates. "D.C. Chafes at Morella's Advisory Board Idea," *The Washington Post*, May 9, 2001, at B01.

²⁶ The CFO has made such information available to the Control Board, but is not required to make the information publicly available.

²⁷ DC Appleseed does not propose that the public comment process be made so extensive as to create an undue time-consuming burden on the CFO. It seems unnecessary, for example, for the CFO to follow anything like the procedures required to issue a rule under the D.C. Administrative Procedures Act.

²⁸ The budget and financial plan are defined in the FRMAA as "the budgets for the District government ... for the applicable fiscal year and the next 3 fiscal years (including the

1. Discussion

The annual budget is arguably the most important political document produced by a government. It reflects the priorities and hopes of policymakers. It drives decisions on levels of service delivery, capital improvements, and other functions, and reflects tradeoffs between levels of expenditures and taxes.

The budget also provides a critical foundation for fiscal control. As the blueprint for annual program and other expenditures, the budget establishes guideposts that executive branch agencies must follow if the government as a whole is to avoid deficits. Unless the budget itself is prepared professionally and with integrity, the information needed for sound fiscal management will be inherently suspect.

Under the FRMAA, during the Control Board's tenure, the CFO is responsible for preparing the annual budget and financial plan, currently assigned to the Deputy CFO for Budget and Planning ("Budget Director"). The FRMAA directs the CFO to estimate expenditures during the budget preparation process, to monitor expenditures during the year, and to estimate the surplus or deficit that the District will face at the end of a fiscal year and for the four following years.²⁹ These responsibilities allow the CFO to compare budget information to prior year actual expenditures reflected in the accounting system, and to project intra-year expenditures on the same basis as those contained in the budget.

During the Control Board's tenure, the Budget Director is appointed by and reports to the CFO, but can only be removed by the Control Board after consulting with the Mayor and CFO.³⁰ With the dormancy of the Control Board, absent a change in the law, the Mayor would appoint the Budget Director with the advice and consent of the Council.³¹

Under the current budget process, (1) agency financial personnel develop the budget requests for agencies, which are submitted to the Budget Office, (2) the Budget Director and his or her staff prepare the overall budget by revising the agency submissions to improve program cost estimates and to reflect the Mayor's overall priorities, and (3) the budget is transmitted to the Council. During the past year, the current system worked well according to those DC Appleaseed interviewed in the Mayor's office and the Council. Specifically, the Mayor's staff felt that the Mayor's policy objectives were accurately reflected in the budget, while those interviewed from the Council trusted that the program estimates in the Mayor's budget were derived reasonably.

2. Recommendations

projected revenues and expenditures of each fund of the District government for such years)”
Pub. L. No. 104-8 § 201 (b); 109 Stat. 108.

²⁹ Pub. L. No. 104-8 § 302.

³⁰ Pub. L. No. 104-194 § 142.

³¹ Pub. L. No. 104-8 § 302.

DC Appleaseed recommends keeping the Office of Budget and Planning (the “Budget Office”) – including the technical aspects of preparing the budget and financial plan – under the CFO. DC Appleaseed further recommends that the CFO be required to consult the Mayor before the CFO hires or fires the Budget Director.

If the CFO does not play a significant role in budget preparation, the estimates in the annual budget could be generated under political pressure and, as a result, be less accurate. Specifically, expenditure projections might reflect unduly optimistic conclusions that provide short-term political benefits for the Mayor and members of the Council. A professional Budget Office is needed to produce an annual budget that reflects credible financial numbers.³²

By keeping the Budget Office under the CFO, DC Appleaseed’s recommendation would also allow the necessary expertise to develop within the CFO’s financial cluster to monitor expenditures during the year and issue quarterly public reports projecting the potential for surplus or deficit in the total appropriations and in individual accounts. Similarly, the CFO would be able to acquire through this process the information needed to prepare five-year projections showing the major trends the District is facing.

Given the importance of the annual budget, it is important that the Mayor have confidence that the District’s Budget Director will work with the Mayor to develop a credible budget proposal reflecting the Mayor’s priorities. Requiring that the CFO consult with the Mayor before hiring or firing the Budget Director would help in this regard. Having the Budget Director serve under (and at the pleasure of) an independent CFO will lend credibility to the estimates within the budget. And, as long as there is a harmonious relationship between the CFO and the Mayor, the budget also should reflect the Mayor's budget priorities.

However, if the CFO has policy differences with the Mayor (*e.g.*, over the amount of appropriate capital spending/borrowing), under the structure that now exists in the District and that this report recommends be maintained, the Budget Director would presumably follow the CFO’s direction. Failure of the Budget Director to develop a budget in accordance with the Mayor’s priorities might lead the Mayor to attempt to duplicate the budget function within the Mayor’s office. At best this would create duplication of effort; at worst, confusion and gridlock. Thus, while there is merit in continuing the current arrangement (budget function under the CFO), it would be wise to revisit the arrangement in the future.³³

³² Regardless of whom the Budget Director reports to, it is critical that the Budget Office – as all offices in the District’s financial cluster – be established as a professional office, staffed by analysts with appropriate credentials in public administration, public policy, business, accounting, or a related field.

³³ The vast majority of cities and counties place the Budget Director under the Mayor or other chief executive official, including the following cities examined by DC Appleaseed: Baltimore, Buffalo, Columbus, Denver, Milwaukee, New York City, Pittsburgh, San Francisco, and Seattle. Some cities use a joint process that may involve one or more elected official (*e.g.*, Indianapolis and St. Louis) or both the Mayor and the Council (Minneapolis). In

DC Appleseed further recommends that the Council and the public – in addition to the Mayor – have full access to the budget prepared by the Budget Office, as well as the underlying assumptions. Such information is critical if the Council and the public are to have the information they need to assess adequately the Mayor’s proposed budget. To use this information effectively, the Council also needs to increase substantially and develop further its fiscal staff, as was recommended in DC Appleseed’s 1999 Council Reform report.³⁴ Such a legislative staff is common in state governments and in some larger localities.

D. Congressional Involvement in the Budget Process

1. Discussion

Under current federal law, with certain limited exceptions relating primarily to the payment of debt service on bonds issued by the District, the District may not spend any revenues – whether generated from local or federal sources – without an appropriation of those revenues pursuant to an act of Congress.³⁵ The District is required to obtain not only Congressional enactment of its annual budget and financial plan, but also Congressional approval of each supplement to the District’s budget.³⁶

Typically, the budget process begins in the late summer or early fall some 12 to 15 months before the fiscal year begins. The Mayor completes his or her development of the proposed budget and submits a budget proposal to the Council in February or March.³⁷ After the budget is enacted by the Council and signed by the Mayor,³⁸ Congress generally takes up the District’s budget as it considers the budgets of various federal departments and agencies. Once

contrast, the Chief Financial Officer Act of 1990, which applies to the larger federal government agencies, delegates the budget responsibility to agency CFOs. Pub. L. No. 101-576.

³⁴ “Operational Reform of the District of Columbia Council: A Fix-It-Yourself Manual,” DC Appleseed Center, February 1999, at 7-10 (“DC Appleseed Council Reform Report”).

³⁵ Pub. L. No. 93-198 § 446. Approximately 76% of the revenues that support the District’s budget come from local sources. Greater Washington Society of CPAs, “2000 Audit Briefing,” at 10.

³⁶ Pub. L. No. 93-198 § 446.

³⁷ Prior to the creation of the Control Board, the Mayor was required by District law to submit the budget by February 1 and the Council had 50 days to review and act on the proposed budget. The timing of this process has changed somewhat during the tenure of the Control Board, but typically the local approval process has been completed by June, and the budget is then submitted to Congress.

³⁸ The Control Board’s approval of the budget has been required since the FRMAA’s enactment, and will be required unless and until the Control Board is dormant. Pub. L. No. 104-8 § 202.

enacted by Congress, the President must sign the appropriations bill before the District can spend any revenues. The goal is to have an approved budget in place by October 1, the beginning of the District's fiscal year. Unfortunately, Congress has not always acted timely to adopt the District's budget and, as a result, the District has begun more than one fiscal year not knowing the size or details of its approved budget.

If it has not acted on the District's budget prior to the start of the fiscal year, Congress generally adopts a continuing resolution that permits the District to spend at or near the level of the prior year. Such delays in adopting a new budget limit the District's ability to plan adequately, to implement new programs, to hire new staff, and to do other things included in the budget that were not a part of the budget of the previous year. While federal agencies endure such limitations whenever the federal budget enactment is delayed, no local political jurisdiction other than the District of Columbia is subject to such uncertainty.

In addition, the District's budget and its budget priorities often are amended by Congress. The District is often required to spend money for projects that are not its priorities or denied permission to spend its own revenues for programs that are its priorities. In recent years, Congress has also mandated that the District establish three different reserve funds and has threatened to withhold District appropriations if the District failed or refused to act in a manner that Congress desired.

A central justification for Congress's exercise of control over the District's budget has been that the District has not managed its finances properly. The failure of the District to estimate revenue and program costs adequately, as well as to ensure that contracts and the costs of implementing legislation were within the approved budget, contributed to the mid-90's financial crisis. By maintaining control over the District's appropriations, Congress can exercise some control on a routine basis.³⁹

2. Recommendations

DC Appleseed strongly recommends that Congress remove itself from the District's budget process. It is a process that is unique among state and local governments in this country, and is also cumbersome, time consuming, inefficient, subject to political vagaries, and profoundly undemocratic.⁴⁰ Moreover, the District has, over the past five years, established the foundation for sound fiscal management. With continued independence for the CFO, Congress can expect better financial information from and management in the District, including in the areas of revenue estimation, budget preparation, and spending controls. In this context, Congress need not rely on the annual appropriations process to ensure that the District's finances will be well-managed.

³⁹ See, generally, Pub. L. No. 104-8 § 2.

⁴⁰ Because District residents have no voting representation in Congress, they are not represented in the body that has ultimate authority to decide on the District's expenditure levels and program priorities.

If Congress is not willing to remove itself entirely from the budget process, it should at least remove itself from or significantly limit its role in the supplemental budget process. Congress should permit the District to adjust its spending during the fiscal year based on revised revenue estimates provided by the CFO without going through a tedious supplemental budget process that includes Congressional approval. Because the independent CFO will re-estimate revenue each quarter, Congress can be reasonably assured that supplemental spending will be based on sound forecasts. With such controls in place, Congress should, at the very least, limit its review of supplemental appropriations to something similar to its review of substantive laws, albeit on a much more accelerated basis.⁴¹

If Congress is unwilling to allow the District to adjust its budget and expend revenues up to the full amount of adjusted revenue estimates, Congress should consider permitting the District to make expenditures within certain guidelines. For example, Congress might permit the District to spend up to 80% of the additional estimated revenues without seeking Congressional approval, or could limit the expenditure of such additional revenues to capital programs or other non-recurring budget items.⁴²

E. Fiscal Impact Statements

1. Discussion

Under District of Columbia law, all laws enacted by the Council are required to be accompanied by a Fiscal Impact Statement (“FIS”) that sets forth, among other things, the potential impact that implementing the legislation will have on the District’s budget and financial plan for the first four fiscal years that the legislation will be in effect.⁴³

⁴¹ Congress has the power to disapprove any non-emergency law enacted by the Council and signed by the Mayor. This review process requires non-emergency laws passed by the Council and signed by the Mayor (or laws vetoed by the Mayor if the veto is overturned by the Council) to be submitted to Congress. Congress then has 30 legislative days (or 60 in the case of criminal laws) within which to pass a joint resolution disapproving the law, which must be signed by the President or passed by a two-thirds vote of both the House of Representatives and the Senate over a Presidential veto. Pub. L. No. 93-198 § 602 (c).

⁴² The FY2001 Appropriations Act enables the District to reprogram funds (with significant limitations) within an approved budget without Congressional approval, but does not enable the District to expend any funds above those in the Appropriations Act unless subsequently approved through the supplemental Appropriations process. Pub. L. No. 106-522 § 111.

⁴³ Home Rule Act, Pub. L. No. 93-198 § 602 (c)(3), as amended by Pub. L. No. 104-8 § 301. See also District of Columbia Council Rule 443 (c).

The FRMAA requires that, during a control year, the Control Board review all legislation enacted by the Council to determine what the financial impact will be and whether the legislation is consistent with the budget and financial plan. If the Control Board determines that the legislation is inconsistent with the budget and financial plan, it must notify the Council of its findings and provide an explanation for that conclusion. The Council may not submit such legislation to the Congress for review until the concerns of the Control Board are satisfied. If the Council declines to change the legislation in a manner that the Control Board deems adequate to address its concerns, the Control Board may disapprove the legislation.⁴⁴

As the law now stands, the CFO is not required to prepare FISs. However, in recent years, the CFO has done so for some legislation introduced at the request of the Mayor and some by members of the Council.⁴⁵ In addition, before the Mayor signs or vetoes legislation, the CFO typically reviews the FIS that accompanies the law enacted by the Council (which may differ from the one the CFO prepared) and provides comment to the Mayor about the impact of such legislation on the budget.

If prepared in an unbiased and complete manner, an FIS allows the Council and the Mayor to assess the costs of the proposed legislation and, if it is enacted, to later budget adequate funds to implement the legislation. If prepared poorly, an FIS can enable the enactment of legislation inconsistent with the budget and, ultimately, cause deficit spending or the interruption of government services. The staff in the CFO's Office has practical experience developing budgets and assessing the cost of implementing legislation. By contrast, there have been numerous occasions when the FIS prepared by the Council and its staff failed to provide a complete picture of the potential cost of legislation to the District.⁴⁶ It is important that, once the Control Board becomes dormant, some mechanism be put in place to provide for careful scrutiny of the potential fiscal impact of all legislation enacted by the Council.

2. Recommendations

DC Appleseed recommends that the CFO be required to review all legislation after it is enacted and before it is signed by the Mayor, and to comment on its consistency with, and impact on, the budget and financial plan.⁴⁷ Such a requirement will provide the public and elected leaders with the information they need to understand legislative impacts more fully, and may foster greater fiscal responsibility.

⁴⁴Pub. L. No. 104-8 § 203.

⁴⁵ Staff in the Office of the CFO estimate that the Office of the CFO prepared FISs over the past year for between 25 and 30 percent of all legislation. Interview with staff, Office of the CFO, May 2001.

⁴⁶See DC Appleseed Council Reform Report, at 30-31.

⁴⁷ For the CFO to have adequate time to review legislation, it may be necessary to require the Council to submit legislation to the CFO at an early stage in the legislative process – such as when legislation is first referred to a Council committee.

In addition, DC Appleaseed recommends that the CFO continue to provide assistance to the Council and the Mayor, if either so requests, in the preparation of FISs during the development of legislative proposals. Continuing to involve the CFO before legislation is enacted will promote better understanding of the fiscal impacts of legislation than was the case before the CFO gained independence.

However, DC Appleaseed believes that the CFO should not be given the authority, now held by the Control Board, to veto legislation passed by the Council. Granting such power to the CFO would, in DC Appleaseed's view, make the CFO's position – an appointed one – too powerful vis-a-vis elected officials and would therefore be inconsistent with basic principles of political accountability. If the CFO finds a piece of legislation inconsistent with the District's budget and financial plan, the CFO should be able to influence the legislative process adequately by publicly recommending that the Mayor veto the legislation.

F. Contract Review

1. Discussion

Currently, the Council, the Control Board, and the CFO have the authority to review and disapprove contracts before they are executed. Specifically, the Council has the authority, both during and after the control period, to review contracts over \$1 million and all multi-year contracts.⁴⁸ Further, the FRMAA authorizes the Control Board and the CFO, during a year that the Control Board is operating, to review and approve all District contracts and collective bargaining agreements, including contracts not subject to Council review.⁴⁹ Under current law, only the Council's contract review authority and the CFO's responsibility to certify the availability of funds before contracts are executed will continue once the Control Board becomes dormant.

While it is in the public interest to shed light on questionable contract practices that may result in an improper contract award, the Council's contract review process does not appear to be the best process to accomplish that purpose. Under the Council's procedures, the Mayor transmits required contracts to the Council and the Council has ten days to "act on" the contract, and if the Council takes no action, the contract is deemed approved.⁵⁰ For these purposes, "action" by the Council entails a Council member registering a desire to review the contract, in which case the Council Chair assigns the contract review to the appropriate Council committee; the committee holds a hearing on the contract (usually inviting contracting agency

⁴⁸ Pub. L. No. 93-198 § 451.

⁴⁹ Pub. L. No. 104-8 § 203.

⁵⁰ D.C. Law 8-257; D.C. Code § 1-1181.5A(a-b). There is also a streamlined process for Council review of contracts, in which a summary of the contract is provided to the Council by the Mayor and if no disapproval is introduced in 96 hours, the contract is deemed approved. D.C. Code § 1-1181.5A(j). Legislation is currently attached to the FY 2002 Budget Support Act which would lengthen that time from 96 hours to five days.

representatives to present testimony); the committee marks up the contract bill; and the contract is placed on the Council's Committee of the Whole agenda.

The existing process is unnecessarily time-consuming and too often very political. The Council's contract review can add 45 days or more to the contract process. On the other hand, while all of the people interviewed by DC Appleseed acknowledged the value of some kind of contract review, not one expressed the belief that the Council has the resources to review contracts effectively. Thus, the Council's contract review process often serves as little more than a means for unsuccessful bidders to appeal denials to a political body.

DC Appleseed's review of other cities reveals a variety of contract review procedures. In most of the cities DC Appleseed surveyed, a central financial official (usually the Controller) is required to certify that funds are available for the contract before the contract is awarded. Indeed, that is the case in the District, where the CFO provides such certification. Moreover, in the majority of the 12 cities DC Appleseed surveyed, the legislature does not have a role in contract approval.⁵¹

2. Recommendations

DC Appleseed recommends that (1) the CFO continue to be required to certify that funds are available before a contract (including any collective bargaining agreements) is executed, and (2) the Chief Procurement Officer ("CPO") be given the authority (which in many cases can be delegated to agency contracting officials) to certify that contracts have undergone proper contracting procedures.⁵²

As an additional check, DC Appleseed recommends that the Inspector General be required to issue an annual report on District contracts that will assess the extent to which procurement rules were followed during contracting, and whether vendors have complied with District regulations. DC Appleseed also recommends that additional public information be provided on contract awards. Specifically, the CPO should make available, online and in written form at a central location, records that support decisions to award individual contracts. These recommendations can help ensure that contracts are awarded only for those programs for which

⁵¹ In seven of the 12 cities surveyed by DC Appleseed, no legislative approval of contracts is required, and either the Finance Director, Controller, or Auditor is involved in contract review. In the other five cities, the legislature must approve contracts over a certain threshold amount, although that amount varies. In four of those cities, the legislature's approval threshold is lower than the current threshold for District Council review, while in one city, the legislature's approval threshold is the same as the District's.

⁵² While many jurisdictions place the CPO under the CFO, the District already provides some independence for the CPO, and there appears to be no reason for change.

funds have been budgeted, that more public information on contracts is available, and that agencies are complying with procurement rules.

DC Appleseed also recommends that the requirement for Council review of contracts be eliminated.⁵³ That is not to suggest that the Council should not play a role in overseeing and setting policies related to government contracts. To the contrary, the Council should continue to utilize its legislative and budget authority to establish rules for government contracts, and its oversight authority to review particular contract awards and procedures. In addition, the Council should exercise its oversight authority to monitor whether the CFO and CPO are performing their contract reviews adequately. It is only the contract-by-contract review in which the Council currently engages that DC Appleseed believes should be discontinued.

⁵³ At the very least, the value of contracts that are subject to Council review should be raised substantially (limited, for example, to contracts above \$10 million) and should be indexed to account for inflation.

III. INDEPENDENCE OF THE CFO

A. Discussion

Broad support exists for continuing the CFO's independence in the post-Control Board period. Every individual interviewed by DC Appleseed agreed that the increased independence of the CFO under the Control Board has been a key factor in improving the District's financial situation and promoting the confidence of the public and the financial community in the integrity of the District's financial operations.⁵⁴ More specifically, the establishment of an independent CFO is widely credited with increasing the accuracy of revenue estimates and budget projections, providing professional tax assessments and collections, and reporting timely and trustworthy opinions regarding the status of the District's finances.

However, in the future, the CFO must operate as an integral part of a District government that does not include the Control Board, and be responsive to the policy decisions of the Mayor and other elected officials. Accordingly, the CFO ought to have adequate incentives to support the development of the Mayor's budget, to expedite appropriately the approval of contracts and disbursements needed to meet program goals, and to balance the costs and benefits of sound financial management with the costs and benefits of providing basic government services. The question for this section of DC Appleseed's report is how to create a structure that appropriately balances independence and political responsiveness.

Under current law, when the Control Board becomes dormant, that balance will be struck by allowing the Mayor to (1) appoint the CFO, subject to confirmation by the D.C. Council and then 30 days for review and comment by committees of both the Senate and the House of Representatives, and (2) remove the CFO for cause, subject to approval by a two-thirds majority of the Council, as well as an identical 30-day layover in Congress.⁵⁵ While this particular approval process is unique, the underlying idea is not: of the 12 cities surveyed by DC Appleseed, most had a central financial official who was independent of the mayor, achieved either by appointing the official to a fixed term or by making the position an elected one. The District's CFO currently holds an additional measure of independence – the CFO has independent authority over the procurement, personnel, and legal counsel for the Office of the CFO, and the CFO's budget request for his or her Office cannot be modified by the Mayor or Council.

⁵⁴ A summary of the methodology used to research and prepare this report – including the number and categories of people interviewed – is attached as Appendix A.

⁵⁵ By contrast, the law provides that, during the Control Board's tenure, (1) the Control Board must concur in or reject the Mayor's appointment after confirmation by the Council, and (2) the CFO can be removed for cause by the Control Board or by the Mayor with the Control Board's approval. Pub. L. No. 104-8 § 302, as amended by Pub. L. No. 106-522 § 155.

B. Recommendations

1. CFO Appointment and Removal

DC Appleseed recommends that (1) the CFO be appointed by the Mayor to a fixed four-year term that is coterminous with the Mayor's term, subject to confirmation by a majority of the Council, and (2) the Mayor be allowed to remove the CFO, but only for cause and with the concurrence of a majority of the D.C. Council.⁵⁶ DC Appleseed further recommends that the process for Council review of the CFO's removal be as follows: (1) the Mayor notifies the Council of his or her intent to remove the CFO, including an explanation of the reasons for that removal; (2) the Council has ten legislative days within which to disapprove the removal; and (3) if the Council does not act within the ten-day period, the removal takes effect.

Establishing a fixed term of office would provide some insulation from demands made by elected officials or their appointees that may be inconsistent with sound financial management, while providing that the Mayor's and CFO's terms be coterminous will help ensure that the Mayor is able to work with the CFO to achieve the Mayor's policy goals. While we recognize that staggered terms would provide an additional measure of independence for the CFO that might prove valuable, we concluded that, on balance, it is better to allow each Mayor to choose the CFO with whom the Mayor must work.

Together with the fixed term, the requirement that the Council confirm the CFO's appointment would supply the CFO with the required degree of independence from the Mayor. However, DC Appleseed believes that the current two-thirds Council majority requirement for removal is too high a threshold. This requirement would be too likely to force the Mayor to work with a CFO whom the Mayor has determined is unfit for office (and therefore should be removed for cause). To reduce the likelihood that such a scenario would occur, DC Appleseed recommends replacing the current two-thirds Council requirement for removal with an opportunity for the Council to disapprove the removal within ten legislative days of the Mayor's decision.

DC Appleseed strongly recommends eliminating the Congressional layover required to appoint or remove the CFO, which would be required after September 30, 2001, under current law. Such a provision would only serve to introduce into the CFO selection and dismissal decision-making process a body – Congress – that is not accountable to those most directly affected by the CFO's decisions – District residents. Additionally, Congressional review of dismissals creates a situation in which the District could operate with a “lame duck” CFO who has lost the political support of both the Mayor and the Council.

⁵⁶ The law governing the removal of National Labor Relations Board members provides a model upon which the “for cause” definition applicable to the CFO's removal could be based: “Any member of the Board may be removed by the President, upon notice and hearing, for neglect of duty or malfeasance in office, but for no other cause.” 29 U.S.C. App. § 153 (a).

Finally, DC Appleseed recommends against making the CFO position an elected one. While this approach would ensure a high degree of independence, DC Appleseed believes that having an elected CFO position would be significantly less certain than an appointed one to (1) attract individuals with the professional and financial qualifications the position needs to ensure sound financial management, and (2) result in the Mayor and CFO having a good working relationship. Not one of the people DC Appleseed interviewed supported the concept of an elected CFO.

2. The Office of the CFO's Personnel, Procurement, and Legal Counsel Functions

DC Appleseed recommends that the personnel, procurement, and legal counsel functions for the Office of the CFO be transferred back to the Mayor's control two years after the Control Board becomes dormant. During this two-year period, the rules currently governing the CFO's office would continue in effect. To facilitate a smooth transition, at least one year before the two-year period concludes, the CFO and the Offices of Procurement, Personnel, and Corporation Counsel would have to develop a transition plan. At the end of this transition period, the functions would be transferred back to the Mayor and the rules applying to personnel, procurement, and legal counsel for the rest of the D.C. government would apply.⁵⁷

DC Appleseed's recommendation represents a balance between the desire to preserve the independent personnel, procurement, and legal counsel operations in the Office of the CFO, which prevailed during the Control Board period, and the realization that, in the long term, keeping a separate system for the CFO in place only helps to fracture the government. DC Appleseed recognizes that the District government's current centralized personnel and procurement systems are flawed. While the temptation exists to wall off the CFO's Office from these flawed systems so that the Office can continue to operate as it has thus far, continuing such a dual-track system in perpetuity is not a good idea. The solution is to fix the entire system, and to have the CFO join in the task of repair.

However, DC Appleseed realizes that the professionalism and the goal of rewarding performance rather than tenure, which has been built up within the CFO's Office over the past few years, might not survive immediate re-entry into the centralized system. DC Appleseed hopes that the two-year transition period will provide the opportunity for District-wide systems to be reformed while allowing the Office of the CFO to develop and build systems strong enough to withstand any negative effects accompanying the return to the centralized system, should these reforms not occur. If the District-wide systems have not been reformed within two years so that the CFO's Office can function adequately, the transition period may need to be extended.

⁵⁷ That is not to say that the CFO will be unable to make decisions thereafter regarding whom to hire, including those who are outside of civil service, but only that the centralized rules for hiring would apply to the CFO.

3. Budget for the CFO's Office

DC Appleseed recommends that the budget for the Office of the CFO not be exempted from the budget process imposed on virtually all other District agencies. We simply do not believe that the CFO's function (or that of any other District agency) is so much more important than other District functions (such as schools and police) that the Office of the CFO's budget should enjoy an exemption from being considered in the political process alongside the spending plans for other government services that are, in effect, competing for the same limited funds.⁵⁸

However, there is justifiable concern that, through the budget process, the Mayor could exert undue pressure on the CFO, thereby compromising the CFO's independence. Accordingly, DC Appleseed recommends that (1) the Office of the CFO submit its budget request to the Mayor (as do all other agencies), (2) the Mayor reflect in the Mayor's overall budget his or her judgment regarding the size of the budget for the CFO, and (3) the Mayor be required to submit the CFO's original request to the Council at the same time that the Mayor submits his or her budget for the entire District government. In addition, DC Appleseed recommends that the CFO continue to be provided the independent right to appear before the Council to support his or her budget request. Thus, the Council would receive the two proposed budgets for the CFO – one embedded in the Mayor's overall budget and the other as originally submitted by the CFO to the Mayor – and have access to more information with which to assess whether the Office of the CFO's budget is adequate.

DC Appleseed's recommendations represent a balance between the need to protect the CFO from possible mayoral threats of a diminished budget and the need for the CFO to operate as an integral part of the District government. Our recommended budget process for the CFO is similar to that used by the federal government for agency inspector generals' offices ("IGs"). Federal IGs have direct reporting responsibilities to Congress, and the Office of Management and Budget provides Congress with the original budget request each IG originally made to his or her agency if the IG's request was lowered during the overall budget process.⁵⁹

⁵⁸ The issue of the CFO's role in the preparation of the District's budget is addressed in section II.C of this report, which should be distinguished from the discussion of the budget for the Office of the CFO in this subsection.

⁵⁹ *See, generally*, Inspector General Act of 1978, 5 U.S.C. App. §§ 1, 4. This process was designed to insulate the IGs from undue political pressure.

IV. REPORTING RELATIONSHIP OF AGENCY CFOs

A. Discussion

In all governments, there is a tension between two responsibilities of financial personnel located at the agency level: (1) serving the financial management goals of the central government, and (2) meeting the needs of agencies that carry out government functions. Currently, the agency CFOs in the District government report to the central CFO. As a result, the degree of independence that the central CFO has from the Mayor is comparable to the independence that agency CFOs have from their agency directors. The question addressed in this section of our report is whether, when the Control Board becomes dormant, the independence of agency financial personnel should remain as presently established in law or should be modified.

CFOs at the agency level serve a variety of functions critical to a government's financial management. They help prepare agency budget requests, help ensure that contract obligations and expenditures are consistent with the budget and financial plan, and make sure that accurate and timely financial information is reported to the central CFO. Because the vast majority of funds expended in the District are administered by agencies, the integrity and the quality of work performed by agency level CFOs is essential both to the District's overall fiscal management and to the development and implementation of programs.⁶⁰

DC Appleseed's survey of financial operations of 12 major cities reveals that, while there are a variety of models for managing local government finances, none of the cities' financial operations have been structured quite like the District's during the control period. In each of these other cities, financial personnel for each agency report only to that agency's director. This is true whether the chief financial officer (or auditor, controller, *etc.*) is appointed or elected.

The ultimate goal for the District ought to be no different: integration of the agency CFO function into the agencies themselves. However, the current reporting relationship of agency financial personnel in the District to the central CFO has been widely credited with helping to curb maverick spending by agencies, improve the accuracy of financial information, and stabilize the District's finances. In DC Appleseed's view, these positive outcomes for the District outweigh the arguments for agency directors' regaining absolute control of agency CFOs and for following the prevailing trend of decentralized financial operations in the cities that DC Appleseed surveyed.

⁶⁰ The "District of Columbia Receivership Accountability Act of 2000" (the "Act"), approved October 30, 2000, Pub. L. No. 106-397 § 3, separately governs the responsibilities for fiscal management, and budget preparation and submission, for agencies under receivership. Each receiver must consult with the Mayor and central CFO in preparing the annual budget. Generally, the receiver's estimate of the expenditures and appropriations for the fiscal year is to be included, without revision, in the annual budget for the District of Columbia, and subject only to recommendations by the Mayor and/or Council, respectively. Under the Act, only where the terms of the court order establishing the receivership specifically authorize the Mayor and Council to make revisions to the receiver's annual budget can the receiver's estimate be altered.

There is a continuing need for a strong CFO role in District-wide finances – including agency financial operations – if the District is to maintain a financial operation that is professional, produces timely and accurate financial information, and helps assure that expenditures are made within approved budgets. Agency CFOs presently provide an important independent check on agency overspending. Without independence, agency financial staff could be subjected to political pressure by agency directors to make decisions that are not consistent with sound fiscal management.

However, DC Applesseed concludes that it would be unwise to eliminate agency directors completely from the process of selecting, evaluating, and removing such personnel. First and foremost, agency financial personnel must work collaboratively with agency directors to help develop budgets, implement programs, and avoid deficits. Granting agency directors limited authority over agency financial staffs can help ensure that directors will receive an appropriate level of cooperation and service.

Moreover, failing to provide any reporting relationship between agency CFOs and agency directors may reduce the likelihood that agency CFOs will serve as advocates for fiscal responsibility within agencies. Having agency CFOs report exclusively to the central CFO gives agency directors an excuse not to pay attention to and be responsible for their agency's finances. If something goes wrong, agency directors can always blame the financial officials over whom the agency directors have no control. Finally, representatives of nonprofit organizations interviewed by DC Applesseed raised a concern that the "one size fits all" policies of the central CFO may not suit every agency. Particularly in agencies with budget and procurement needs that are uneven throughout the year – such as the school system – these interviewees believe that granting the central CFO absolute control over agency CFOs has impeded the ability of agencies to fulfill program goals.

B. Recommendations

DC Applesseed recommends that the CFO retain ultimate authority over agency CFOs, but that agency directors be given increased input into the process of selecting, evaluating, and dismissing agency CFOs. Specifically, DC Applesseed recommends that agency directors be given, in each of these processes, a role which can be eliminated by the CFO only if an agency director has failed to maintain appropriate financial management standards. These recommendations are designed to continue elements of the current financial management's central control structure, while promoting collaboration between the CFO and District agencies to accomplish the policy and program priorities established by elected officials.

1. Appointment

Rather than hiring agency financial personnel directly, the CFO should: establish the criteria governing the selection of agency financial personnel; facilitate the recruitment of qualified candidates to establish a pool of candidates; select the pool of candidates for each agency; and delegate to the agency director the authority to select an agency CFO from that

pool.⁶¹ Each agency director should be permitted to recommend individual candidates for (but not add candidates to) the pool from which the agency director must select.

2. Evaluation and Removal of Agency CFOs

The CFO should delegate to the agency director partial authority to evaluate the agency CFO. The agency director should evaluate how the agency CFO performed as a part of the agency senior management team on the programmatic side, while the CFO should evaluate the agency CFO based on performance of financial management responsibilities. The removal of the agency CFO should be at the sole discretion of the CFO, but exercised only after consulting with the agency director.

3. Delegation of Financial Management

The CFO should delegate certain financial management authority to the agency CFO selected by the agency director. For example, agency CFOs could be granted the authority to approve the reprogramming of funds up to a specified amount from one part of the agency's budget to another. Maintenance of the delegation should depend on the performance of financial management duties. A finding by the central CFO that an agency CFO has failed to perform financial management responsibilities competently should allow the CFO to withdraw delegation of authority to the agency CFO, returning to the central CFO absolute authority over agency financial matters. In such circumstances, control over the funding for such functions would shift from the agency to the central CFO, and the CFO would also be allowed to withdraw the power from the agency director to play a role in hiring and evaluating the financial personnel for that agency.

4. Budget for Agency Financial Functions

The budget for the operation of agency CFOs should remain part of the budget for each agency, rather than being under the central CFO's budget. The CFO's authority to withdraw the delegation of authority from the agency CFO – and, with it, the funding for financial functions – should provide a reasonable means for assuring that the agency's financial functions will be adequately funded.

⁶¹ An alternative system may need to be adopted if the central CFO is unable to identify more than one qualified person who is interested in an agency CFO position. One possibility is for the central CFO to recommend a single candidate (instead of a pool of candidates) for the position, and for the agency director to have the power to reject that recommendation, in which case the central CFO would recommend an alternative. Under any system adopted, DC Appleaseed recommends that agency directors be given a significant role in the process of hiring agency CFOs.

CONCLUSION

DC Appleseed, with this report, has sought to balance the need in the District for accurate and unbiased financial information and management, with the need for elected leaders and their appointees to be able to execute programs. Over the next few months, a political process – in which the District’s elected leaders should play a lead role – will govern how this balance is ultimately achieved. DC Appleseed will continue to work to ensure that our report’s recommendations – and the principles underlying them – are considered in the political process that will determine the District’s future financial structure.

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APPENDIX A: Methodology

I. INTRODUCTION

In the fall of 2000, the DC Applesseed Center assembled a 15-member Project Team, whose members are listed on the second page of this report, to examine fiscal management in the District of Columbia. The Project Team (1) conducted the research outlined in this Appendix, (2) developed its findings and recommendations during meetings of the entire group and a number of subgroup meetings, and (3) prepared this report. This report has been approved by the DC Applesseed Board of Directors.

II. PRINCIPLES

A theme that runs through this Report is that the District's financial structure must provide the CFO continued independence from political pressures while ensuring that – under Home Rule government – the CFO has the incentives and ability to respond to the policy directives of elected officials. To achieve these two goals, DC Applesseed's recommendations were guided by the following principles:

§ *professionalism* - employees of the Office of the CFO must be guided by the highest standards of professionalism so that people have confidence in the budgets, estimates, and figures that come from the Office;

§ *transparency* - outsiders must be able to understand how figures are derived and the assumptions upon which the figures are based – which requires frequent and timely reporting of and easy public access to financial data – so that those with a stake in related policy decisions have the information they need to participate intelligently; and

§ *integrity* – the CFO must act with integrity and avoid even the appearance of impropriety so that Congress, residents of the District of Columbia, and the bond markets have confidence in the Office's pronouncements and work product.

III. DOCUMENT REVIEW

To review the District's financial management, DC Applesseed Project Team members reviewed Public Law 104-8 (and subsequent amendments thereto), which established the Control Board and the position of CFO, and determined how the diverse functions and authorities of the Control Board and the CFO are scheduled to be restructured with the dormancy of the Control Board. In addition, Project Team members examined the original Home Rule Act, and amendments thereto, for information on the structure of the District government. The Project Team also reviewed numerous reports and articles related to financial management in the District during the past 26 years.

The DC Applesseed Project Team also reviewed literature on municipal financial management generally, including several articles provided by the Government Finance Officers

Association on fiscal management generally. The documents referenced in this report are listed in the bibliography that precedes this appendix.

IV. SURVEY OF FISCAL MANAGEMENT IN OTHER CITIES

For comparative information, DC Appleseed examined fiscal management structures in numerous cities and states. We sought information from two groups of cities: (1) three that have had recent experiences with financial oversight boards: Detroit, Philadelphia, and New York, and (2) 13 cities DC Appleseed examined for its 1999 Council Reform project: Baltimore, Boston, Buffalo, Cleveland, Columbus, Denver, Indianapolis, Milwaukee, Minneapolis, Pittsburgh, San Francisco, Seattle, and St. Louis.⁶² Information was collected from 12 of these 16 cities; Boston, Cleveland, Detroit, and Philadelphia did not respond to DC Appleseed's information requests. Project Team members from Holland & Knight examined city charters and codes, and spoke with individuals in each jurisdiction regarding the structure of each city's fiscal management and the functions of its financial officers. Those municipal officials are not included in references made in this Report to those interviewed.

V. INTERVIEWS

From December 2000 to April 2001, DC Appleseed Project Team members conducted 15 interviews with individuals who had specific knowledge of fiscal management in the District of Columbia. These individuals included District government officials (including from the Control Board, D.C. Council, Office of the CFO, and agencies), federal personnel from the legislative and executive branches, and civic/business leaders in the District. Among those with whom we spoke are several individuals who were involved in some respect in the Control Board's creation.

These interviews provided considerable information about fiscal management in the District of Columbia. The DC Appleseed Project Team did not accept at face value the validity

⁶² This list was developed using the following criteria: (1) 1994 population between 300,000 and 800,000; (2) strong Mayor-Council form of government; and (3) a "non-traditionalistic" political culture and a "less conservative" political philosophy.

To define political culture, the DC Appleseed Project Team used Daniel Elazar's definition, which he devised by examining public values, attitudes, and beliefs of electorates, and then grouping states into three subcultures—individualistic, moralistic, and traditionalistic. *See, generally*, Elazar, Daniel J., *American Federalism: A View from the States*, New York, 1984. DC Appleseed's Project Team excluded from its sample cities within states (such as New Mexico, Tennessee, and Florida) that Elazar classified as traditionalistic—defined as those with political cultures in which politicians come from society's elite, rival factions within the elite compete for office, and the government's role is to maintain the existing social and economic hierarchy.

The DC Appleseed Project Team evaluated conservatism by using Piskulich's conservatism index, which is based on the voting records of each state's Congressional delegation as represented by the average difference between the annual "scorecards" produced by the Americans for Constitutional Action and the Americans for Democratic Action for the years 1960 through 1984. *See, generally*, Piskulich, John Patrick, *Collective Bargaining in State and Local Government*, New York: Praeger Publishers (1992). The index provides a relative scale from least to most conservative. Given the political ideology of the District, DC Appleseed's survey excluded all cities in the 20 most conservative states (including Nebraska, Georgia, and Louisiana).

of every comment made in these interviews, but rather examined all interviews critically and focused on the themes that emerged from the interviews.

Appendix B – Comparative Financial Data
(\$ in millions)

	<u>Revenues</u>	<u>Assets</u>
District of Columbia –		
General Fund	\$5,305	\$1,612
Control Board	3	6
Capital Projects	164	640
Enterprise – Lottery	216	91
Pension/Agency Funds	332	3,027
Fixed Assets	N/A	3,100
Long-Term Liabilities	N/A	3,511
Components –		
DC General Hospital	69	28
Water and Sewer Authority	228	1,594
Convention Center	10	883
Sports Commission	7	27
Housing Finance Agency	26	862
University of the District of Columbia	<u>19</u>	<u>125</u>
Total, District of Columbia (population 572,059)	<u>\$6,379</u>	<u>\$11,995</u>
Comparative Local Counties		
Fairfax County, VA (population 949,749)	<u>\$3,078</u>	<u>\$12,029</u>
Prince George’s County, MD (population 801,515)	<u>\$1,953</u>	<u>\$4,278</u>
Montgomery County, MD (population 873,341)	<u>\$3,295</u>	<u>\$10,818</u>
State of Maryland (population 5,296,486)	<u>\$27,399</u>	<u>\$73,901</u>
State of West Virginia (population 1,808,344)	<u>\$8,184</u>	<u>\$19,944</u>
Federal Government Agencies		
U.S. Department of State	<u>\$9,921</u>	<u>\$22,999</u>
U.S. Department of Commerce	<u>\$12,144</u>	<u>\$10,592</u>
U.S. Agency for International Development	<u>\$6,311</u>	<u>\$19,171</u>
Comparable “Fortune 500” Companies		
No. 283 – Saks (Birmingham, AL)	<u>\$6,581</u>	N/A
No. 284 – Union Carbide (Danbury, CT)	<u>\$6,526</u>	N/A
No. 285 – Seagate Technology (Scott Valley, CA)	<u>\$6,448</u>	N/A
No. 286 – Automatic Data Processing (Rosebud, NJ)	<u>\$6,288</u>	N/A
No. 287 – Campbell Soup (Camden, NJ)	<u>\$6,267</u>	N/A
No. 288 – Gannett (Arlington, VA)	<u>\$6,244</u>	N/A

Sources: *District of Columbia, Maryland, and Fairfax, Prince George’s, and Montgomery Counties – Respective Comprehensive Annual Financial Reports (Fiscal Years Ended in 2000).*

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