Office of the District of Columbia Auditor

April 27, 2020

The Hon. Phil Mendelson
Chairman
Council of the District of Columbia
1350 Pennsylvania Avenue NW
Washington, DC 20004

Dear Chairman Mendelson and Councilmembers:

In this difficult time for the District of Columbia I write to share my perspective on the District's finances from my service as a Councilmember during the financial crisis of the 1990s and as D.C. Auditor today, responsible for providing information to support your oversight. I am sharing information separately on budget savings to be found at the Office of the D.C. Auditor and we are preparing an overview of federal funding streams made available in recent action by the U.S. Congress. I appreciate the challenge you face to reduce spending this year and in FY 2021 due to the impact of the coronavirus as outlined by Chief Financial Officer Jeffrey DeWitt on Friday. It is my hope that the actions the Council took to address the District's financial crisis 25 years ago, which led to two decades of financial growth, might be of use to you today.

Mayor Bowser has shared her administration's "guiding principles" for budget decisions and you might also want to develop a framework for spending decisions for the current and ensuing years. The first three of the Mayor's five principles are:

- Maintain core government functions that focus on the health, well-being and safety of DC residents and businesses.
- Maximize resources available for the immediate public health response to COVID-19.
- Maximize resources available for those in our community hardest hit by the COVID-19 public health emergency.

The fourth principle—avoiding RIFs, furloughs or layoffs—may not be possible given the financial challenges. You might consider seeking consensus among Councilmembers on goals to frame your discussions, a practice I followed in developing committee budgets in the 1990s.

The pivotal years in returning the District to solvency were 1995 and 1996. What the Council faced then is summed up by the Comprehensive Annual Financial Report for fiscal year (FY) 1994 published early in 1995: *the District had a $335 million operating budget deficit that equaled* *<u>more than 10 percent of the actual local funds budget at that time</u>.* In response the federal government took steps to impose a financial control board—The Financial Responsibility and Management Assistance Authority—which began operations on October 1, 1995.

Throughout the spring of 1995 elected officials did little other than debate and develop budgets. The Council enacted and the Mayor vetoed the Multiyear Budget Spending Reduction and Support Act of 1995, containing tax and fee hikes and 10 furlough days for all District employees in the fiscal year ending that September. This was a first legislative "bid" and forced a period of intense negotiations among Council, Executive, District employee representatives, and others.

Shortly after the veto Mayor Marion Barry submitted and the Council ultimately approved a package of spending cuts that included wage cuts and furlough days negotiated with the majority of the District's collective bargaining units. These included:

- A cut to base pay of 6% in FY 1995
- A cut to base pay of 4% in FY 1996
- Six furlough days in FY 1995
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Those steps produced an estimated savings of $87 million across both fiscal years. In addition, the legislative package proposed a 4% pay cut in FY 1995, a 3% cut in FY 1996, four furlough days in FY 1995 and six furlough days in FY 1996 for the District's non-union workers. Councilmembers took individual voluntary pay reductions to match the 6% reduction in base pay that our actions imposed on a majority of the District's workforce.

These were extraordinary actions that helped to shrink the District's budget deficit to less than $100 million by the end of FY 1996, and the first balanced budget and a slight surplus at the conclusion of FY 1997. It was a difficult period that no one then serving would want to repeat and yet the situation you face today may be even more dire. In 1997 and 1998 the District saw unexpected revenue growth, a prospect to be wished for but very far from a certainty today given the deep and broad impact of the coronavirus pandemic on jobs, pay, and revenue. What follows are not recommendations but, rather, a menu of options you may wish to consider.

Personnel actions

Reductions in force (RIF), furloughs, and early retirement with or without buy-outs are draconian steps. All were used to address the District's 1990s financial crisis. Worker furloughs have the advantage of immediate savings without a loss of jobs for workers. Reductions in force have the advantage of permanency with spending impact across multiple fiscal years. They pose a management challenge: what agencies, programs, and services to cover and which to exempt. The District's then-independent school system used multiple "early-out" options to reduce the education workforce—early retirement options that were provided in order to minimize the number of positions that would ultimately be cut through a RIF.

Work with the District's collective bargaining units

In 1995 the Council's early action forced the Executive to renegotiate labor contracts. Individual collective bargaining units voluntarily entered into memoranda of understanding with the District with slightly differing provisions giving those represented a say in which poison pill they would take. Similar action could be initiated today.

In 2018 the Council approved a new agreement for Compensation Units 1 and 2, including annual pay raises of 3%, 2%, 3%, and the largest, 3.5%, scheduled to take effect October 1, 2020, for FY 2021. The FY 2021 fiscal impact estimated by the Office of the Chief Financial Officer was $87.8 million of which just under $65 million would be paid from local funds. I don't know the status of bargaining for the successor agreement to take effect in FY 2022, but it would be worth considering whether the leadership of Compensation Units 1 and 2 would bring the FY 2021 increase back under consideration in negotiating the next contract given the crisis facing the District today and the possibility of more drastic personnel actions to meet the revenue shortfall.

I have not researched the status of other collective bargaining agreements, but experience shows there is a clear advantage in working with the District's unions.

Non-union salary increase

Traditionally the District has approved pay raises for non-union employees in line with those granted to Compensation Units 1 and 2 in bargaining, and that has been the case for the last three years, i.e. the Council approved overall raises of 3%, 2%, and 3% and it was anticipated that the FY 2021 budget would include a 3.5% increase for non-union employees. Given the circumstances today you may want to consider not moving forward with that increase. If you took action to roll back this fiscal year's 3% increase provided to the vast majority of District employees, that would reduce expenditures by roughly $86 million.

Employee furloughs

District government employee furloughs are a blunt, unattractive option that many legitimately see as breaking faith with employees, many of whom have contributed their time and talent in recent weeks in the public health crisis. But that said, if the Council is unable to make other spending reductions to meet the revenue shortfall between now and September 30 this option may come under consideration. With a workforce nearing 37,000 employees, the amount that could be "saved" through furloughing non-essential employees would be significant. A one-week furlough of all employees would yield approximately $55 million.

Housing Production Trust Fund

In transmittal letters to Congress a year ago, Mr. Chairman, you highlighted an expenditure increase of $193 million to preserve and create affordable housing in the District and Mayor Bowser referred to the highest ever allocation to the Housing Production Trust Fund of $119 million, after four previous years topping the $100 million mark. Important though the goal of affordable housing remains, the current budget crisis puts this specific expenditure squarely before you to make a judgment on whether the District should continue this level of investment or make a one- or two-year reduction in the investment with a plan to bring the funding back up by the third and fourth year of the financial plan.

Pay-go capital

One of the significant increases in the FY 2020 District budget over the FY 2019 budget was the Pay-As-You-Go capital line representing revenues that otherwise would have been available for operating costs but were transferred with the approval of the Chief Financial Officer for high priority capital projects. The spending line was $133 million in FY 2017, $123 million in FY 2018, dropped to $86 million in FY 2019, and was boosted to $285 million in FY 2020. The bulk of that increase was designated to pay the District's $178.5 million share of WMATA capital expenditures. While using operating dollars to support capital projects is a desirable strategy for controlling debt service costs, such transfers are a far less attractive option when revenues are hard-hit.

Programs/agencies that have seen significant increases

One area that could be considered for budgetary review are those agencies that have seen the largest increases in recent years. The current year's approved budget represented a more than 8 percent increase over the approved FY 2019 budget, but some agencies have seen significantly larger spending increases. A handful of agencies saw their budgets double between FY 2017 and FY 2020, including the Department of Housing and Community Development, the Office of Campaign Finance, and Deputy Mayor for Education. Another two dozen agencies saw their budgets increase 20 percent in the same three-year period. Such levels of increase clearly represent priorities of elected officials, but also may be areas for careful review and potential reduction.

Programs receiving federal funds

A broad category of options for your consideration are those programs and services that are funded with both federal and District dollars and a careful review of such programs and services would allow you to judge whether during this financial crisis the District dollars could be reduced or eliminated to provide a lower level of services that rely solely on federal funds. During the financial crisis the Council zeroed out District funding for job-training for District residents, which was then and remains a high priority and for which we received significant federal funds. In 1997 Council oversight demonstrated that the job training efforts were largely ineffective in placing residents in jobs. The Council reallocated District dollars in the FY 1998 budget stating that local funding for workforce development would resume when the government could demonstrate effective use of federal job training dollars.

Dependent eligibility verification audit

States and cities have found significant savings from auditing the eligibility of dependents listed on public employees' health insurance plans, an option I have mentioned to Councilmembers and executive branch officials since taking this position. This is a type of audit the District as employer—not ODCA—

would typically undertake through a contract with a firm that specializes in dependent eligibility audits. Third-party firms estimate between five and eight percent of individuals listed as dependents are not actually eligible. A small city in Texas found 12 percent of enrollees were ineligible. The state of Illinois conducted such an audit of its State Employees Group Insurance Program in 2015; Durham, N.C., and Milwaukee have also conducted such audits in recent years. When former City Administrator Robert Bobb served as emergency financial manager for Detroit's public schools he discovered through an audit that ineligible dependents on worker health plans were costing the city $2.6 million annually. Other cities and states have had similar experience reducing costs through such audits and the District could conceivably address a small part of its revenue shortfall in this manner.

Additional tools for evaluation

Mr. Chairman there are additional tools you may want to consider if you are not already doing so, including the last comprehensive enterprise-wide review of spending with which I am familiar, the *One City Performance Review* that Councilmember Gray initiated when he served as Mayor.. That review identified 148 initiatives that were estimated to produce more than $220 million in savings and/or additional revenue in FY 2013 and more than $2.4 billion over a 5-year period. ODCA has made use of this analysis in our audits including our 2018 review of the District's employee parking program. We updated the performance review's analysis and recommended that the District consider seeking market rates for employee parking which would yield an estimated $4 million in additional District revenues. I mention this as one just example from among the 148 initiatives outlined in that comprehensive review that could be revisited and, potentially, updated. Three of the higher-value government-wide initiatives proposed and their estimated 5-year savings were:

- Centralize and consolidate core administrative and professional services, $68.6 million
- Conduct strategic sourcing for multiple expense categories, $55.2 million
- Develop and enforce minimum spans of control for District supervisory staff, $44 million.

That type of budget review may have been what the Council had in mind a year ago when you authorized an Expenditure Commission to be created to "to review the District's current budget structure and prepare comprehensive recommendations to the Council and the Mayor on future budgets, including potential sources of revenue; and specifies functions, reporting, composition, appointment, and authority." The Committee of the Whole report on the proposal noted that other jurisdictions have used expenditure commissions and the hope that the commission "will lead to efficiencies and improve the efficacy of the District's budget." I understand the Commission has not yet been created but it remains an option the Council may wish to use going forward.

Best practices in spending discipline

Following the Great Recession of 2008-2009 the National Association of State Budget Officers issued an analysis and commentary based on interviews with members on their experiences addressing the revenue shortfalls. One point made in *State Budgeting and Lessons Learned from the Economic Downtown* was the value to be found in eliminating rather than simply reducing funding for programs or services that have been deemed to be ineffective. "Eliminating inefficient or ineffective boards, programs and services is difficult," NASBO noted, "but the benefits are potentially greater." Reducing but not eliminating funding for an ineffective program "can result in expectations for restoring funding cuts in the future, which can drain resources that could be put to better use."

Another "best practice" piece of advice offered by NASBO: decide what activities should not be candidates for reductions. "Budget cuts to some areas such as contract monitoring, tax compliance, internal or external audits of departments, may leave states vulnerable to abuse or actually cost a state more money than is saved through reductions. Cuts to areas known to reduce future spending obligations, such as crime prevention and juvenile justice programs, should also be avoided if possible," NASBO wrote.

A crisis also brings opportunity for lasting reforms, another point NASBO noted in the recession study: "The recession brought with it opportunities for lasting government reform, and many states have reduced future budgetary risks by enacting changes to areas like health care, employee retirement systems, and corrections. States can capitalize on periods of economic decline by making substantial changes to spending priorities while there is sufficient political will and greater stakeholder understanding for budget adjustments."

Please let me know if I can provide any additional information on any of the issues raised here. My staff and I would be happy to be of assistance in meeting the challenges ahead. Thank you for your consideration and for your leadership in these difficult times.

Sincerely yours,

Kathleen Patterson
D.C. Auditor

cc: Councilmembers
Officers of the Council