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Discussion

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James L. Magavern†: In spite of Mr. Elliot's remarks, it is important to recognize the legitimately political nature of many of the kinds of decisions that are entailed in budgeting and the importance of local self government. My remarks, and I think the comptroller's position in this whole tangle of issues, are derived from a concern not only with the issuance of debt instruments, as important as that is, but with a more general need for financial integrity and accountability in government. Budgeting is important to provide accountability not only in a strict financial sense, but in a much broader political sense. One of the great challenges to government today at all levels is to make the decision-making process accessible and understandable to the people so that the elected officials can be held responsible. One of the sources of erosion of confidence in government is the financial gimmickry indulged in by just about every level of government not least of all by the State of New York.

A key objective of the City Bar Association's project (in fact, it may be the fundamental objective) is to assure a balanced budget. The Bar proposes a constitutional requirement that budgets be balanced. (I note in passing that the proposed statute provides some lenience which is not expressed by the constitutional provision. The constitutional provision should be qualified so as not to leave us with a statute at variance with the language of the constitutional provision.) A legal requirement already exists for balanced budgets in both state and local government. The problem is not an absence of legal principle; rather, the problem lies in enforcing it and in the ingeniousness with which people can find means to evade legal requirements. The principal means of evasion appears to be faulty revenue estimates, faulty estimates of mandatory expenditures which are made whether or not they are appropriated, and the rollover technique, deferring obligations to another year. The remedies

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* The following remarks were made subsequent to the delivery of Mr. Elliott's paper. The discussion has been extracted and edited from a verbatim transcript of the seminar proceedings. Each participant has been provided with a copy of the edited version and the opportunity to make corrections in it.—Ed.

† A complete list of the participants appears on page 27.—Ed.

proposed by the project is to mandate disclosure and to establish the comptroller as a monitor of local budgeting and ongoing financial operations.

Before turning to a specific proposal I wish to advance, let me tell you in a very tentative way what I think is presently going on in the comptroller's department. We have a disclosure bill which has been criticized today as inadequate. In part, I think this criticism ignores the fact that there are other things going on (or may be going on) that will fill some of the other needs. One idea being considered may be called a "budget bill." This budget bill would be a mechanical approach of limiting revenue estimates to the amount of revenues collected in a prior year with some possible adjustment. New York City, I understand, had such provisions, but they were dropped. Had they been maintained, the problems that did develop in New York City might have been averted. The proposed budget bill would be a self-executing mechanism. It would not require a heavy intrusion of state administrative officials into local affairs. Additionally, it has the benefit of simplicity.

Secondly, we are certainly moving toward generally accepted accounting principles. We should recognize, I think, that the need for generally accepted accounting principles is probably much greater at the state level than at the local level. I do not think the localities, except when there is state complicity, have the freedom to move cost and revenue items back and forth from one year to another. I do not think they have the freedom to continue to accumulate an ever-growing deficit.

At this point, a question occurs to me relating to Professor Burton's distinction between accounting and budgeting. Does the constitutional power and the statutory power of the comptroller to prescribe accounting systems and accounting methods entail the responsibility of the state and local governments to budget in accordance with those accounting systems? Is there such a distinction between accounting and budgeting? If the law prescribes an accounting system and balanced budget, is there an implication that the budget must be balanced not only on a cash basis but also in accordance with the accounting methods that have been prescribed?

Finally, as to monitoring, the Department of Audit and Control is moving toward much greater emphasis on general financial evaluation of communities, particularly troubled ones. Progress has been made in developing a computerized capability for providing early warning and for analyzing problems as they emerge, enabling the comptroller to provide constructive advice to the localities in dealing with problems as they emerge. Admittedly, we are a long way from anything that could be considered satisfactory, but we are certainly moving in the right direction. We have deemphasized the old-post audit function used to discover misuse of public funds. I do not want to diminish the importance of that, though. Even though the audit may be five years late, the fact that there will be an audit is important. Nevertheless, the emphasis should be, and I think is, toward ongoing financial evaluation.

I would like to propose an alternative to the injection of the comptroller into the primary role of the fiscal monitor. Our goal is both to make the monitoring effective at a much earlier stage in the budgeting process and to design an effective means of enhancing the accountability of local government to its own citizens. We should look for a way to build a monitoring and disclosing process into the local budget-making process itself. We should not allow the budget to be made and then come in afterwards and say, "Well, here is a problem, there is a problem." First, that is too late. Second, it does not serve the purpose of enhancing accountability for local self-government.

The alternative that I propose is to require an ongoing financial review process in local government by a financial advisory committee comprised of people motivated to maintain their own professional standards. This committee would review, on a quarterly basis, not only current budgetary accounts, but also an outline budget for the following year. There would be a continuing review for two years into the future. The committee would be looking not only at what is happening within the current fiscal year but also to what is going to happen in the following year. The official would be required to submit not only an executive budget, but also a proposed outline budget for the following year which would deal with major accounts and major revenue estimates. When the official releases the executive or tentative budget it would have to be simultaneously released to this committee. The committee, already established, would be familiar with the conditions of the community and its government and would be able to respond quickly. The committee could report within a very short period of time whether the proposed new budget appears to be in balance and would identify those areas of difficulty or potential imbalance. This report would then be available to the public. The executive could use this report in making up the final budget. It would be available to the legislature when it acts on the budget and it would focus public attention upon both the executive role and the legislative role. It would constitute a deterrent to gimmickry on the part of either the executive or the legislature. If the voters still want to put up with the gimmickry, well, that may be a price of democracy.

I do not mean that there should not be alternative remedies. The state does have an interest in the integrity of local finances. If things really get bad the state should be able to step in. I believe, however, that the responsibility should be focused on the decision-making processes at the local level. Thank you.

James A. Brigham, Jr.: I'd like to confine my remarks to the balanced budget requirement. It is a requirement that the City strongly endorses. We also feel that public officials must be held accountable, both for their prospective judgment in the sense of adopting a balanced budget that meets certain standards, and in their actual performance, which means reporting on the results of the budget after the close of the fiscal year.

The key question in my mind is, what are the standards? I feel quite uncomfortable about the provision in the recommendations of the committee that the state comptroller establish those standards.

First of all, the comptroller appropriately is operating in a political environment, but if we are talking about true accountability the standards of local government budgeting and reporting ought to be divorced from that political environment. I would suggest that having the comptroller establish the accounting principles does not do justice to the requirements of accountability. Indeed, if the city were to follow the state's accounting and budgeting practices, I would probably end up in jail.

I would like to relate an example of the difficulties that the City and other localities could be faced with if the standard of generally accepted accounting principles is not followed. The audit by Peat, Marwick and Mitchell of the city's 1978 financial statements resulted in recognition by the city of about 144 million dollars in revenues and expenditures in fiscal 1979 that were at variance with the accounting for those items proposed by the state comptroller. These issues had been reviewed by the city's independent accountant as well as by the Control Board and approved by those bodies. The Special Deputy Comptroller suggested that the City should account for the items differently. Without getting into the merits of the issues, the net result of that would have been that in the middle of the year the City would have been forced to cut 144 million dollars out of its operating expenses, which would have been incredibly disruptive to the operation of the government.

The Control Board, in its wisdom, did not recognize the suggested changes in accounting and so the city did not have to cut those expenses. But I would suggest that the committee consider establishing the standard for balanced budget as generally accepted accounting principles. I would also suggest that the comptroller might be permitted to allow exceptions to generally accepted accounting principles, but only with justification and only for a limited period of time.

However, I do not think that the comptroller should be able to mandate an exception to generally accepted accounting principles. And, indeed, if a municipality has an independent audit, I believe that the accounting determination of its auditor should prevail. Thank you.

John C. Bender: There are a couple of specific issues that I want to address concerning the comments on the committee's report. The first one is an issue noted by Don Robinson raising the question, whether procedures other than those used for debt issuance should be instituted to monitor and to supervise local fiscal practices. We spent a good deal of time in the committee and the subcommittee level debating whether or not some sort of local or fiscal practices board should be instituted, and whether or not that would be an appropriate form of regulation given the New York City history, the Yonkers history and some of the experiences of New York State during the last few years.

After a fair amount of discussion on the issue, the committee decided that the flexibility that had already been evidenced by the different approaches taken to these problems in different places was an important part of New York State's response. Additionally, the need to defer to home-rule and to local responsibility was an important part of the committee's recommendations.

The wisdom and usefulness of this approach, can be seen in the different approaches taken toward budget regulation and monitoring in New York State over the last few years. In 1975, statutes establishing control boards for New York City and Yonkers were nearly identical. Subsequently, statutory restrictions were imposed on budget increases for Yonkers with a fiscal agent exercising certain supervisory authority. This shows the need to maintain some flexibility in establishing monitoring mechanisms.

The second point I wish to make relates to Jim Magavern's proposal of a budget bill. The bill was described as a simple and straightforward approach to regulating local budgetary practices and towards eliminating much of the bureaucratic establishment that would be necessary for ongoing budget review. As I gather, this is somewhat comparable to the Yonkers situation where revenue estimates for prior years collections are limited. The difficulty with this approach is that it is inherently conservative; unless a review of revenue estimates is allowed circumstances in which it is perfectly appropriate to increase the amount of projected revenues will be ignored. There is no way to do that unless you have some review of budget decisions and some exercise of judgment in connection with them. That leads you, of course, back into a fairly elaborate bureaucratic mechanism, especially if you're going to do that on a statewide basis.

The third point on which I wish to comment is the question of whether or not generally accepted accounting principles can be used as a budgeting standard or whether they are instead a reporting standard. It is emphasized continually by people like Sandy Burton that those are in fact reporting standards. The committee's proposal also sees it as a reporting standard. That proposal requires a balanced budget, a budget the results of which, when reported in accordance with county standards promulgated by the comptroller, which could be generally accepted accounting principles or any other principles as may be necessary, do not result in a deficit. Simply saying that you want a budget that's going to result in no deficit when reported in accordance with generally accepted accounting principles does not solve the problem of budget administration or deciding whether or not the budget when presented at the beginning of the year is balanced. For example, the prime budget for New York City, when presented to the Control Board for review at the beginning of this year, contained a revenue item in it of 80 million dollars that was attributable to the sale of a right of way for Westway. The accountants held that if those revenues were received during the year they could be reported as a revenue in support of expenditures in accordance with generally accepted accounting principles. Looking at that budget in the beginning of the year and trying to determine whether or not it was balanced in accordance with the statutory restrictions which involved generally accepted accounting principles required a number of judgments about whether or not the Westway revenues would be realized during the year.

There is nothing in generally accepted accounting principles that informs you about whether or not it is reasonable to assume that all of the procedures necessary to the realization of those Westway revenues would be completed during the course of the year. For example, generally accepted accounting principles would not require state and local authorities to approve or disapprove of Westway before anticipated revenues from Westway could be included in the proposed budget.

As the fiscal year progressed, we decided that the budget was balanced when it included that Westway revenue. Six months later we made a different judgment about whether or not that Westway revenue could be included. There were different factors affecting our judgment. We had gone through six months. There wasn't much progress on the Westway hearings and it was less likely at that point that the revenues would in fact be realized by the end of the fiscal year and would be available for inclusion in the budget. At that point it was no longer appropriate to say that a budget that includes that Westway revenue was "balanced in accordance with those standards." We exercised a good deal of judgment and discretion during that time. This is essentially the point raised by Sandy Burton; that is, generally accepted accounting principles will solve all of the issues. They really do not. There are a lot of very complex issues remaining that require the exercise of a good deal of judgment and discretion during the course of a budget review.

Finally, the question whether the state ought to exert its powers and assume responsibility for something more than the course of debt issuance, or accept responsibility for fiscal practices other than in connection with debt issuance, I think raises some other interesting problems. Most of the discussion here has focused on a balanced budget as being the one factor that indicates fiscal stability and fiscal health. That just is not so. A balanced budget is the last stop. It's the bottom line. There are lots of other indications of fiscal health and lots of other ways to monitor the relative fiscal health of municipalities. To the extent that we are talking about the state asserting responsibility for monitoring the fiscal practices and the fiscal health of the communities, we might talk about it monitoring something much more elaborate than balanced budgets. We might talk about monitoring taxes per capita, debt per capita, operating expenses per capita. Those are some of the factors that were identified in the report that was recently published by Touche Ross & Co. and First National Bank of Boston.

It seems to me that in order for the state to assume such responsibility we have got to take a much more ambitious approach than simply requiring a balanced budget. It would be the state's responsibility to look at economic, social or structural conditions affecting the fiscal health of municipalities. To realize the balanced budget the state must take responsibility at some earlier point and take a look at the extent to which taxing practices, external economic events or trends are affecting the local fiscal health and perhaps intervene at a somewhat earlier point than the balanced budget test would permit. Thank you.

CONCLUDING REMARKS

Evan A. Davis: I would like to talk for just a minute about the constitutional questions, particularly about debt and tax limits.

We are here today in large degree because over a ten-year period the City of New York ran up a cumulative operating deficit of between six and seven billion dollars. It issued large amounts of short-term debt which were continuously rolled over until a point came where the process could not be continued and the city faced a crisis, the state faced a crisis, the authorities that operate within the state faced a crisis, and in many ways, the national government faced a crisis.

The city and state followed this policy of deficit financing without violating the constitution. Indeed, the only part of the process that violated the constitution was the moratorium declared on the payment of short-term city notes after the fiscal crisis struck. Jim Magavern said earlier that at the heart of many of the committee's proposals is a desired response to this deficit financing problem. I think that is accurate. I think that is true of our budget proposal, constitutional proposals and disclosure proposal. Disclosure is something that will bring early warning of this kind of problem not only to investors and the market, but also to voters and the news media.

Debt limits and tax limits relate to the deficit financing question. Existing debt limits for local governments are presently quite meaningless. Additionally, MAC bonds issued to support the cumulative deficit of the City of New York have no impact on the City debt limit and is subject only to a statutory authorization notwithstanding that it is debt that future generations of New York City taxpayers are going to pay.

The existing local finance article says nothing about short-term debt. The legislature could and did do what it wanted to do in the area. I think the committee feels that whatever may be the merits of the issue of a balanced budget at the federal level or at the state level, there is a need to mandate that local government live within its means. This mandate helps contain the cost of government and provides incentives for professionalism, for efficiency and for productive governmental service.

There are crises. There will be temporary exceptions from time to time, but the policy of the state should be against deficit financing in order to provide local governments with an incentive to operate efficiently. An inclusive debt limit that includes consideration of short-term debt will help to enforce this concept of living within your means.

We on the committee have gone a long way towards simplification of the constitution, and have done some very controversial things. I would say that our proposals when they were advanced in Cornell, where there was a larger percentage of people from areas other than New York City than are present today, encountered rough sledding on the simplification issue. Outside of the city there is resistance to any change in the debt limit and to any change in the tax limit. Obviously this resistance is heightened by the temper of our times which emphasizes cutting back government expenditure, a balanced federal budget, and measures like California's Proposition 13.

The committee approached these problems like lawyers. We wanted to suggest constitutional provisions that make sense, that are workable, and that set coherent policies. We therefore did not want to continue with a debt limit that has become meaningless. Nor did we want to continue with a "gift and loan" provision that is circumvented by creating an authority every time the private sector fails. Sometimes the proper way is to provide creatively for cooperation between public and private sectors. The existing principle in the constitution forces the creation of authorities, even though the public has shown resistance to the use of authorities over the years.

The constitution's full faith and credit provision and first lien provisions also serve a useful purpose. The one fiscal crisis device that was declared unconstitutional, the moratorium, was based upon these provisions. The moratorium decision had a positive impact on the credit of not only the state but also on the credit of the localities and authorities operating within the state. Courts will, and must, exercise certain equitable discretion in enforcing any provision which has as its underlying thought the principle that debt must be paid. Judge Breitel's opinion in *Flushing National Bank* was important for the reason that the city was thereby forced to pay its debt.

I think those provisions are useful. I think they do support the credit of local government and I think you have to have them so that in times of trouble there will be additional legal support to allow the public sale of debt.

As Ed Kresky notes, this is a long process, and I have come to realize the truth of that quite clearly. But we have made some progress. We have had this conference and the conference at Cornell. Interested state officials have read our report and have it under study. This process should go forward. It is the hope of the committee that a statewide commission, not only of lawyers and accountants, but of thoughtful citizens can be established.

Finally, a few general comments. One thing I want to do in particular is to recognize George Dwight who was the chairman of the Municipal Affairs Committee during the entire year that we were putting this report together. It was George who kept us all going and kept us on schedule and raised all the money and really made it possible. So we owe a great debt of gratitude to him and I'm glad he was able to come today.

I want to give a little progress report on where our proposals stand. You heard this morning about the disclosure legislation that is being introduced by the comptroller's office. My own view is that this is a very large step toward the goals that the committee had in mind. In a competitive bid offering, where the underwriters do not participate directly in the preparation of the document, there is a particular need for regularizing the disclosure process. On the other hand, there is resistance on the part of some localities to doing this. When we went up to Cornell we heard about it in great detail from the representatives of organizations of counties, towns and villages. I think the important thing is to start the process. Get people in the habit, get them moving.

I think the comptroller's bill is going to get people moving. I think there probably are other steps to be taken and to some extent the comptroller's office has existing power with regard to accounting standards and this power is being used to move localities along. I am hopeful that the comptroller's bill will pass. I think this is something to be done right away. The legislature has debated this thing for three years now. Two governor's bills, one prior comptroller's bill, a new comptroller's bill, and our report have contributed to the debate. I think it is time for them to get along and adopt something and get New York State committed as a matter of state policy to full disclosure by local government.

The constitutional reform is going to involve a longer debate. There was not unanimity of viewpoint within the committee. There is no unanimity of viewpoint within the state. We hope constitutional proposals will be introduced in the state legislature in the next couple of weeks. As I noted before, we urge the creation of a temporary state commission to continue our investigation. I hope that many of the people here could participate in the work of such a temporary state commission, because I think that the kinds of viewpoint and kinds of comments that have been made today would be very useful to furthering this work.

Thanks again to Professor Harper, the Fordham Urban Law Journal and Fordham Law School for holding this symposium on our report. I thank particularly the extremely distinguished panelists and members of the audience who have taken the time to write these papers and prepare these comments and make all these useful and helpful suggestions. Thank you very much.