AN EXAMINATION OF MUNICIPAL FINANCE REFORM REGARDING

MUNICIPAL BANKRUPTCIES IN THE UNITED STATES

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AN EXAMINATION OF MUNICIPAL FINANCE REFORM REGARDING

MUNICIPAL BANKRUPTCIES IN THE UNITED STATES

Keren H. Deal

A Dissertation

Submitted to

the Graduate Faculty of

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in Partial Fulfillment of the

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Degree of

Doctor of Philosophy

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MUNICIPAL BANKRUPTCIES IN THE UNITED STATES

Keren H. Deal

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Keren H. Deal, daughter of Richard and Phyllis Hill, Sr., was born September 16, 1967 in Montgomery, Alabama. She graduated with her B.S. in Accounting from Auburn University Montgomery in 1992 and received her M.B.A. in Business Administration from Auburn University Montgomery, with an emphasis in accounting, in 1995. She received her C.P.A. in 1999. She worked for the State of Alabama in various classifications, including Accountant I, II, and III from 1985 to 2000. In August 2000, she accepted an Instructor of Accounting position in the Auburn University Montgomery Accounting and Finance Department. In 2002, she married John H. Deal, Jr. and was blessed with the birth of their son, Zachary, in November, 2002. In 2005, she entered the doctoral program in Public Administration and Public Policy at Auburn University. In 2007, she received her doctoral degree in Public Administration with an emphasis in Public Finance and Governmental Accounting. In June 2007, she returned to Auburn University Montgomery as an Assistant Professor in Accounting.

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DISSERTATION ABSTRACT

AN EXAMINATION OF MUNICIPAL FINANCE REFORM REGARDING

MUNICIPAL BANKRUPTCIES IN THE UNITED STATES

Keren H. Deal

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Municipal bankruptcy is considered rare. A total of 569 U.S. municipalities filed Chapter 9 from 1938-2005; however, the occurrence of Chapter 9 cases since 1990 seems to be escalating nationwide. At the time of this writing, 29 states allow their municipalities to file for Chapter 9 protection. Of these 29 states, 14 states do not require an additional step to be taken by the municipality prior to filing bankruptcy documents, such as approval by the Governor or state agency or commission. Alabama's current legislation allows municipalities to file for Chapter 9 protection without notification of the state government.

Alabama is ranked fourth in all municipal bankruptcy filings that occurred between 1990 and 2004. However, when considering the total state municipal

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bankruptcy filings per number of local governments per state, Alabama is ranked first in the total filings per number of local governments during the 1990 to 2004 period.

In light of the increase in filings, an analysis of the nine Alabama municipal bankruptcies was conducted. The overall contributing factors found were a mixture of financial mismanagement by public officials and the economic decline of the municipalities from loss of businesses and demographic changes. The total financial impact of these municipal bankruptcies is unknown; however, an analysis of the interest rates of debt issuances from two of the municipalities that underwent bankruptcy showed that both municipalities incurred higher-than-average interest rates. This translates to a higher burden on the local taxpayer to repay the debt.

This study also performed a comparative analysis on the financial reform methods enacted by Florida, Georgia, North Carolina, Ohio, Pennsylvania, and Tennessee in dealing with local government fiscal stress and municipal bankruptcy. A secondary analysis of the policies and procedures currently employed by the Alabama State Department of Education (SDE) for local boards of education in Alabama was also conducted.

Bankruptcy, of any type, should be considered as a last resort. Numerous municipal bankruptcies indicate underlying state policy problems in addressing local government finances. This study found information that might be useful to elected officials in Alabama and public administrators in considering other state programs as well as the SDE for municipal finance reform and in determining future policies for local governments in Alabama.

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None of this would have been possible without the help of my family. My husband and son, Chip and Zachary, along with my parents and niece, Richard, Phyllis, and Kaitlyn Hill, have supported me without fail. All of you have endured the highs and lows with me throughout this entire process. Your unwavering love, patience, and understanding have made this possible. This degree is as much yours as it is mine and I will be eternally grateful for your support.

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CHAPTER I

AN EXAMINATION OF MUNICIPAL FINANCE REFORM REGARDING MUNICIPAL BANKRUPTCIES IN THE UNITED STATES

Introduction

Local governments are created by the state through either state constitutional organization (counties) or incorporation by the state. Counties are considered the administrative arm of the state and perform state-mandated duties such as administration of elections, maintenance of the roads, property recordkeeping, and judicial functions. In contrast, a municipality is a political unit which is incorporated by the state for purposes of local self-government and provides services such as police and fire protection, sanitation and parks and recreation. Various types of municipalities include cities, towns, boroughs or villages. Other types of local governments in the United States include townships, school districts and special districts (Dye & MacManus, pp. 326-329). Presently, there are approximately 90,000 local governments in the United States.

According to the National League of Cities (NLC) report "City Fiscal Conditions in 2005," American municipalities continue to be faced with key fiscal challenges in their administration of public services (Pagano & Hoene, 2006, p. 1). Although NLC's 2005 survey yielded a more positive outlook on the financial condition of municipalities, the findings also indicated a growing concern over ongoing and prospective fiscal challenges for municipalities. Among those challenges are soaring employee health care and

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pension costs, increases in services to segments of the population such as the aging, mandated public safety expenditures, and infrastructure concerns (Pagano & Hoene, 2006). Furthermore, Fitch Ratings, a bond credit rating agency, recognized that the "… impact of disaster preparedness, both in terms of capital and operations; rapidly rising costs for construction materials and fuel; and a possible correction in the real estate market and increase in interest rates… " would test local government officials in their financial management abilities in the coming years (Fitch, 2006, p. 3). Combine this with Laughlin's assessment that the "… continuing economic effects of September 11, 2001, compliance with mandatory Department of Homeland Security directives, and reduced tax revenues coupled with increased costs for delivery of service… " and the state of municipal finance could easily be headed towards chaos (Laughlin, 2005, p. 37).

The term financial condition has been used in discussions of state and local government's financial health for many years. Often, the term has been used synonymously with financial health or financial position. In fact, older versions of the Accountant's Dictionary consider the terms, financial position and financial condition, one and the same. The International City/County Management Association (ICMA) defines financial condition as a "… local government's ability to finance its services on a continuing basis… " (ICMA, 2003, p. 29). Another definition states "… financial condition is a government's ability to meet its obligations as they come due and to finance the services its constituency requires" (Mead, 2001). Ladd and Yinger define fiscal health as the ability of a city to deliver public services to its citizens (Ladd & Yinger, 1991, p. 7). For this research, the definition will be expanded to other municipalities as well. From a combination of the above definitions, this dissertation will

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use the following new definition of financial condition: a government's ability to meet its financial obligations as they come due and its ability to continue to provide key services to its constituencies without interruption.

The opposite of fiscal health in a municipality is fiscal stress or fiscal strain. Martin states that the expression fiscal strain was created in the 1970s to describe the financial problems of large cities such as New York (Martin, 1982, p. 1). Clark and Appleton define the term as a "lack of adaptation by government to a changing environment" (Clark & Appleton, 1989, p. 47). In the same context, Pagano and Moore describe the term fiscal stress as "an imbalance between a city's revenue-raising capacity and its expenditure needs" (Pagano & Moore, 1985, p. 23). Rose and Page indicate that in a municipality with fiscal stress there are "….more claims upon the public purse for services than there is money to meet these claims" (Rose & Page, 1982, p. 1). One might particularly agree with Martin's further depiction of fiscal strain "… as an imbalance between revenues and expenditures, not due to seasonal fluctuations in revenue collections, where the municipality is living beyond its means and is fiscally strained" (Martin, 1982, p. 1).

In 1985, the Advisory Commission on Intergovernmental Relations (ACIR) studied the causes of local government financial emergencies. The study found "… poor management practices of spending more than receipts, failing to respond to fewer receipts than expected, or imposition of unexpected expenses, such as court judgments" (ACIR, 1985, p. 5). Park (2004) considered municipal bankruptcy a form of government failure as well as market failure as he found that both economics and politics played a role in the cases he studied. Watson, Handley and Hassett (2005) illustrated that financial

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mismanagement as well as socioeconomic factors such as declining population, rising per capita costs of the government, structural changes in the economic base, natural or man-made disasters, and civic distrust all contribute to the fiscal decline of a municipality and may result in bankruptcy.

Financial health, fiscal stress and municipal bankruptcy must be studied in order to avoid future filings of municipal bankruptcy as well as to improve the financial health of local governments. Authors such as Howell and Stamm (1979), Rose and Page (1982), Rubin (1982), Martin (1982), Pagano (1985), Pammer (1990), Ladd and Yinger (1991), Mikesell (1993), and Honadle, Costa and Cigler (2004) have all studied fiscal health and distress in local governments. Freyburg (1997) and Laughlin (2005) have studied the various statutes that states have in place in response to municipal bankruptcy within their political framework. Baldassarre (1998), Watson, Handley and Hassett (2005), and Landry (2007) have all conducted individual case studies of particular municipal bankruptcies – Orange County, California; Prichard, Alabama, and Greene County, Alabama, respectively. Honadle (2003) conducted a survey of how states approached local government fiscal crisis within their state and found that there were various approaches utilized by the states from a mixture of predicting, averting, mitigating and preventing local government fiscal stress and thus municipal bankruptcy to no state intervention at all. No comparative study of the various approaches to municipal finance reform by individual states was found by the author.

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Statement of Problem

From a financial perspective, the Advisory Commission on Intergovernmental Relations (ACIR) considers a local government financial emergency to exist when the government either cannot meet its current or future financial obligations (including bond payments, payrolls, employee pension funds and/or vendor obligations) and/or has exhausted its tax or revenue sources (ACIR, 1985, p. 2). A worst-case scenario of a financial emergency is when a local government must file for Chapter 9 protection under U.S. Bankruptcy Law. Chapter 9 bankruptcy is a safeguard offered by the federal government to allow a municipal entity protection from creditors while the entity develops and negotiates a plan for adjusting its debts. Under Chapter 9 of Title 11 of the United States Bankruptcy Code, a municipal entity is defined as a "… political subdivision or public agency or instrumentality of a state" (United States Bankruptcy Code).

To many, bankruptcy is indicative of financial failure by management. In contrast, local government bankruptcy is unique in that this particular financial failure not only denotes management failure but political failure, as well. Although the loss of a major industry and/or taxpayer, an unforeseen tort judgment, or a natural or man-made disaster can have an instant negative impact on the local government's finances, most financial problems in those local governments studied can be attributed to an eroding or declining tax base, mandated health and social welfare costs, costly labor contracts and increasing employee benefit costs, and lack of financial management oversight, or in some cases fraud, by the appointed officials. Any municipal bankruptcy filing can negatively impact the citizenry that receives services, either by cutting/eliminating

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services or increasing taxes; the investor who invested in the bond issue by not receiving timely payments as promised; or the vendor who provided services/goods to the entity, by not receiving timely payment.

Chapter 9 legislation was enacted in 1934 in response to the high municipal bond defaults due to the economic depression of the 1930s. During this period, municipal bond defaults went from 678 in 1932 to approximately 4,770 by the end of the 1930s (Hempel, 1973, p. 1340). This was not the first occurrence of municipal bond default. The first recorded default by a local government occurred in Mobile, Alabama in 1838 (ACIR, 1973, p. 9). Cohen (1989) studied municipal defaults and found that the worst rates of municipal defaults were during four major depression periods in the United States: 1837-43; 1873-79; 1893-99 and 1929-37. The highest rate of defaults occurred in response to the Great Depression when many municipalities had issued bonds to finance infrastructure, transportation systems and real estate developments. In response, Congress enacted the first municipal bankruptcy protection to manage those municipal defaults. In 1936, the U.S. Supreme Court held that the Municipal Bankruptcy Act was unconstitutional in the case *Ashton v. Cameron Water Improvement District No. 1*. The court found that the bankruptcy legislation was in interference to state sovereignty as granted to the states through the 10th Amendment to the Constitution (Ashton, 1936). Congress enacted a revised Municipal Bankruptcy Act in 1937, and the Supreme Court upheld this Act in *United States vs. Berkins, et. al.* (Berkins, 1938). The Act had been amended to include voluntary filings along with state permission requirements. As such, the amended legislation did not seem to violate state's rights. In 1940, Congress amended the Act to include protection for county-type governments and

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in 1946 the Act was made a permanent part of the U.S. Bankruptcy Law and referred to as "Chapter 9".

Municipal bankruptcy is considered rare. Approximately 569 U.S. municipalities filed for Chapter 9 protection from 1938-2005.

Table 1.1
Municipal Bankruptcy Filings, 1938 – 2005

Years	Number of Municipal Bankruptcies
1938 – 1939	106
1940 – 1949	215
1950 – 1959	31
1960 – 1969	8
1970 – 1979	7
1980 – 1989	43
1990 – 1999	109
2000 – 2005	50

Sources: Author's Compilation of U.S. Bankruptcy Court Statistics (2006); ACIR (1973, 1985); Hempel (1973); Stowe (2002)

The greatest number of these filings, 321, occurred in the period 1938 to 1949. The Great Depression, World War II, and postwar economic changes may have contributed to this high number of filings. Only 89 filings occurred in the period of 1950 to 1989. This low number of filings could be attributed to the federal government involvement in state and local affairs especially in the areas of economic and social policies. During this time frame, Lyndon B. Johnson's Great Society (1964) and Richard M. Nixon's General Revenue Sharing (1972) provided federal funding to address state and local issues. In 1980, federal grants and revenues to the state and local governments totaled over 25 percent of the state and local expenditures. In comparison, federal grants and revenues made up approximately 10 percent of state and local expenditures in 1950.

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Often the impacts of these funds were felt for years after the initial expenditures. Ronald Reagan's New Federalism (1980) brought about a change in this historical trend of state and local government dependence on federal revenues by reducing the amount of federal aid and creating a greater reliance on block grant funding which placed greater restrictions on how the funds could be spent (Dye & MacManus, 2003, pp. 77-80).

Since the 1980s, the federal government has given the state and local governments more responsibility in handling major public policy issues such as education, health and welfare, and environmental concerns. Many have coined this period as "devolution revolution" in intergovernmental relations. According to the National League of Cities, this devolution brought fiscal stress to the local governments in the form of reduced federal and state aid and unfunded federal and state mandates. The fiscal stress was only deepened for many local governments by their limited and eroding tax bases along with increasing expenditures in the area of personnel, health and welfare, and homeland security (2003, pp. 1-3).

The number of municipal bankruptcy cases escalated in the period of 1990 to 2005. During this time frame, 159 of the total 569 municipal bankruptcy filings occurred. While the table does show that the average number of filings per year went from 10.9 per year in the period of 1990-1999 to approximately 8.3 in the 2000-2005 period, this may be attributed to the legislation enacted by Congress in 1994 that required states to "specifically authorize" their municipalities to file for Chapter 9. Some states, such as Tennessee, have chosen not to give their local governments this option.

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A few financial analysts have forecasted that these bankruptcies may continue to occur given that many municipalities are one step away from insolvency and "… have underfunded pensions as well as health-care liabilities they can't afford" (Fitzgerald, 2006, p. 1). Currently, large municipalities such as Pittsburgh and San Diego are in a state of fiscal stress (City of Pittsburgh Recovery Plan, 2004, p. 4; Mysak, 2005; Shea, 2005). Also, in the wake of Hurricane Katrina, many financial analysts expect that those cities affected by the hurricane as well as those cities that received the influx of displaced residents may find themselves in financial distress for years to come (Mysak, 2005; Municipal Bankruptcy in Perspective, 2006). Other national disasters might have a similar impact on local government financial health.

In Alabama, nine municipal bankruptcies were filed during the 1990-2004 timeframe. These bankruptcies were filed by all levels of local government in Alabama including county, city, town and special authority districts. Table 1.2 lists the specific governmental jurisdictions involved:

Table 1.2
Alabama Municipal Bankruptcies, 1990 – 2004

Year	Municipality
1991	City of Lipscomb
1992	Town of North Courtland
1994	Alabama State Fair Authority
1996	Greene County
1998	West Walker Water Authority
1999	City of Prichard
2002	West Jefferson Amusement and Public Park Authority
2002	Etowah Solid Waste Authority
2004	Town of Millport

Source: Public Access to Court Electronic Records or PACER (2006)

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A thorough analysis of the municipal bankruptcy filings nationwide 1990-2004 indicates that Alabama is ranked fourth in all municipal bankruptcy filings. This ranking is shown in Table 1.3.

Table 1.3
Municipal Bankruptcy Filings By State, 1990 – 2004

State	Number of Filings	Percentage of Total
California	28	23
Texas	26	22
Nebraska	11	9
Alabama	9	7
Missouri	9	7
Illinois	5	4
Oklahoma	5	4
Arkansas	4	3
Arizona	3	2
Colorado	3	2
Montana	3	2
West Virginia	3	2
Idaho	2	2
New Hampshire	2	2
North Carolina	2	2
Florida	1	1
Louisiana	1	1
Mississippi	1	1
Pennsylvania	1	1
Tennessee	1	1
Utah	1	1
Washington	1	1
Total	122	100

Source: PACER (2006)

The 122 filings reported by Public Access to Court Electronic Records (PACER) for each bankruptcy court do not match the 158 filings reported by the U.S. Bankruptcy Court. This may be due to the implementation of PACER in the courts at different time periods in the late 1980s and early 1990s across the United States.

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Analysis of the municipal bankruptcy filings indicates that a majority of the filings in California and Texas were composed of hospital and utility districts respectively. All of the Nebraska filings were made by Sanitary Improvement Districts (SID). The Missouri, Illinois and Oklahoma bankruptcy filings mirror Alabama's in that a mix of political structures, mostly city, town, village and special authority districts, filed for Chapter 9 bankruptcy protection during this time period.

In 1973, the U.S. Advisory Commission on Intergovernmental Relations (ACIR) issued a report on financial emergencies in local governments. The report stemmed from the financial crisis being felt by the New York City government and its inability to meet its obligations. The recommendations of the report were that "… each State should establish by statute a set of guidelines to determine when the financial condition of local government necessitates State intervention and to set for the requisite procedures for carrying out remedial State action" (ACIR, 1973, p. 7). The Commission stated that the federal government's role to provide a legal mechanism (Chapter 9) for municipalities to receive bankruptcy protection was in place. However, in accordance with the residual powers given to the states via the 10th Amendment to the U.S. Constitution, states were to maintain power over their municipalities and provide whatever level of financial guidance or intervention as necessary. The Commission sanctioned the use of state

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power in dealing with municipal financial emergencies in stating that the

> … exercise of such power is called for because (1) severe local financial crisis in a State threatens the credit of both the State and other municipalities within the State; and (2) the unit itself may be penalized (with higher interest) because of lower credit rating and its obligations declared ineligible for purchase by potential institutional investors (ACIR, 1973, p. 77).

The ACIR report provided the results of a 1973 survey of state governments that examined how states were handling municipal financial distress. The ACIR conducted the survey in order to ascertain the level of state supervision of municipal financial practices. ACIR found that 15 states had a statute in place for receivership in the event of a local government defaulting on its obligations (ACIR, 1973, pp. 77-78). The survey findings showed only three states did not have a designated state agency responsible for supervision of municipal financial management, requirements for filing budgets or financial reports with the State, and requirements for controls over short-term municipal operating debt (pp. 163-170). The survey pointed out that Alabama was one of those three states and it had no statute designating a state agency with the responsibility for municipal financial management.

In response to the New York fiscal crisis in the 1970s, Congress amended the Chapter 9 legislation to allow for "… an automatic stay upon the filing of a Chapter 9 petition as well as a provision permitting a debtor to file if prepetition negotiation with each class of creditors was impractical" (National Bankruptcy, 1994, p. 3). The 1978 amendments were the first major modifications of the legislation since 1937 and were part of the Bankruptcy Reform Act of 1978. The legislation substantially overhauled all

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bankruptcy practices to make it easier for business entities and individuals to file for bankruptcy as well as introduced reorganization as a possibility for businesses in the creation of Chapter 11. Also, the 1978 legislation established bankruptcy courts in each federal judicial district within the United States.

The National League of Cities (NLC), the Government Finance Officers Association (GFOA), and the National Association of Bond Lawyers joined together in 1988 to promote changes to the Chapter 9 legislation which were called "The Municipal Bankruptcy Amendments" (Spiotto, 1995, p. 1141). These changes were necessary since the wording of the 1978 legislation seemed to invalidate contracts with bondholders when an entity became fiscally stressed. Under the 1978 legislation, a ruling could be made to divert special revenues from a municipal entity (such as an utility) which was dedicated to the payment of debt service to other municipal uses, such as the payment of salaries. The 1988 amendments not only protected bondholder rights, they also ensured that "… general failure to pay debts is the criterion for municipal insolvency and eligibility for filing" (Spiotto, 1995, p. 1141).

In 1991, Bridgeport, Connecticut became the largest city to file for bankruptcy protection. At the time of the filing, Bridgeport had a $16 million deficit and was losing many of its city residents to other cities due to the increase in crime rates and the highest tax rates in the state. The State of Connecticut objected to the filing on the grounds of lack of specific authorization by the state to seek Chapter 9 protection. The state also argued that Bridgeport should have gone through the State Financial Review Board prior to filing for bankruptcy protection (Municipal Bankruptcy in Perspective, 2006, p. 8). Bridgeport's case was dismissed due to the entity not meeting insolvency requirements

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since it had not exhausted its borrowing power and would be receiving funds in tax revenues within the fiscal year. The State Financial Review Board then intervened and made major financial decisions on behalf of Bridgeport. Following this intervention, Connecticut and other states placed pressure on Congress to enact a requirement for states to specifically authorize their municipalities to receive debt relief under Chapter 9. As part of the Bankruptcy Reform Act of 1994, Congress amended Chapter 9 to require specific state authority in order to file. Prior to that amendment, the legislation was construed as "general authorization" under state law.

Freyberg (1997) conducted an inventory on how states were handling municipal bankruptcy in light of the 1994 amendment to Chapter 9. Like Freyberg, I took a current state-by-state inventory, shown in Table 1.4, of eligibility under state statutes to determine whether a state has enacted legislation allowing its local governments to seek Chapter 9 municipal bankruptcy protection and what municipal finance reform methods are being utilized. A guide to show the different approaches taken by the states is detailed in Table 1.4.

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Table 1.4
State Approaches to Municipal Bankruptcy

Approach	States
Hands Off (where authorizing legislation is in place; no additional requirements at the state-level)	Alabama, Arizona, Arkansas, California, Colorado, Minnesota, Missouri, Nebraska, Oklahoma, South Carolina, Texas
Resolution by Local Government	Idaho, Montana, Washington
Mixed Approach (where both hands off, approval, and no specific authorization are in place for different types of municipalities)	Kentucky, Oregon, Iowa
Approval by Governor	Connecticut, Wyoming
Approval by State Commission or Board	Illinois, Louisiana, Ohio
Approval and Intervention System (normally administered by a state agency)	Florida, Michigan, Nevada, New Jersey, New York, North Carolina, Pennsylvania
Prohibits Filing (explicitly through legislation)	Georgia, Kansas, Massachusetts
No statutes found (no specific authorization to file for municipal bankruptcy)	Alaska, Delaware, Hawaii, Indiana, Maine, Maryland, Mississippi, New Hampshire, New Mexico, North Dakota, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Virginia, West Virginia, Wisconsin

Source: Author's Compilation of State Statutes (2006)

To date, 29 states have passed municipal bankruptcy legislation. Some states have enacted straight-forward legislation without the requirement for additional procedures. Other states have enacted additional steps or intervention reforms as suggested by the 1973 ACIR Report. States in this later group require their municipalities to follow certain protocols. This could include consent by the governor, establishment of a financial emergency board, a local resolution to authorize filing, or designating a specific commission within the state administrative structure to oversee the financial intervention of the municipality.

Twenty-one states have either elected not to provide specific legislation that would allow their municipalities to file for municipal bankruptcy, or they explicitly

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prohibit their municipalities from filing for municipal bankruptcy. Georgia and Kansas are examples of those states that prohibit their local governments from filing. Honadle (2003) found that "… state policies and practices relative to local government fiscal crises vary considerably across the 50 states from no role to monitoring to state-takeover of local governments in emergency status" (Honadle, 2003, p. 1).

Alabama's legislation allows municipalities to file for Chapter 9 protection without further procedures or steps of notification at the state government level. Furthermore, authors such as Honadle (2003) and Kloha, Weissert, and Kleine (2005), surveyed Alabama state government officials and found that none of the reform methods concerning municipal bankruptcy suggested by the ACIR in 1973 and 1985 had been implemented in Alabama.

The need for municipal finance reform in Alabama is especially significant when considering the ratio of total state municipal bankruptcy filings to number of local governments per state. As Table 1.5 indicates, Alabama is ranked first in the total filings per number of local governments during the 1990 to 2004 period.

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Table 1.5
Ranking of Municipal Bankruptcy Filings
To Local Governments, 1990-2004

State	Number of Municipal Bankruptcy Filings	Number of Local Governments Per 2002 Census	Municipal Bankruptcies to Local Governments
Alabama	9	1171	.0077
California	28	4409	.0064
Texas	26	4784	.0054
Arizona	3	639	.0047
Nebraska	11	2791	.0039
Oklahoma	5	1798	.0028
Missouri	9	3422	.0026
Arkansas	4	1588	.0025
Colorado	3	1928	.0016
Illinois	5	6903	.0007

Source: PACER (2006); Bureau of Census (2002)

In light of the increase in bankruptcy filings experienced by Alabama municipalities during the 1990-2004 period, I analyzed the specific reform methods (approval, intervention, prohibits filings, and no statutes) enacted by other states. I also conducted a case study of the Alabama Chapter 9 filings. The purpose of this study was to determine if any of those filings are similar to those financial emergency situations experienced by states that decided to support municipal finance reform methods to avoid bankruptcy filings as well as promote financial health for their local governments. This comparative analysis should serve to assist Alabama public officials in determining municipal finance reform methods that should be enacted in order to avoid future bankruptcy filings in Alabama. I conducted interviews of political and administrative officials in the City of Millport, Greene County, and City of Prichard. These interviews provided me with a better understanding of how the municipal bankruptcy affected the respective entities. The findings of this study contribute significantly to the knowledge

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base of the public finance field in understanding the contributing factors of financial distress situations as well as encouraging possible reforms for states that do not currently have municipal finance reforms in place.

Research Questions

The following questions guided this study:

1. What were the specific factors that led to the nine municipal bankruptcies in Alabama during 1990–2004?
2. How did the respective filings affect the financial health of the local government as well as the state of Alabama?
3. What methods do other states employ in addressing fiscal distress and municipal bankruptcy?
4. What methods does the Alabama State Department of Education employ in addressing fiscal stress for the local boards of education in Alabama?

Purpose and Significance of the Research Questions

The purpose of this research is to analyze the various causes of municipal bankruptcy in Alabama in hopes of avoiding such fiscal distress in the future. Also, the comparative study of fiscal distress interventions and procedures employed by other state governments will shed light on reform possibilities available to Alabama. The need to maintain positive financial health in Alabama's municipalities is paramount in order to provide services that the citizens require. It also will serve to maintain effective stewardship and accountability for public funds.

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This study should benefit the state of Alabama as well as other states that have not employed the reform methods advocated by the ACIR in 1973 and 1985. Also, this study contributes to the knowledge base on the various factors that contribute to municipal bankruptcy at all levels of local government as well as provided insight on steps municipalities can take to avoid such filings in the future. Finally, this study shows how municipal bankruptcy filings affect the state's citizenry as well as the financial health of the state.

Methodology

The data examined for the case study included court documents of bankruptcy filings and newspaper clippings. Also, interviews of local public officials in Alabama provided insight into the municipal bankruptcy filings that occurred between 1990 and 2004.

A review of state statutes, related financial distress, and bankruptcy filings were used as the foundation for the comparative study of the various reforms in place nationwide. Interviews of state personnel and academics in other states provided significant benefit for this comparative study. The theories relating to lesson drawing (Rose, 1993) were utilized in examining policies and procedures enacted in other states. Rose states that "The comparative study of public policy is concerned with the way in which different governments respond to a common problem" (1993, p. 24). Further, Rose posits that "… American state officials are likely to turn to neighboring states….in dealing with a problem" (1993, p. 63). The Council of State Governments categorizes the 50 U.S. states into regions consisting of eastern, mid-western, southern, and western regions. Alabama is located in the southern region; thus, I chose neighboring states such

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as Florida, Georgia and Tennessee as well as states in the eastern region, North Carolina, Ohio and Pennsylvania, to conduct a comparative analysis of their financial policies concerning their local governments.

The statutes of these states offer a variety of approaches in dealing with financial stress and municipal bankruptcy, as shown in Table 1.5, and provide for excellent comparative analysis.

Table 1.6
States Chosen for Municipal Finance Study

Methodology	State
Approval by State Commission or Board and Intervention System	Ohio
Approval by Governor/Board and Intervention System	Florida, North Carolina, Pennsylvania
Prohibits Filing	Georgia
No Statute in Place	Tennessee

Source: Author's Compilation of State Statutes (2006)

In order to provide additional material for the comparison, I conducted a secondary analysis of the Alabama State Department of Education's (SDE) financial intervention that was enacted through state legislation in 1995 and has resulted in the SDE "taking over" various school systems throughout the state since that time. This analysis provided insight as to legislation that is already in place for Alabama school districts. It will also help offer insight regarding whether this legislation could be transferred to other levels of local government within Alabama.

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Overview of Chapters

A brief review of the contents of the succeeding chapters follows. Chapter II provides an extensive review of the literature. Topics and concepts covered will be financial condition, fiscal health, fiscal distress, and municipal bankruptcy. The major authors reviewed include Howell and Stamm (1979), Rubin (1982), Martin (1982), Ladd and Yinger (1991), Cahill and James (1992), McConnell and Picker (1993), Lewis (1994), Berman (1995), Spiotto (1996), Freyburg (1997), Baldassare (1998), Dougherty, Klase and Song (2000), Ward (2001), Frank and Dluhy (2003), Honadle (2003), Honadle and Li (2004), Park (2004), Kloha, Weissert and Kleine (2005), Watson, Handley and Hassett (2005), and Landry (2007). Also, literature from the ACIR and the U.S. Government Accountability Office will be reviewed.

Chapter III provides a historical overview of the Chapter 9 legislation beginning in 1934 with the initial enactment of the legislation. This chapter also reviews all of the amendments to 1934 legislation including the most recent amendment which occurred in 1994. This history also includes the number of filings since 1934 and a listing of the various municipalities that filed for Chapter 9 protection since 1970.

Chapter IV discusses the methodological and approaches used. This chapter includes details on the comparative analysis, case studies, the interviews, and primary and secondary analysis of the documentation. Rose's Lesson drawing theories (1993) will be utilized as the theoretical basis for the comparative analysis of other state municipal finance reforms.

Chapter V summarizes and discusses the municipal bankruptcies in Alabama. Chapter VI presents and discusses the comparative analysis of the municipal financial

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distress methodologies employed by the six states in the study. Chapter VII focuses on the Alabama State Department of Education procedures and legislation in place that mandates the financial procedures of the local boards of education in Alabama.

Chapter VIII discusses the overall findings and relates the findings to the research questions that informed the research. A summary of the data collected is provided along with the comparative analysis, case study, secondary analysis, and interview details.

Chapter IX provides a conclusion for this study and suggests the specific reforms Alabama public officials should consider in identifying and assisting those municipalities in fiscal distress. This chapter also provides ideas for topics for additional study. The final elements of this dissertation include a reference section and appendices that includes the methods used for data collection (e.g., interview questions, list of state statutes).

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CHAPTER II

LITERATURE REVIEW

The increase in the number of municipal bankruptcies since 1990 and most notably the financial crises that were experienced in Bridgeport, Connecticut (1991) and Orange County, California (1994) highlight the significance of studying fiscal crisis in local governments and reinforce the need to study and better understand the causes. Existing research has concentrated on differing theories of the causes of fiscal stress as well as the role that state governments play in the process. Although the Municipal Bankruptcy Act of 1937 was upheld by the U.S. Supreme Court in 1938, the literature surrounding fiscal stress and financial emergencies did not actually take off until the fiscal crises experienced by Cleveland, Ohio and New York City in the 1970s. Since that time, the research in the field has brought forth awareness in the importance of studying such fiscal stress scenarios in order to understand the dynamics, both internal and external, that create fiscal and financial crisis in local governments (Carmeli, 2003; Honadle, 2003). This chapter reviews the introduction of fiscal stress research in the 1970s and some conceptual frameworks of fiscal stress based on national studies as well as state and local government studies of financial emergencies and municipal bankruptcies.

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Introduction to Fiscal Stress

In 1971, President Richard Nixon addressed the subject of fiscal stress in local governments by indicating that "… if we do not have welfare reform and revenue sharing, we are going to have States, cities, and counties going bankrupt over the next two or three years" (ACIR, 1973, p. 1). His statement was due in part to the fiscal stress being experienced in Cleveland, Ohio. Although Cleveland was not the first municipality to experience fiscal stress since the introduction of legislation for municipal bankruptcy in 1934, it was the first major U.S. city to experience fiscal decline since the depression. This produced an awareness of the need to study financial emergencies in local governments in order to address the situation at hand as well as to avoid financial stress for local governments in the future.

In 1973, the Advisory Commission on Intergovernmental Relations (ACIR) studied the financial condition of 30 major cities in the U.S. in an attempt to identify factors that contributed to the fiscal decline in municipal affairs. The ACIR found that " …to define a financial emergency mainly in terms of a city's ability to meet its financial obligations is to ignore a city's responsibility to the people who are dependent on the city for its services" (ACIR, 1973, p. 3). The Commission posited that the study of financial emergencies must take into account a wide range of municipal interests from the citizenry who received and purchased the services, the bondholders who invested in the entity, and the vendors who expected payment for their services required by the local government. The study found that there were eight warning signs for impending financial problems within a local government. The ACIR labeled these as common characteristics and stated

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that these do not always occur in tandem or in conjunction with other warning signs.

These are:

1. Operating fund where current expenditures exceed revenues
2. Consistent overage of expenditures over revenues for several years
3. Excess of current liabilities over current assets
4. Short-term operating loans outstanding at the end of the fiscal year
5. High property tax rates coupled with high delinquency in property tax collections
6. Sudden substantial decrease in assessed property values unexpectedly
7. Under-funded pension funds
8. Poor budgeting, accounting and reporting techniques

(ACIR, 1973, p. 4)

The study also found that severe financial emergencies within local governments were not only a result of bond defaults, but also a result of not meeting payroll, pension benefits, and payments to suppliers (p. 75). The Commission concluded that:

> Unsound financial management stands out as one of the most important potential causes of financial emergencies in local governments. The Commission recommends therefore that each State designate or establish a single State agency responsible for improvement of local financial management functions such as accounting, auditing, and reporting. The Commission further recommends that the agency be responsible for early detection of financial problems in order to prevent local financial crisis (p. 5).

Other recommendations included state regulation of municipalities' short-term accumulated operating debt, locally administered retirement systems be either regulated by the state or consolidated into a state-administered system, state statutes on when the financial condition of local governmental entities necessitate state intervention along with remedial procedures, and updates within the Federal bankruptcy provisions.

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In 1985, the ACIR updated its 1973 study. In addition to the eight common characteristics previously cited, the ACIR found that additional factors played a role in the financial problems faced by local governments. These were municipal bankruptcy; default on general-obligation bonds, general-obligation notes, government-purpose revenue bonds or notes, and private-purpose revenue bonds such as economic development indentures; and failure to meet other obligations such as payroll, vendor payments, and so forth. The Commission noted that new developments in the area of municipal finance that were not addressed in the 1973 report included cities dealing with court judgments, investment losses, the growing use of deficit-funding bonds like that in New York City and the voluntary sale of local government assets in order to meet current obligations. The Commission maintained that financial mismanagement was still the primary cause of financial strain which may lead to bankruptcy, default and a combination of both in local government. Further, the Commission restated its position that state actions are the most appropriate methodology for dealing with local government financial emergencies and noted that there had been some improvement in that area since 1973. States such as New York and Ohio had implemented municipal finance reforms but other states continued to either ignore or provide minimal action in this area of national concern (ACIR, 1985, pp. 2-6).

With regard to the municipal bankruptcies filed since the 1973 report, the Commission found that 21 were filed nationwide during 1972-1984 compared to only 10 cases filed during 1960-1971. The increase in cases was attributed to an increase in special authority districts, such as real estate developments, filing Chapter 9 (ACIR,

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1985, p. 8). Further, the Commission found another cause for future concern was the increase in defaults during the same time period mentioned above. From 1972-1983, over 100 defaults occurred on municipal-backed securities. This included 36 on government-purpose debt and 82 on private-purpose debt that is only associated with the government through the tax-exempt status on the related interest of the debt. The study noted a high number of defaults in four states – Oklahoma, Alabama, Tennessee and South Carolina. The three largest defaults were New York City, Cleveland, Ohio and Washington Public Power Supply. The Commission echoed its earlier findings on financial emergencies and concluded the most likely causes of these mishaps were unsound financial management, unbalanced budgets, and large operating deficits (ACIR, 1985, pp. 15-26).

The United States General Accounting Office (GAO) also studied the effects of fiscal stress on U.S. communities. These studies took place in 1984, 1990, 1991, and 1992. The 1984 report focused on the procedures in place for the federal government to come to the aid of large firms and municipalities when requested by the state government. This study was in response to the fiscal distress being experienced by Conrail, Lockheed, and Chrysler (for-profit firms) and New York City. The primary purpose of this report was to give Congress an overview of how the federal government came to the aid of a large municipality like New York and to offer lessons learned for future financial stress of large municipalities. The report detailed the federal assistance that was given to New York City in the form of direct loans in 1975 and loan guarantees in 1978. The 1984 GAO report stated that the bankruptcy system in place was

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unprepared to deal with a failure like that of New York City since the municipality had to continue to provide services to its citizens as well as meet its past-due obligations. The GAO questioned whether the bankruptcy court was better at "… managing a large city than its elected officials and their staffs …" (p. 3). It also pointed out that a municipality of this size certainly could not liquidate its assets in order to satisfy its debts. The report concluded that

> If the problems are largely specific to the firm or municipality, the Congress must decide whether the national interest will be served best through a legislative solution, or whether market forces and established legal procedures should proceed. In reaching this determination, the Congress should take into account all costs, of a corporate or municipal collapse, not just those borne by the potential aid recipient and others benefiting from the potential aid. These costs would include those borne by the corporation's or municipality's constituents (GAO, 1984, p. 118).

In 1990, the GAO considered whether states were meeting the needs of fiscally distressed municipalities. Congress had requested the report from the GAO after federal revenue-sharing grants were discontinued in 1986. Members of Congress were considering whether local governments were being fiscally affected by the reduction in revenues as well as still able to meet their constituents' needs (GAO, 1990, p. 13). The GAO report defined distressed municipalities as "… those in which residents bear substantially higher tax burdens in order to obtain levels of public services comparable to better-off communities" (GAO, 1990, p. 48).

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The term financial condition has been used in discussions of state and local government's financial health for many years. Often, financial condition has been used synonymously with financial health or financial position. In fact, older versions of the Accountant's Dictionary consider the terms, financial position and financial condition, one and the same. The International City/County Management Association (ICMA) defines financial condition as a "… local government's ability to finance its services on a continuing basis" (ICMA, 2003, p. 29). Another definition includes "… financial condition is a government's ability to meet its obligations as they come due and to finance the services its constituency requires" (Mead, 2001, p. 1). Ladd and Yinger define fiscal health as the ability of a city to deliver public services to its citizens (Ladd & Yinger, 1991, p. 7). McKinney (2004) considers fiscal health to be "… the ability to finance existing levels of services, access to reserves, and the revenue base to respond to regional economic disruptions such as the closing of a major local employer, and the ability to meet growth, change and decline" (p. 507). From a combination of the above definitions, this dissertation uses the following new definition of financial condition: a government's ability to meet its financial obligations as they come due and to continue to provide key services to its constituencies without interruption.

From a financial management perspective, Khan and Hildreth (2004, p. 1) maintain that public financial management lacks a coherent framework and this is mainly due to the many diverse needs and interests that all levels of government serve in today's society. They echo Rose and Page (1982) in arguing that public officials must use limited resources in order to meet endless claims upon those resources. With this same

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sentiment, Hildreth (1996) stated that "Citizens expect their governments to do needed activities but within fiscal constraints" (p. 1). Further, good financial management leads to a healthy financial bottom line for the local government in meeting the diverse needs of its population.

Hildreth (1996) recommends certain financial and nonfinancial measures that the governing body, especially the management as well as the finance officers, should accomplish in order to maintain a healthy financial bottom line. Some of the financial measures include: balance the budget; obtain a positive variance between what was budgeted and the actual results; maintain a fund balance; invest non-recurring funds; stabilize finances over time; maintain intergenerational equity; obtain a low cost of capital; and preserve debt capacity (pp. 328-330). The non-financial measures address achieving efficiency and effectiveness; providing timely service; maintaining quality and value-added activities; making investments; benchmarking performance to other peer or successful governments; making appropriate market disclosures for the capital market; maintaining adequate public communications; and mobilizing invisible assets such as community consensus to increase taxes in response to propositions submitted by the elected representatives (pp. 330-332). Hildreth concludes that success in public financial management is a delicate balancing act and is measured in more than dollars; however, the citizenry, credit markets, and other governments consider the bottom line of the budget and the financial statements in assessing the financial condition of a government.

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He states:

> For any organization to remain a going concern, assets must equal or exceed liabilities and cash has to be available to cover the bills….this is the easy part of finance….it is a delicate balancing act facing finance officers as they adjust to the competing financial concerns of public policy (p. 338).

Many researchers have also studied fiscal stress and hold various views on what may lead to further fiscal stress or municipal bankruptcy in a local government. Some authors maintain that fiscal stress for local governments is a result of deficit spending (Rubin, 1982; Rose & Page, 1982; Martin, 1982). This means that current expenditures exceed current revenues for the government's operating period. Mikesell (1993) posits that liabilities exceeding assets is a good indication of fiscal stress and may eventually lead to bankruptcy. Pammer (1990) considers fiscal strain to be two-fold in that a local government may not have access to enough current cash reserves to pay current bills or may not be able to generate enough revenues in the current period to meet expenditures that occur normally in the budget cycle. I consider Wilson's (1984) definition of fiscal stress to be the most comprehensive. According to Wilson, fiscal stress in a local government should be considered present when current expenditures exceed current revenues by a significant amount; continuous deficit spending in small amounts; and/or current liabilities exceeding current assets on a local government's financial statements. All three of these scenarios should be considered warning signs to management that financial trouble may be on the horizon for the governmental entity (p. 2).

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Other views of fiscal stress include socio-economic factors that are outside of the government's control; these are also considered relevant by this author. Ladd and Yinger (1991) posited that the national economy as well as social trends affected the fiscal stress environment in the local government. Pagano and Moore (1982) considered fiscal stress from a broader sense in that "… fiscal stress is a structural phenomenon, reflecting shifts in the social and economic conditions of the city" (Pagano & Moore, 1982, p. 23). In their study on fiscal stress and retrenchment strategies in U.S. cities, Clark and Appleton defined fiscal strain on a city to be lack of adaptation by the government in a changing environment (1989, p. 47).

Studies on Fiscal Stress

In the wake of the financial crises experienced by many major and minor U.S. localities from the 1970s to date, many theorists have conducted studies on local governments in America. Most studies were conducted as an attempt to define fiscal stress from the concept of identifying common financial and accounting factors among financially strained local governments.

Howell and Stamm (1979) and Ladd and Yinger (1991) focused on a comparative analysis of U.S. cities while Martin (1982), Rubin (1982), and Frank and Dluhy (2003) focused their research on major U.S. metropolitan areas. Table 2.1 depicts a summary of this literature in chronological order. The following paragraphs will serve as a discussion of their findings.

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Table 2.1
Chronological Summary of Empirical Studies On Fiscal Stress

Author(s)/ Date	Unit of Government Studied	Relevant Findings
Howell and Stamm, 1979	66 U.S. cities with mean population of 250,000	1. Fiscal stress is more prevalent in older, mature, industrialized cities who have lost industry 2. Financial and socio-economic indicators are necessary to predict and avert fiscal stress 3. Fiscal stress is more likely to be economic – cities who do not attract economic development are also prone to higher service costs 4. Financial and budgetary reporting practices are inadequate and inconsistent in local government
Martin, 1982	Boston, Massachusetts and Detroit, Michigan (1970 – 1980)	1. Financial problems are result of years of ignoring warning signs – inaccurate forecasting in budgeting, continuous deficits and financial mismanagement 2. Solid accounting and financial system necessity for good financial health in local government
Rubin, 1982	Midwestern city (Anonymous)	1. Politics, social and economic conditions contributed to fiscal stress in local government 2. Lower credit rating by Moody's brought about public awareness of the fiscal stress – put pressure on politicians to address growing fiscal problems 3. State mandated financial reforms (pension funding mainly) placed pressure to address fiscal problems
Ladd and Yinger, 1991	86 U.S. cities between 1972-1982	1. Fiscal health of a government depends on national economic and social conditions 2. Fiscal deterioration impacts the disadvantaged citizens of the local government with higher taxes and/or cuts in public services 3. Up to state and federal government to ensure that city fiscal conditions do not negatively impact those residents

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Table 2.1 (cont.)
Chronological Summary of Empirical Studies on Fiscal Stress

Frank and Dluhy, 2003	Miami, Florida 1996-2001	1. Do not ignore warning signals – financial problems do not happen overnight 2. Establish internal checks and balances especially when delegating authority to lower levels of management 3. Financial management practices key to good fiscal health

In the late 1970s, Howell and Stamm (1979) conducted a study of 66 U.S. cities with a mean population of 250,000 in order to gain an understanding of municipal fiscal stress. The largest city in the study was Baltimore, Maryland at approximately 900,000 in population and the smallest Rochester, Minnesota at approximately 54,000. The authors created a comprehensive financial database from the 1975 annual reports of the cities and utilized U.S. Census data from the 1972 Bureau of the Census City and County Data Book, the 1972 Census of Manufacturers and the 1970 Census of Population.

The database was made up of 16 clusters that focused on economic conditions such as median family income and manufacturing capital spending and social conditions such as change in population, percent minority population and unemployment rate, and structural conditions such as population density (pp. 6-7). The 66 cities were then categorized into four clusters based on the six economic variables chosen for the study and further divided into high-low populations dependent upon social and structural characteristics. The resulting 16 clusters represented relatively similar economic, social and structural conditions. The researchers then applied the 13 financial variables they

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believed best represented municipal financial performance. These variables included social, health and welfare expenditures per capita, current operating expenses per capita, local taxes per capita, intergovernmental revenues as a percent of total revenues, total debt and interest per capita and municipal capital spending per capita. The financial indicators also focused on other financial variables such as ratio of city full-time personnel to total local employment and tax effort in the form of local taxes to personal income (p. 8). It is important to note that the original study population had to be downsized from 120 to 66 cities due to missing financial and informational data on 54 cities in the original population. For the 66 cities studied, 13 financial indicators used represented the only data consistently available. Missing information included the details relating to pension fund liabilities, tax revenue categorical breakdown, and condition of infrastructure and property, plant and equipment in the financial reports (pp. 21-22).

The study found that older industrially aged cities are more likely to be fiscally stressed than younger, growing cities due to high tax, debt and expense ratios. This is largely attributable to a fall-off in investment by industry as well as a decrease in the number of industries. Also, financial indicators should be used in tandem with socio-economic indicators when assessing the financial condition of a municipality. The study found that grant-in-aid programs from the federal and state level help resolve the social and structural problems of the city, but not the financial and economic problems. Fiscal stress is most likely a result of economic problems within the city. Finally, older cities are less effective in leveraging their capital spending toward attracting economic development than younger cities in their early growth stages. The slowdown of growth

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for a city normally occurs at the same time as the demand for services begins to rise. Many consider this to be a "catch-22" for government managers who are attempting to lure potential economic investment (pp. 19-21).

Howell and Stamm concluded that the 1973 ACIR recommendations toward state involvement in municipal financial stress and bankruptcy are key to monitoring and alleviating fiscal stress conditions in local governments. Further, financial variables such as those used in this study could be utilized as an early warning system that would allow enough time for municipalities to adjust their spending habits. Also, city officials would need to incorporate strategic planning into the budgeting process. Key issues in strategic planning were determining the objectives of the city; considering whether the city is growing or maturing; analyzing how the city is changing; and determining what the city can do to encourage economic growth and stability in order to avoid fiscal stress. Ultimately, the study concluded that city management must live within its means by prioritizing city needs while also making efforts to rebuild and maintain the economic base in order to sustain operations (pp. 22-25).

Martin (1982) introduces the expression "fiscal strain" with regard to the New York City financial crisis in the 1970s. Martin suggests that the underlying factors of fiscal crisis, as well as the majority of other municipal fiscal woes, are political as well as financial. She points out: "When an imbalance between revenues and expense occurs and is not due to seasonal fluctuations in tax receipts, a city is living beyond its means and can be said to be fiscally strained" (p. 1).

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Martin (1982) conducted case studies on the annual financial statements and budgets of Detroit and Boston, two U.S. cities that faced fiscal stress during the late 1970s. Her findings indicated that financial problems for both cities were not "news" to city officials as the problems had been accumulating for years and were not addressed by city management in a timely manner (p. 129). These findings countered other popular theorists who considered fiscal stress from a socio-economic perspective only. The origins of fiscal strain were from financial mismanagement in the accounting and budgetary system and from those charged with recording the financial information.

In the case of Detroit, Martin studied the city's fiscal health from 1970 to 1980 and established that its main financial problem was related to accounting. Lack of a balanced budget and living beyond its means contributed to a growing deficit that was projected to be $1 billion in 1984-1985 if not addressed by city management. The city would make up for the shortfall at the end of each fiscal year with short-term notes that would contribute to the growing deficit of the city. Also, Martin found that the city did not reserve for contingent liabilities such as legal judgments that the city faced. In 1980, a court judgment in the amount of $80 million was awarded to police and fire fighter union members as a pay raise, and Detroit's city management had not budgeted for this contingent liability although it did make mention of the pending judgment in the notes of the financial statements (pp. 53-101, 132-135).

Martin studied Boston's financial problem as well. She found that Boston suffered from a property tax deficit, an under-funded pension plan and a state referendum that limited tax levies. As in Detroit, court litigation played a role in the financial

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problems experienced by the city when taxpayers won a $75 million judgment against the city for over-assessing commercial property. This only contributed further to the city's deficit. Further, the city's independent authorities (water, sewer, and schools) contributed to the city's financial strain when Boston had to pick up their respective annual deficits even though the city had no fiscal control over their financial affairs. Like Detroit, Boston utilized loans and borrowing in the form of tax anticipation notes (TANs), revenue anticipation notes (RANs), and bond anticipation notes (BANs) in order to finance the city's yearly deficits (pp. 102-128, 134-148).

Martin concluded that city financial problems do not happen overnight. Rather, the problem accumulates over years of inaccurate forecasting, continuous deficits and financial mismanagement. She particularly advocated a solid accounting and financial system within a municipality, indicating "…particular attention should be paid to encumbrances, reserve for bad debts, and contingent liabilities …" (p. 129) when considering the financial health of a particular government. Martin depicts these items which are normally enumerated fully in the notes to the financial statements as the warning signals towards financial stress.

Rubin (1982) studied fiscal stress on a local government through a case study of an unnamed middle-sized Midwestern city. The author examined the social, political and economic causes of the financial decline of the city as well as the recovery of the city over a six-year period during the 1970s. Rubin found that the future impact on a municipality undergoing fiscal stress can be overwhelming in that borrowing costs are normally increased, debt service takes a larger portion of the budget thus decreasing

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discretionary spending, and costs of goods and services increase largely due to the reluctance of vendors to deal with an organization that is delinquent with payments (p. 3). From a political perspective, Rubin found that "The politicians, evasive about the causes of fiscal stress, tended either to minimize its importance or to blame it on national trends over which the city had no control" (p. 76). Interviews with the mayor and city council revealed two scenarios: diversion of the blame for the city's fiscal situation on former administrations and/or other politicians and a minimization of the fiscal stress situation as an accounting problem rather than a financial management problem. Rubin found that city politicians tried to hide the deficits due to the deterioration of the tax base and once the size of the deficits became an issue, the mayor and council members did not have a strategic plan in place to control costs (p. 97).

Concerning the social aspect of fiscal stress in this particular case study, Rubin found that migration of the middle class, mainly white, to new suburbs contributed to an economic and social segregation in the city. Annexations of some of the new subdivisions created higher service and infrastructure costs (e.g., new schools and street lighting) which the city had not forecasted in its budgetary process. The increase in population and related tax base were insufficient to handle these costs. No financial planning was in place to cover the deficits created by the expanded expenditure base (p. 116).

The city experienced a loss of manufacturing industry which only added to the economic burden and financial malaise of the city. The steel industry had suffered a decline over the previous 30 years and the federal government also closed a facility

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within the city limits that prompted other major employers to move their businesses. Although the city management did attempt to bring a shopping mall into the city in an effort to increase the tax base, the city had to increase its operating costs as part of the incentive package to lure potential retail tenants and to provide infrastructure and capital for the future development. As a result, this initiative further compounded the financial problems of the city (pp. 93-97).

Rubin also studied the financial recovery of the city and found that three outside actors contributed to recovery: the credit rating agency (*Moodys*), the state government, and the federal government. *Moodys* reduction of the city's credit rating resulted in increased public awareness and pressure on the city management to curtail its expenditures and eliminate the deficit. Although the lowering of the credit rating did increase borrowing costs for the city, Rubin maintained that the threat of a lower rating or a withdrawal of credit rating motivated management to face the fiscal situation and make improvements. The state government also asserted that the city would have to pay a larger amount of money into the pension funds of its employees in order to maintain stability in the funds. Finally, the federal government stepped in with increased aid in the form of revenue sharing, Housing and Urban Development (HUD) block grants, and Comprehensive Employment and Training Act of 1973 (CETA) and Environmental Protection Agency (EPA) funds. Rubin concluded that the role of the state and the federal government in this crisis did not solve the fiscal crisis, yet provided timely assistance in the financial recovery of the city (pp. 101-106).

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Ladd and Yinger (1991) conducted a study of 86 U.S. cities between 1972 and 1982 in order to consider what attributes of fiscal stress are directly related to those influences beyond the control of city officials. The authors considered the fiscal health of these cities from the approach that a city's financial condition is not just in the hands of the local management. It is also restricted due to the state government deciding its tax revenue capacity as well as responsibility for public services. They concluded:

> A city's actual fiscal health depends on the economic and social factors that influence standardized fiscal health and on its state-determined fiscal institutions, including its access to broad-based taxes, the taxes collected by overlaying jurisdictions, its service responsibilities, and the inter-governmental grants it receives from its state (p. 14).

The actual fiscal health of the cities was calculated by the authors on the restricted revenue-raising capacity minus the actual expenditure need for the years 1972 and 1982. This analysis showed that the average fiscal health of these cities decreased by five percent over these years. These authors considered this to be an indication of modest deterioration in fiscal health that was more prominent in larger cities than smaller cities (pp. 193-207). They concluded that even with the growth in revenue sharing between federal and local governments, as well as state and local governments: "The typical city needed additional revenue from outside sources equal to 5 percent of its 1982 actual revenue-raising capacity" (p. 287).

Ladd and Yinger expected this decline to continue for future years unless state or federal fiscal policy countered these unfavorable economic and social trends. They

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arrived at two broad conclusions from this fiscal study. First, national economic and social trends are the source of the weakening fiscal condition in U.S. cities; these trends are outside of city management's control. They found these circumstances to be particularly prevalent in larger cities with the heaviest impacts upon their poorer residents who will receive less than adequate services and higher than average tax burdens in order to offset the expenditure costs of the local government. The authors cited the fact that: "Poor, elderly, and handicapped people, as well as blacks and Hispanics, all of whom are disproportionately represented in central cities, face formidable barriers to mobility, barriers that limit their ability to improve their fiscal options" (p. 293). The poorer or disadvantaged residents are unable to afford moving to a better locale in response to a city's fiscal stress. Those who can afford to move are more likely to be the ones who contribute a higher percentage towards the entire tax burden and will leave a deeper fiscal gap in the city's revenue-raising capacity. This has a further negative impact upon those residents who are in greater need of city services. A recent example of such impacts may be seen in New Orleans in the aftermath of Hurricane Katrina.

Ladd and Yinger (1991) called upon a higher level of government to step in and assist these cities in order to ensure that all residents are treated fairly especially when faced with disparaging national and economic social trends outside the scope of local governments. Although the authors maintain that city management must be held accountable for its financial management and must strive to provide services at the most efficient and effective level, Ladd and Yinger believed that the national and state governments concern for the residents of the fiscally-stressed local governments must be

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paramount in order to provide some sort of financial mechanism to offset the further fiscal decline of those cities. The authors stressed that the state has the ultimate power over how their local governments conduct their fiscal affairs since the state enforces the fiscal rules and offers various levels of flexibility under which the municipality operates. They also proposed an equalizing grant program as an opportunity for state governments to ensure that those poorer, disadvantaged local governments within a state could receive state aid in order to avoid fiscal stress (pp. 293-313).

Frank and Dluhy (2003) studied the fiscal decline of Miami, Florida during the period of 1996-2001. Their intent was to draw lessons from this financial crisis that municipalities could utilize in their future planning to avoid such a crisis themselves. In Miami's case, the State of Florida appointed an oversight board to oversee the daily operations of the city. They found that this outside intervention by the state was most helpful in the recovery of the city's finances. The state oversight board implemented several financial practices such as approval of contracts, operating and capital budgets, strategic planning for reserves, and maintenance of revenues for the city. Also, the authors found that the financial practices previously employed by Miami city management were not up-to-date, did not promote good stewardship of the city's finances through internal checks, and were not current in the accounting procedures (pp. 17-35).

Frank and Dluhy cited four "micro lessons" to be taken from this financial crisis:

1. Do not ignore early warning signals – hints were present all along that the city was in financial trouble and city management did not heed the warnings. The authors mentioned that Howard Gary, former city manager for Miami, had

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projected $65 million in deficits as early as 1989. These deficits were due to a shrinking tax base and increasing spending obligations. The elected officials seemed to ignore his warnings (p. 36).

2. Establish internal checks and balances, especially if delegating authority to lower level management. Lack of communication, procedures and internal and external controls all contributed to the financial chaos in this particular city government.
3. Keep your professional positions filled with experienced, educated, professional civil servants. Also, continuously train the staff in proper and up-to-date accounting and budgetary procedures. In 1995, 500 mid- to upper-level employees left the city's workforce and the city did not refill these positions leaving the city without many experienced and educated mid-level managers. Also, the city was without a Certified Public Accountant on staff until 1998.
4. Create stability within city government by filling key staff positions with competent and educated people and terminating incompetent or corrupt employees (pp. 36-38). .

The Miami city government had seven city managers during the period of recovery. They attributed this large turnover to political and organizational instability as well as lack of trust and professional relationships between the city manager, mayor, state commission, and key department heads in the fiscal crisis aftermath. Frank and Dluhy (2003) concluded that Miami's fiscal crisis could have been avoided if management practices, especially those in the accounting and budgeting areas, had been implemented

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and if the government officials had been held accountable by the voters of the Miami area (p. 38).

The study of fiscal stress also has been considered local governments within one state or one metropolitan area. Dougherty, Klase and Song (2000) surveyed local officials in West Virginia to learn how small and rural governments cope with fiscal stress. Ward (2001) surveyed public officials in 64 Louisiana local parish governments to consider how governments respond to fiscal stress situations. Kloha, Weissert and Kleine (2005) studied the financial data from 97 cities and 53 townships in Michigan and created a composite model of financial indicators to predict local fiscal stress. Table 2.2 highlights the relevant findings of these studies.

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Table 2.2
Chronological Summary of Empirical Studies on Fiscal Stress in Local Governments within State Boundaries

Author(s)/Date of Publication	Units of Government Studied/Period of Study	Relevant Findings and Recommendations
Dougherty, Klase, and Song, 2000	West Virginia local governments, 1996	1. Survey of local officials showed that fiscal stress is influenced by financial techniques, budget and fiscal conditions, local own-source revenues, and intergovernmental grant revenues 2. When facing fiscal stress, more concern is shown over public finance issues related to raising revenues in lieu of financial management issues associated with managing the limited resources they have
Ward, 2001	Louisiana local governments, 1992	1. Urban governments are more likely to choose revenue enhancement strategies whereas rural governments will likely choose cost reduction strategies when facing fiscal stress 2. Federal and state policies should play a role in how local governments, both urban and rural, face fiscal stress, especially in economic downturns
Kloha, Weissert and Kleine, 2005	Random sample of 97 Michigan cities and 53 townships, 1991-2001	1. State and local governments should be proactive rather than reactive towards fiscal stress 2. 10-point fiscal stress model utilizing financial and socio-economic data indicates trends that result in fiscal stress

Dougherty, Klase and Song (2000) examined the relationship between public finance issues, financial management issues, and fiscal stress conditions in small/rural communities in West Virginia. The focus of the research was to learn how small and rural governments cope with fiscal stress situations. The study focused on how public

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finance issues (revenue-raising capacity and concerns) and financial management issues directly influence the fiscal stress experienced within the community. The authors offered that previous research, such as Martin's (1982) had focused on mostly urban areas. Their research would consider rural areas using West Virginia's communities as a sample population (pp. 545-549).

The researchers sent out a survey in 1996 to 1,803 elected and appointed local officials in West Virginia and had a response rate of 31.3 percent. The survey questionnaires asked for the local official's assessment 164 public finance and financial management issues. A four-point Likert scale was used to rate each issue. A non-issue received a 0 and a pressing-issue a 4.

The authors defined fiscal stress, their independent variable, as consideration by municipal officers of whether the current level of revenues were adequate to cover the current level of expenditures or current demand for services (p. 556). They found that fiscal stress was significantly influenced by financial techniques, budget and fiscal conditions, local own source revenues, intergovernmental grant revenues and payments in lieu of taxes for federal land holdings. No statistically significant relationship was found between fiscal stress and the size of metropolitan area, the presence of professional city management, or level of population. The research showed that public finance issues were scored as a pressing issue on the local official's survey responses and financial management issues were of little concern. This finding was contrary to the researchers' expectations for the study (pp. 550-557). They concluded that "… officials in small and rural governments are more concerned with Public Finance issues related to raising

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revenues under conditions of Fiscal Stress than in Financial Management issues associated with managing the limited resources they have" (p. 562). Like Baldassare (1998) and Martin (1982), the authors concluded that this might be attributed to the fact that public officials do not always possess the professional knowledge and skills needed to recognize the importance of financial management tools in addressing fiscal stress in their communities.

Ward (2001) conducted a survey of Louisiana's 64 local parish governments in 1992 in order to consider whether rural governments respond differently to fiscal stress situations than more urbanized governments. The survey focused on 10 possible coping strategies that could be employed by local officials when facing a loss in intergovernmental aid as a revenue source. These coping strategies included increased taxation, program reduction, local intergovernmental agreements, privatization of services, and personnel reduction. The study results showed that differences were present in how urban and rural governments approach retrenchment strategies. Results indicated that a larger percentage of urban governments would choose revenue enhancement strategies, such as grants or privatization of services. The more rural governments would consider expenditure reduction strategies. Ward reported that "… results show that urban governments are better equipped to rebound from sudden cuts of aid" (p. 569).

Ward also concluded that federal and state policies should play a role in how both urban and rural local governments handle fiscal stress, especially in economic downturns. The author suggested that higher levels of government focus on providing more grant opportunities to rural governments rather than to urban governments that have more

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revenue options. Privatization and/or intergovernmental agreements between local governments should also be encouraged by state governments in order to lower service costs as well as lessen the stress on the rural governments that depend on revenue sources such as intergovernmental grants and aid (pp. 565-569).

Kloha, Weissert, and Kleine (2005) developed and tested a composite model to predict local fiscal distress in hopes of developing an early warning system that will enable state and local government officials to be proactive rather than reactive to fiscal distress situations. They approached their definition of fiscal stress from a long-run and short-run perspective since they found past research focused on fiscal stress from either perspective but not both. These authors arrived at the following definition of fiscal stress: "… a failure to meet standards in the areas of operating position, debt and community needs and resources over successive years" (p. 314). They found a disagreement in the present body of research on which fiscal stress indicators are most suitable for use by local governments and noted that public officials are uncertain which indicators are best. They also found that current indicators advanced by the International City Management Association (ICMA) and other research failed to allow for diversity among state and local governments in the United States.

The authors used a sample of 97 cities and 53 townships in Michigan, totaling 150 local governments, during the time period of 1991-2001 for cities and the 1994-2001 time period for townships. The data were comprised of financial information from comprehensive annual financial reports and audits of those reports as well as socio-economic data from the U.S. census and labor statistics. The authors believed that no

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single indicator could be used to assess a government's fiscal position and both financial and socio-economic factors play a role in assessing whether a government is headed toward fiscal stress or financial health. Some of the indicators studied included population growth, prior and current general fund operating deficits, general fund balance as a percentage of general fund revenues, and general fund expenditures as a percentage of taxable value (2005, pp. 317-319).

Kloha, Weissert, and Kleine (2005) developed a 10-point scale of fiscal stress using a pre-set standard on the nine variables that distinguished "good" from "bad" performance indication. If a government scored "good", then it received 0 points for that variable. If the government scored "bad", then it received either 1 point if this was the first year the deficit was noted or 2 points in the case of a repeat deficit from previous years. Those local governments that scored 5 to 7 points were placed in a fiscal watch (5 points) or a fiscal warning (6 to 7 points). Those local governments with a score of 5 points or higher were notified, in writing, by the researchers. Those with a score of 6 to 10 were also placed on a published list. The average score was 1.5 for all the local governments included in the sample. The results identified those local governments that were already considered fiscally distressed by Michigan state officials and had already placed into state receivership (Highland Park, 2000; Hamtramck, 2000; Flint, 2002).

The authors concluded that this particular 10-point scale achieved their major objective of predicting fiscal stress before it occurred in the local government. In addition, the scale can indicate progression towards fiscal stress as well as show where there has been improvement in those local governments that pick up on their financial

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predicament and address those issues accordingly. The authors maintain that state governments could incorporate this system into their municipal finance reforms for local governments. This particular financial indicator system provides an easy-to-interpret system for municipal finance oversight, could be used by local governments in assessing their past and future performance, and would be valuable to citizens in evaluating the performance of local elected officials (pp. 313-321).

The results and findings of the studies addressed so far contribute an understanding of factors that cause fiscal stress as well as municipal bankruptcies in local governments. They point to a variety of internal and external factors that contribute to financial stress in local government. Their recommendations run the gamut from improving accounting and financial management practices to monitoring economic trends outside the control of the local government. Further, the works of Ward (2001) and Kloha, Weissert and Kleine (2005) second the ACIR recommendation (1973, 1985) that the state government should be responsible for lending financial aid and/or oversight of fiscal affairs within fiscally stressed municipalities.

Municipal Bankruptcy

While the fiscal stress and financial health literature has become more prevalent since the fiscal strain experienced by Cleveland, Ohio and New York City in the 1970s, the literature on municipal bankruptcies is scarce. From a financial perspective, a municipal bankruptcy can be considered to be more damaging than fiscal stress (Hildreth in Shafritz, 1998, p. 891). Hildreth recognizes that fiscal stress in a local government is

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certainly not as rare as municipal bankruptcy and that many local governments face fiscal stress at some point; however, very few governmental entities have filed for municipal bankruptcy protection as provided by federal law. This may be partly due to the limited number of states that allow their municipalities to file Chapter 9 bankruptcy protection.

I found only a few comprehensive case studies on actual municipal bankruptcies. These include Baldassare (1998), Park (2004), Watson, Handley, and Hassett (2005), and Landry (2007). The findings from these studies are highlighted in Table 2.3 and are discussed below. Other studies on municipal bankruptcy have focused on the legal issues involved, not the financial or economic impact felt by those municipalities. The contributions by legal scholars McConnell and Picker (1993), Lewis (1994), Spiotto (1996), and Freyberg (1997) will also be discussed later in this section.

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Table 2.3
Chronological Summary of Empirical Studies on Municipal Bankruptcies

Author(s)/Date of Publication	Municipal Bankruptcy Cases Studied/Date of Bankruptcy	Relevant Findings and Recommendations
Baldassare, (1998)	Orange County, California (1994)	1. Local governments need to maintain high standards for fiscal oversight and accountability 2. Local elected officials need more financial expertise in order to make sound fiscal policy 3. Municipal bankruptcies should be avoided even if extraordinary efforts are necessary 4. The state government should closely monitor the fiscal conditions of its local governments proactively, rather than reactively 5. Local officials need to be wary of fiscal policies that are popular in the short run but financially disastrous in the long run
Park, (2004)	Bay St. Louis (1977), San Jose School District (1983), Colorado Metropolitan Centre District (1983), Bridgeport (1991) and Orange County (1994)	1. Strengthen the audit powers of the state 2. Incorporate financial trends in municipal financial reporting 3. Require local governments to carry adequate liability insurance 4. Privatize those functions that can be better handled by the private sector 5. Encourage local governments to use insured bonds 6. Prohibit local governments from engaging in speculative investment strategies
Watson, Handley and Hassett, (2005)	Prichard, Alabama, (1999)	Five economic and social forces that contribute to fiscal stress in local governments: 1. Financial mismanagement 2. Declining population 3. Rising Per Capita Costs 4. Structural Changes in Economic Base 5. Natural or Man-Made Disasters

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Table 2.3 (cont.)
Chronological Summary of Empirical Studies on Municipal Bankruptcies

Landry, (2007)	Orange County, California (1994) and Greene County, Alabama (1996)	1. Need for strict investment limitations on municipal management 2. Independent financial audits for all levels of local government should be done on a consistent and timely basis 3. Five-year budget financial plans that forecast revenues and expenditures under different scenarios necessary

Baldassare (1998) conducted a study of the Orange County, California bankruptcy that occurred in 1994. To this date, Orange County is the largest municipality, as well as the first county government, in U.S. history to file for Chapter 9 bankruptcy protection. Baldassare found that research in the previous 20 years had shown fiscal stress in a local government normally to be experienced when a local government had rising public expenditures and declining tax revenues. However, Orange County was different. Its fiscal stress was mainly due to massive financial mismanagement by the county treasurer who had used risky investment tactics on the government's funds and accumulated losses of over $1.6 billion. Not only was Orange County the largest municipality to file for Chapter 9, it was unique in the amount of public funds that were mismanaged and misused. The county government defaulted on over $100 million in bonds after filing the bankruptcy (pp. 7-8).

Baldassare points to three conditions that enabled the bankruptcy to occur in Orange County, California. These include political fragmentation, voter distrust, and state fiscal austerity. Political fragmentation was mainly due to the overlapping

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jurisdictions created by formation of large numbers of suburban regional governments with decentralized services that were costly as well as duplicated in competing jurisdictions in the area. Baldassare posits that local officials were not considering policies that would benefit the jurisdiction, the region or the state. Instead they were focused on their self-interest in the form of offering local benefits which may be at the detriment or costs to their neighboring municipalities.

The second condition considered by Baldassare was voter distrust which essentially points to an attitude that local governments should spend within their means and not raise taxes further. Many citizens, regardless of ideology or political preferences, have the opinion that local elected officials do not pursue the most efficient spending strategies in dealing with budget constraints. The citizens believe that politicians offer to raise taxes as the only option in dealing with rising expenditures. The author makes the point that "Only in rare circumstances can voter distrust be overcome and a local tax increase pass" (p. 22). Thus, local governments are placed in an impossible position: maintain the level of services that the citizenry demands but do so with the current level of taxes and by pursuing other revenue strategies. Baldassare found that Orange County officials noted this overwhelming pressure in dealing with their populace. The officials were compelled to consider risky investment strategies in order to receive more interest revenue to offset the decreases in tax revenues.

The third element, state fiscal austerity, is a condition that resulted from massive federal and state funding cuts to local governments in recent years. Baldassare suggested that local government officials are challenged to find other funding sources in light of

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these reductions as well as economic conditions, both of which are out of their control. Services mandated by both the federal and state government are not fully funded and this places additional pressure on the local officials to find additional resources. In support, the author cites two bills that passed in California: California's Proposition 13 (a referendum to reduce property tax rates on homeowners) and Proposition 218 (limitations on local tax increases). Both left local government officials at a loss for revenues and reduced their budgetary flexibility (pp. 16-32).

Baldassare concluded that many local fiscal stress situations can be avoided if state and local elected officials are willing to draw lessons from the Orange County bankruptcy. These lessons involve holding local officials accountable for their actions and maintaining high standards for fiscal oversight and accountability. In the case of Orange County, the county treasurer's actions were left unchecked by other local government officials as well as state officials. He warns that other governments should take notice and charges other states to implement regulations and structures to ensure that proper financial controls are followed by local government management. Further, the author warns that many local officials are given accounting and financial management positions without the proper financial expertise, especially in dealing with complex investment strategies that are common in municipal finance today. He charges that it is the responsibility of all local elected officials to have a better understanding of financial and accounting regulations, and he calls on experts in the financial and accounting industry to continuously educate and update the officials on best practices in municipal finance. Baldassare also believes that local governments and states should take whatever

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steps necessary to avoid municipal bankruptcy mainly due to the negative stigma that the entity will suffer from future and present creditors and the credit markets as well as those who are considering locating their home or business in the area.

Another suggestion offered involves state monitoring of the fiscal trends of local governments. Baldassare stresses that by being proactive rather than reactive, state monitoring would "... give state leaders an opportunity to discuss fiscal problems and solutions with local officials before they reach the crisis stage" (p. 254). Not only would a monitoring system help avoid bankruptcy filings and the negative publicity, it also gives assurance to those in the credit market and economic development that the state places a priority on their local government's fiscal health and does not wish for their citizenry to suffer due to a fiscal crisis. Lastly, the author suggests that local officials educate their citizenry regarding the finances of the local government especially with regard to debt management and expanding service costs. Voter distrust is a key issue in the citizenry's opposition to raising taxes; however, Baldassare suggests that local officials take whatever steps are necessary to be more transparent in their municipal finances. Those officials should also avoid short-run solutions that will harm or threaten the greater public good in the long-run. These steps would help local officials avoid financial disasters as well as reinstate a greater level of voter trust in political stewardship. The author makes other points concerning areas of interest to California governance; however, they are not relevant to the focus of this study (pp. 240-260).

Park (2004) has also studied municipal bankruptcies and developed a theory as to why municipalities seek Chapter 9 protection. Park states that researchers in this area

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must be aware that not all governments under fiscal stress will necessarily file for bankruptcy. In most cases, either the state does not allow for municipal bankruptcy protection or other remedies are sought and found. He cites the cases of New York, Philadelphia, Washington, D.C. and Miami which were assisted by either the federal or state government or both. However, the author stresses the importance of further research into the systematic causes of municipal bankruptcy to avoid future filings (p. 229).

Park created and tested a multi-dimensional causal model that details the causes of municipal bankruptcy within a local government from three perspectives: short-run and long-run factors, internal and external factors, and political and economic factors. The author focused his study on whether these factors were present in five municipal bankruptcies that were filed by various forms of local government during the period 1977-1994. The municipalities studied were Bay St. Louis, Mississippi (1977), San Jose School District, California (1983), Colorado Metropolitan Centre District, Colorado (1983), Bridgeport, Connecticut (1991) and Orange County, California (1994) (p. 250). In essence, Park concentrated on the factors shown in Figure 2.1.

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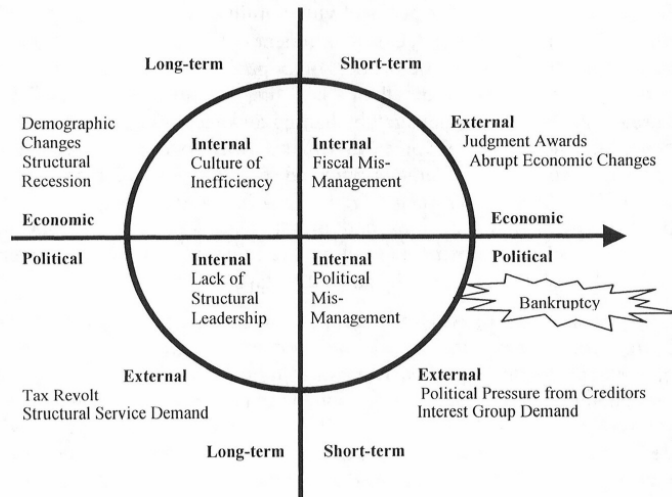
Figure 2.1



Source: Park, Keeok. (2004). To File or Not to File: The Causes of Municipal Bankruptcy in the United States [Electronic Version]. *Journal of Public Budgeting, Accounting and Financial Management, 16(2),* p. 242.

Park (2004) classified those local governments that declare bankruptcy into three groups:

1. Governments that file bankruptcy because they do not see hope for recovery
2. Governments that file bankruptcy because they want to protect their asset base that is threatened by loss of those assets without bankruptcy protection
3. Governments that file bankruptcy as a strategic tool that can be utilized as a bargaining chip in the financial negotiation with creditors, bondholders, etc. (p.243)

He acknowledged that these groups could overlap.

Park's study supported his original theory that municipal bankruptcy can be explained by his hypothesized perspectives. He stated that "… municipal bankruptcy is a

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form of government failure, not just a market failure" (p. 251). Further, Park found that political factors played a heavier role in the financial failure of the governments in the study than the economic factors. In summary, his recommendations to state governments for preventing future municipal bankruptcies include the following:

1. Strengthen the audit powers of the state to ensure that political and economic powers are not abused at the local level. It is ideal to utilize the audits to incorporate financial trends or indicators to assess financial condition of local governments on an ongoing basis
2. Require local governments to carry liability insurance – the numbers of municipal lawsuits involving bodily injury, property damage, personnel judgments are growing
3. Reduce local government's responsibilities – privatize those functions that can be better handled by the private sector
4. Encourage local governments to use insured bonds – this could be done through state-credit guarantee or private bond insurance
5. Prohibit local governments from engaging in speculative investment strategies (pp. 252-254)

Watson, Handley and Hassett (2005) have also studied the causes of financial stress, including the municipal bankruptcy that was filed by Prichard, Alabama in 1999. The authors identified five socio-economic conditions they believe were significant contributors to fiscal stress in local governments. These are financial mismanagement, decline in population, rising per capita costs, structural change in the economic base,

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natural or man-made disasters, and civic distrust. The authors cited financial mismanagement as the most common factor and echoed Martin's (1982) findings that these problems occurred gradually and a lack of strategic planning contributed greatly toward the overall effect. As far as the decline in population, the authors concluded that when a local government faces this scenario, either due to outward migration or loss of industry, the quality of life for the community deteriorates thus making it almost impossible to attract new economic development and maintain adequate levels of public services. Contributing further to the decline in quality of life, the rising per capita costs will also negatively impact the municipality's local finances. The revenue side of the finances is impacted due to a reduction in the taxpayer base; however the demand for services does not normally diminish which contributes to further financial stress on the government's finances. Finally, loss of industry impacts the local economy which also negatively affects the local government's finances. The authors cited the example of Bessemer, Alabama – a booming city in Alabama that relied on the iron and steel industry to contribute to its tax revenue base as well as to provide employment for its citizens.

According to Watson, Handley and Hassett another factor in fiscal distress is natural or man-made disasters. Normally these events are not considered in the financial planning of a municipality. Once a tornado, flood, or hurricane like Hurricane Katrina occurs, many local governments do not have adequate reserves or strategic plans in place to address the devastation. They are not prepared to offset the new financial burdens of replacing infrastructure or assisting their local residents in housing and basic necessities.

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Finally, the authors argue that credibility with the voting public is vital to maintaining fiscal health and averting financial decline (pp. 129-137).

With regard to Prichard's municipal bankruptcy (which will be addressed further in Chapter V), the authors conducted a case study of the events that led to the filing of the bankruptcy. They found that Prichard's local government experienced many of the economic and social factors that they had identified as leading to fiscal distress. Namely, the population decline was nearly 40 percent within a 40 year time frame (1960-2000). This contributed further to the reduction in tax base revenues as well as other revenues such as business license fees due to businesses closing within city limits in response to the population decline. Furthermore, city officials did not acknowledge their reduction in revenues and offsetting increase in per capita expenditures. They were negligible in dealing with the city's finances by using the same fiscal year budget from year-to-year and raising public personnel salaries despite the lack of resources. Watson, Handley and Hassett considered this lack of leadership to be "… a man-made disaster for the ailing community" (p. 148) and infer that Prichard could have avoided municipal bankruptcy if not for the political and managerial impediments experienced by the city (pp. 137-148).

Landry (2007) conducted a comparative analysis of the municipal bankruptcy filings of Orange County, California (1994) and Greene County, Alabama (1996). To date, these two counties are the only U.S. counties to file for Chapter 9 bankruptcy protection. Landry utilized the case study on Orange County conducted by Baldassare and conducted a similar case study on the filing by Greene County, Alabama. Like

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Prichard, the Greene County municipal bankruptcy filing will be studied and discussed further in Chapter V.

Landry found that each government relied on revenue sources that were risky, and those revenues funded a large portion of their governmental operations. In the case of Greene County, the county government relied on the tax proceeds from the GreeneTrack dog-racing entity, and those revenue sources had experienced significant declines in recent years. Orange County's reliance on the revenue source from the investment pool was greater than financially prudent. As Landry puts it:

> Both relied on a type of gambling, albeit one was investment directly by the county, while the other was based on its citizens engaging in gambling behavior to fund vital government operations. The distinction between these is small. The risk associated with each county's method to finance vital operations is beyond even the most liberal notion of fiscal responsibility (p. 16).

Landry concludes that the major factors that led to both bankruptcy filings resulted from lack of leadership and financial mismanagement, especially in planning for the future needs and resources of the county residents.

Landry's research indicated areas of municipal finance reform that might be considered to avoid future filings of municipal bankruptcy in the United States. These include: strict investment limitations on what municipal management can or cannot do in investing public resources, independent financial audits for all levels of local government to be done on a consistent and timely basis, and five-year budget financial plans that

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forecast revenues and expenditures under different scenarios such as cuts in revenue sources or increase in services or both (pp. 16-20).

Municipal bankruptcy theory has also been considered from a legal perspective, and scholars such as McConnell and Picker (1993), Lewis (1994), Spiotto (1996), and Freyberg (1997) have considered the various interactions and involvement of the judicial system and legislative processes with regard to the interpretation of municipal bankruptcy.

McConnell and Picker (1993) found several points of concern in the current municipal bankruptcy legislation. They state: "In most cases, chronic financial difficulty is a sign that ordinary political processes are not functioning properly…to continue past practices may only guarantee continued financial distress in the future" (p. 443). McConnell and Picker compare the fact that private debtors normally relinquish control of their affairs to a trustee as well as endure a close scrutiny of their financial management when undergoing bankruptcy proceedings. Due to constitutional limitations on the federal government, the authors advocate that the role of the trustee should be played by the state in order to assure that the present fiscal problems are noted and removed. They argue for court supervision of the municipal finances, like that found in corporate and private bankruptcy filings, because they believe financial mismanagement by the current political leaders will continue despite the obvious fact that a problem in decision-making and leadership exists. The authors further recommend that courts be allowed to order reductions in wasteful expenditures as a condition for debt relief and that absolute priority should be given to the creditors, in various forms, over the current

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spending needs of the municipality. The authors find a discrepancy in the federal law in that municipalities that file for bankruptcy protection can meet the present insolvency test but are still able to retain extensive and valuable assets despite the admission by the entity that it cannot meet its present or future obligations. Finally, they recommend that the federal government allow states to enact their own respective municipal bankruptcy laws since municipalities are creatures of their respective states (pp. 425-450).

Lewis (1994) like other legal scholars considers municipal bankruptcy to be perceived as "… a conventional symbol of political, managerial or financial failure – and sometimes all three" (p. 4). In her comparative study of those 16 states that authorized municipal bankruptcy for their local governments, Lewis found no homogeneous characteristics among the state governments except low levels of public expenditures and tax burdens. Lewis considered this to be "… a pattern indicative of a preference for economy over competing values in governmental finance" (p. 15). Further, her study revealed that these states for the most part did not require their municipalities to maintain a balanced budget or use Generally Accepted Accounting Principles (GAAP) in their financial reporting. In a comparison of states that authorize and do not authorize municipal bankruptcy, Lewis found the following findings with regard to budget and GAAP requirements as shown in Table 2.4.

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Table 2.4
Comparison of States Budgetary and Financial Reporting Practices

States that Affirmatively Authorize Municipal Bankruptcy (N = 16)	States that Do Not Affirmatively Authorize Municipal Bankruptcy (N = 34)
4 states require a balanced budget in the municipality	13 states require a balanced budget by the municipality (9 at the county level, as well)
5 states require following GAAP in financial reporting	14 states require following GAAP in financial reporting

Source: Lewis, 1994, pp. 14-16

Lewis concluded that municipal bankruptcy has evolved into a more acceptable political tool and that “A passive state position on authorization and on bankruptcy’s conformity with state policies represent agreeing that urban policy should be made in federal court” (p. 21). The author indicated that state legislative agendas should continuously assess the state of their municipal finance policies as well as place heavy consideration on whether it is in the state’s best interest to allow their municipalities to file for bankruptcy protection.

Spiotto (1996) is considered a leading legal scholar in the field of municipal finance and specializes in municipal bankruptcy. He theorized that defaults by local governments occur as a result of either poor economic conditions, incompetent management of the municipality, and/or fraud and dishonesty by the municipal leadership. Other factors that play a part in municipal bankruptcy are taxpayer opposition to increases in taxation, migration in population and industry, urban decline, increasing percentages of municipal budgets committed to personnel costs and benefits, and adverse effects of inflation on municipal service costs (pp. 1096-1099).

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Spiotto asserted that municipal bankruptcy was never intended by Congress to be a "… exclusive remedy for municipal bodies who are unable to meet their current debt obligations" (p. 1102). Rather, it was provided as a protection mechanism against an inordinate number of lawsuits on those municipalities who were unable to meet their financial obligations as a result of the depression in the 1930s. The author suggested that Congress did not intend for states to allow municipal bankruptcy without state oversight or receivership as an alternate relief to the municipalities. He mentions that several states have been successful in preventing a number of municipalities from bankruptcy by giving them the guidance and supervision to work through their financial problems while also giving their creditors assurance that debts will be repaid. His research has shown that these states commonly utilize consultants and advisers to work with the municipalities on financial and budgetary issues or a state-level refinancing authority which gives a state or federal guarantee to refinance debt and pay off the old debt or state receiverships where the municipality's assets are liquidated and available sale proceeds are disbursed to the creditors. Spiotto finds that these approaches offer great advantages in that the blemish of a bankruptcy is avoided by the municipality, the bond market is given some level of assurance that obligations will be honored, and future financing endeavors and costs are not marred by the negativity of a municipal bankruptcy (pp. 1101-1103). He noted that although New York City and Philadelphia endured financial distress, assistance from a higher level of government helped them to create long-term solutions that benefited both the creditor as well as the citizenry. In contrast, Spiotto found Orange County's 1994 bankruptcy to be a failure on the state's part which resulted in negative publicity. He

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agrees with Baldassare's (1998) position that bankruptcy should be avoided at all costs (pp. 1122-1151).

Spiotto called for states to consider their present legislation because municipal bankruptcy may become routine for local governments unless action is taken in the state legislative process. He argued that "… each state must make a decision as to whether or not, and upon what conditions, it will permit any or all of its municipalities to use the provisions of the Federal Bankruptcy Code" (p. 1143). He echoed other legal scholars in calling for states to develop an interim step in the filing process where the state is informed by the municipality or other affected parties that fiscal stress is present and the state should immediately assist the local government. Spiotto mentioned that this could be as simple as review and approval of the bankruptcy petition and a related plan on how the municipality proposes to deal with the fiscal stress. Further, he called on the federal government to amend the municipal bankruptcy legislation "… by means of a federal statute which stayed the effect of litigation against a municipality for six months if the governor of the state approved the request of the municipality for such a stay" (p. 1144). He maintains that this gives the local management time to assess their options under the supervision of the state and inform their citizenry of their present fiscal stress with the help of the state leadership. Spiotto also suggested that any municipal finance reform legislation (restructuring, introduction or otherwise) must consider the massive needs that most municipalities will require when faced with fiscal stress. Some of these needs include accessibility to state funds, such as loans or grants, when faced with deficits or shortfalls, reducing expenditures through the use of long-term planning, assisting in

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negotiation with employees/unions, restructuring of existing debt, and offering easier and quicker access to capital markets through creation of state oversight or financing authority (pp. 1145-1146).

In summary, Spiotto offered the following overall suggestions for both the federal and state governments in dealing with municipal finance reform legislation:

1. Provide a federal statute that gives municipalities protection from crushing litigation where the only viable alternative is to resort to Chapter 9 bankruptcy.
2. Strengthen state and local investment guidelines by employing nationally recognized models such as the Government Finance Officers Association's (GFOA) guidance.
3. Promote financial disclosure to the primary and secondary markets to ensure transparency.
4. States should set up municipal finance assistance commissions to give financially stressed municipalities remedies to their financial woes. Also, a commission should be the approval mechanism for the municipalities to file Chapter 9 protection.
5. State and federal legislation should ensure that municipalities cannot dishonor valid credit obligations issued by the municipality.
6. Filing Chapter 9 should be the last option to all municipalities – discourage it at all costs (pp. 1158-1160).

Freyberg (1997) also did a comparative analysis of how states approached municipal bankruptcy authorization and concluded that "… states have a duty to enact

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statutes regarding the resolution of municipal financial distress, whether or not such states include authorization for filing under federal bankruptcy law" (p. 2). Freyberg found that many factors can create fiscal stress on a municipality and contribute to the municipal bankruptcy. Among these are a national or regional economic recession which may reduce revenues that are available to pay for necessary services along with negligent or fraudulent mismanagement of government funds such as "… incompetent budgeting, imprudent investments, and even misuse of funds for political or personal gain" (p. 9). In addition, the author found that many small municipalities are forced into bankruptcy due to large court judgments either stemming from liability cases or environmental claims (p. 10).

In essence, Freyberg called for the development and adoption of uniform bankruptcy laws across the states. He found several inconsistencies in the present state statutes and made the following recommendations:

1. Some states have comprehensive statutory plans in place – these could serve as models for those states that have either limited or no statutory plans in place.
2. At a minimum, states should require balanced budgets from their municipalities. Freyberg does not claim this will cure all budget deficits; however, it will force the municipalities to plan for the future as well as acknowledge their present cash flow status.
3. Creating a uniform bankruptcy law framework would give guidance on what constitutes fiscal stress for a municipality, what options are available to the municipality from the state government, the financial oversight/authority held by

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the state government, when and how the municipality can file for Chapter 9 bankruptcy, and how to terminate the oversight of the municipality (1994, pp. 11-13).

Freyberg concluded that the development of uniform laws by states would only enhance financial management in the municipalities. This step would give needed assurance to the bond and credit markets that states consider their local government's fiscal health a top priority. The author does not endorse taking Chapter 9 away from municipalities; rather, he believes states should hold the intermediate supervisory role between the municipality and the federal bankruptcy court and should also allow other options in lieu of filing municipal bankruptcy when facing fiscal stress (p. 13).

State Approaches to Fiscal Stress and Municipal Bankruptcy

In response to the Bankruptcy Reform Act of 1994 (where Congress amended Chapter 9 to require specific state authority to file for protection) as well as the growing number of municipalities facing fiscal stress and filing bankruptcy, research by Cahill and James (1992), Berman (1995), Honadle (2003), Honadle and Li (2004), and Kloha, Weissert and Kleine (2005) focused on how the various states approach fiscal stress and bankruptcy for their municipalities. The *Harvard Law Review* (1997) stated that "…responses from states to local urban fiscal crisis have been as diverse as the states themselves, ranging from preventative measures to reactive positions adopted in the face of particular crises" (*Harvard Law Review*, 1997, pp. 733-734).

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Prior to the 1994 amendment of Chapter 9 legislation, Cahill and James (1992) recognized that a gap in the field of research existed on how states were addressing problems of fiscal stress. Their goal was to analyze what methods were in place as well as which methods were successful or unsuccessful in dealing with fiscally stressed municipalities. Their research found that prior to the 1970s, many states dealt with fiscal problems on a case-by-case basis. After the New York City and Cleveland, Ohio financial woes became public, states began to enact legislation that would deal with municipal financial emergencies (p. 90). Cahill and James noted that state-enacted policies and procedures addressed the following areas:

1. Established criteria for determining fiscal distress (i.e., default on debt or failure to meet current obligations)
2. Identified those parties that could instigate action
3. Defined the processes to address fiscal distress (normally plans of action)
4. Named the entity or individual responsible for oversight
5. Defined powers and conditions of the individual, commission, or authority
6. Identified how fiscal stress oversight can be terminated and who has this power (p. 91).

Cahill and James also studied how the states employed their administrative approach to fiscal emergencies, oversight powers, and early warning systems. They found that most states that had either vested responsibility in an existing state agency, normally the governor or a department of community affairs, created a special administrative unit, or created a multi-member authority, commission or board which had

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five or more members. All of the newly created authorities, commissions or boards had an odd number of members in order to avoid voting conflict. The authors found that the statute typically designated those who were eligible for appointment to these authorities or the governor/legislative leadership that would make the term appointments. Further, most legislation stipulated that these bodies needed to be composed of residents who had some experience, expertise or certification in financial management.

The study showed three forms of oversight power were in place in those states that had enacted municipal financial distress legislation. The first type of authority, which the authors labeled "absolute", included state intervention where the administrative authority (either state-agency or legislative-created body) superceded that of the local political authorities. This type of power was only used in the case where the local government failed to adopt or adhere to an agreed-upon financial recovery plan. The second and most common type of power was one where the administrative authority was able to "… establish guidelines and regulations in the financial management area, to monitor adherence to them by local officials, and to take corrective action when necessary" (p. 91). Decisions were still made at the local level; however, state monitoring was in place. The third type of power involved an advisory role to the municipality where the administrative agency or body would offer guidance and suggestions. In this case, the local government was not required to implement those suggestions.

Cahill and James also studied the early warning systems that were in place concerning municipal financial distress. They found that some states had fiscal indicators

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in place that could predict impending fiscal stress in municipal finances in order to avert a financial emergency. The most common type of indicators were those that measured revenue flows and solvency indicators. The authors found that most states did not publish the results from the indicators on a regular basis. Plus, many states did not know which indicators were best for their local governments to use since there was limited guidance from a federal or national organization (pp. 90-92).

In conclusion, Cahill and James noted that many government documents relating to how states address fiscal distress and whether they are successful or not could be considered "fugitive documents" in that

> They (and others like them) done in or for individual state government organizations are difficult to access, due either to a lack of central repository or index, or policies of confidentiality standards in many legislatively based research and analysis offices in state legislatures (p. 88).

The authors noted that further research was necessary to understand the depth of financial stress in municipalities and how states are handling these situations especially so that other states can learn from their mistakes. However, many of these reports are hard to find and inaccessible to the public. This will present a major research challenge.

Berman (1995) studied state interventions of local governments and school districts which Cahill and James (1992) previously labeled as a method of the state using its "absolute power" to intervene in the municipality's affairs. At the time of his study, Berman noted that approximately 50 interventions had taken place with variations in the state-imposed supervision and control. Most interventions that involved municipalities

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were initiated when the state perceived a fiscal crisis was taking place and determined financial stability must be restored. Those interventions that occurred in school districts were either financially-related or tied to other offenses such as improper hiring practices or failure to meet academic standards (pp. 55-56).

Concerning financial distress in municipalities, Berman found two types of approaches employed by the states since the 1930s. The first was direct legislation that addresses local government financial distress on a case-by-case basis. Berman considered this to be a reactive approach by the state government. The second type was legislation that authorized a state agency to monitor the financial trends of all of the state's municipalities and to intervene when those financial indicators point to impending financial problems for the local government. His study showed that the second type of approach was quickly becoming more prevalent in state legislation and resulted in municipalities receiving "… a mixture of aid and regulation" (pp.57-58). He considered this type of legislation to be a proactive approach by the state government and warned that many local governments and citizenry may consider this type of oversight and intervention by the state as conflicting with their local autonomy and collective decision-making at the local level (p. 68).

Berman stated that all states have the legal authority to take over a local government and individual states should make a decision on whether to be reactive or proactive in their legislation towards fiscal stress. He noted that local governments would be more receptive to either approach if the state included various forms of financial aid and technical assistance in restoring the municipality's financial health.

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Berman warned that: "… state intervention appears most useful in dealing with short-term emergency problems" (p. 69). However, intervention has not been shown to help with long-term problems. Additionally, financial woes may visit the municipality again if long-term solutions are not considered during the intervention process, as well.

Honadle (2003) conducted a 50-state telephone survey in 2002 in order to gather research on techniques the various states employed to "… predict, avert, mitigate or prevent the recurrence of local government fiscal crisis in their respective states" (p. 1). The survey consisted of 10 open-ended interview questions and was administered to a member of the National Association of State Auditors, Comptrollers, and Treasurers (NASACT) at the state-level within each state. It was conducted with the intention of creating a framework relating to the roles states take before, during and after a financial crisis is experienced by a local government. Honadle found that states have four potential roles when faced with local government fiscal crisis. Table 2.5 provides the working definition for the roles and a sample of the responses for each state on various approaches to accomplish this role.

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Table 2.5
Honadle (2003) Conceptual Framework on
How States Attend to Fiscal Crisis
Within Local Governments

Role	Working Definition	Sample of Responses How States Accomplish This Role
Predict	States could deliberately or intentionally try to predict local government fiscal crises so they can be prepared to deal with them or at least warn the local government(s) affected	• Audits • Monitoring system • Reporting • Financial analysis
Avert	If state has evidence that a local government is heading for a fiscal crisis, the state could take action to help the local government avoid the catastrophe	• Technical assistance • Advice/Recommendations • Assign management and finance specialists • Financial assistance in forms of grants and loans • Letters, warnings
Mitigate	If a local government experiences a fiscal crisis, the state could take steps to get the local government back on sound financial footing or at least contain the problem	• Technical and management assistance • Loans, funds, grants • Budget approval/monitoring • Oversight or control boards • Bailouts • Make recovery plans
Prevent	After a local government has passed the crisis stage, the state could take action to try to prevent a recurrence of the crisis	• Pass legislation • Continued intense monitoring • Audits • Ongoing technical assistance • Training

Source: Honadle, 2003, pp. 1436-1437; p. 1455

Honadle's survey results showed that "Nineteen states were considered very active (performed all four functions) and another ten states were moderately active (performed at least three of the functions)" (p. 1). She discussed how each state defines local government fiscal crisis as well as the role that the survey respondent indicated their

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respective state played in a local government financial emergency. Table 2.6 provides the summation of Honadle's findings for Alabama as well as the six other states researched in this dissertation.

Table 2.6
Summary of State Official (Individual)
Responses to Honadle Survey

State	How the State Has Played a Role in the Fiscal Crisis of Local Government	How States Define Local Government Fiscal Crisis
Alabama	No state involvement	No definition
Florida	For Miami: The governor's office established an oversight board and the state ran the city for awhile. For Midway: State employees looked at records, procedures, and controls and gave advice (consultation). In both cases, the state got involved after the cities were declared a "financial emergency".	Formal definition in Local Government Financial Emergencies Act as not able to meet financial obligations, deficit fund balances, failure to pay short-term loans for banks or bonded debt, failure to do payroll deductions, failure for one pay period to pay salaries, or payments to former employees due to lack of funds, noncompliance with actuarial conditions required by law (insurance), unreserved or total fund balance or retained earnings deficit for which sufficient resources are not available to cover the deficit for two consecutive years.
Georgia	No response	No response
North Carolina	State gets involved after the localities default or are on verge of defaulting on payments. In a crisis, the state provides technical and management assistance. After a crisis, the state watches the situation more closely.	No definition

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Table 2.6 (cont.)
Summary of State Official (Individual)
Responses to Honadle Survey

Ohio	Called a "fiscal emergency" which is declared by state auditor. Oversight commission of seven members. The city is required to put together a plan for getting out of emergency and the oversight commission approves it. The state provides fiscal supervision and advice to make sure they are doing their financial work correctly. The state also prepares a "90-day accounting report" within 90 days of declaring an emergency as well as performance audits for all local governments in a financial emergency. After certain conditions are met, the state lifts "emergency status" and continues to monitor annual financial reports and audits.	Criteria for "fiscal emergency" for counties, municipalities, townships and school districts include overdue accounts payable from all funds; default on debt for more than 30 days; failure to pay employees for more than 30 days; allocation of taxes to the troubled community from surrounding communities.
Pennsylvania	Usually the state is brought in at the request of the governing body itself. The state provides technical assistance and financial assistance (not a bailout). The state uses loan provisions to deal with creditor and vendor obligations and uses grants to implement recommendations in the recovery plan. After a crisis, the city has a series of exit recommendations to help them avert falling back into fiscal crisis, but there is no enforcement.	Four policy objectives guide the state's definition, including ability of municipality to provide health, safety and welfare of residents; meet creditor obligations; meet debt obligations; and have sound financial management practices. Criteria for fiscal distress are spelled out in state's Municipal Financial Recovery Act.

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Table 2.6 (cont.)
Summary of State Official (Individual)
Responses to Honadle Survey

Tennessee	State comptroller's office has statutory authority. State could allow county to lengthen its debt service (restructure debt). The state could also make a direct loan to a county or guarantee a loan if a county petitions for it. Also technical assistance and the comptroller's office through local auditors; would perform an audit and give assistance and advice. The state would not get involved in trying to prevent a recurrence of fiscal crisis.	Inability to pay debt for capital financing (counties); inability to meet local funding requirements (local school systems)

Source: Author's compilation of Survey Responses in Honadle, 2003, pp. 1443-1469. (Only states in the dissertation comparative analysis are presented here.)

Honadle and Li (2004) analyzed the Honadle (2003) study findings from a different perspective in an attempt to explain the differences between state governments in how they manage fiscal crises in their local governments. Their research expanded the initial study and focused on seven factors. These included differences in fiscal home rule, political culture, proportion of state revenues in local government financing, whether another local government had undergone a financial emergency recently within the state, region, state indicators, and state-administered early warning indicators (pp. 5-6). Using multiple logistic regression analysis, political subculture and proportion of state revenues invested in local governments were found to be statistically significant

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with regard to whether a state reacts in a "very active" manner to a fiscal crisis. In addition, the

> existence of state indicators and state-administered early warning indicators are both strongly positively correlated with states' very active responses; and the existence of state indicators is highly positively correlated with states' at least moderately active responses in dealing with local government fiscal crises (p. 17).

Further, having a previous fiscal crisis was found to be statistically significant in whether a state will be "moderately active" in its approach to financial reform (pp. 13-14).

Honadle and Li concluded that their study results indicated that political culture and the existence of state indicators help explain the activity level a state has taken in response to fiscal crisis in their local governments. They also concluded that states with local governments that experienced fiscal crisis in the recent years tend to get involved, but to a lesser degree than expected. Most states will attempt to address the specific fiscal problems that were experienced by a particular local government. As an example, Honadle and Li pointed to California's enforcement of stronger financial reporting requirements in response to the Orange County bankruptcy.

Honadle and Li also showed that those states that have taken up monitoring the financial trends of local governments via financial indicators will eventually enact the other tasks for averting, mitigating, and preventing the recurrence of financial crisis in their local governments. In concluding, the authors cited Lindblom's (1959) "muddling through" approach to this area of policy making in that most states do not wish to take the

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rational-comprehensive approach but would rather take the incremental approach in addressing their municipal finance reform legislation (pp. 18-22).

Like Honadle (2003), Kloha, Weissert and Kleine (2005) conducted a 50 state survey of state officials during the time period of 2002-2003 utilizing the NASACT database of state officials (also like Honadle). The research focus was to ascertain if financial indicators were being utilized by the states to predict or define local fiscal stress in their local governments. Survey participants were asked if their state used indicators to assess and monitor the fiscal conditions of local units of government. If no system was in place, the participant was queried on whether any discussion or legislation on usage of such indicators had taken place to their knowledge. If the state did use indicators, the participant was asked to describe those indicators and indicate whether they were used as an early warning (proactive) system or only in a fiscal emergency (reactive). Finally, the respondents were asked whether the indicators and their related outcomes were made available to the public (p 239).

The survey results showed that 15 states had an indicator system in place. These states were Alaska, Connecticut, Florida, Illinois, Maryland, Massachusetts, Michigan, Nevada, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania and West Virginia. The number of indicators used by state governments ranged from 30 in Michigan to one indicator in both West Virginia and Alaska. Only 7 of the 15 states employed both proactive and reactive type indicators, and some indicators were more of an accountability measure for citizens to utilize in gauging the performance of public

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officials. Ten states currently not using fiscal indicators were considering or discussing the possibility of implementing financial indicators for their local governments (p. 240).

The fiscal indicators served as an early warning to predict fiscal distress, defined the existence of fiscal distress to allow state legal entry to take action, and/or disclosed information to the public to provide a more transparent government. In their conclusion, the authors noted that while "… oversight of local fiscal behavior is a primary responsibility of the states ….it is not being carried out diligently and effectively in most states" (p. 252). There was a lack of consensus among state governments on which indicators are best to use for their purposes. States were uncertain as to how to summarize the data and determine when a trend should be seen as a "warning" (pp. 252-253).

The authors indicated that "State monitoring of local government with indicators is an issue whose time has come (again)" (p. 253). The limited amount of studies in this area as well as the growing number of municipalities facing fiscal distress and possible municipal bankruptcy warrants further examination of the methodologies used by local and state governments and the legislation that states have enacted in order to address this perplexing problem.

Summary

The importance of addressing fiscal stress and municipal bankruptcies in local governments is increasingly capturing the attention of public finance and administration professionals and organizations. Carmeli (2003) considers fiscal and financial crises of local governments to be a public problem and states "… there are no easy or immediate solutions….Accumulative knowledge is the only way to assure that policymakers will

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address this public problem properly." (p. 1424). Many states have legislation in place to deal with either of these problems; however, other states, such as Alabama, have not enacted any legislation towards this problem and continue to allow their local governments to file for municipal bankruptcy without any intermediary step in place before filing. Local governments are political creatures of the state; thus, the state has a vested interest in maintaining their fiscal health in order to provide for the health, safety and welfare of its citizens. Also, states can not afford the negative publicity of municipal bankruptcies which brandish the states' municipalities as a credit risk, creating further negative impacts for the citizens through higher borrowing costs and lower credit ratings.

The following chapter discusses the history of municipal bankruptcy legislation and related amendments along with a detailed listing of the municipalities that have filed for Chapter 9 bankruptcy protection since 1970.

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CHAPTER III

HISTORY OF MUNICIPAL BANKRUPTCY

This chapter presents a brief history of bankruptcy in the United States, the history of Chapter IX of the Bankruptcy Code and summarizes the legal remedies in place for municipal bankruptcy under the laws of the United States. It also provides a detailed listing of the municipal bankruptcies that have taken place in the United States since 1970.

History of Bankruptcy

Bankruptcy is a condition in which an individual, corporation, or local government experiences financial problems so severe that the entity cannot pay its debts. Liabilities, in many cases, exceed assets severely and the debtor must resort to relief under the judicial system. According to Park (2004, p.230), the earliest mention of the concept of bankruptcy is found in the Bible in the *Book of Deuteronomy* (15:1-2) which states

> At the end of every seven years you must cancel debts. This is how it is to be done: Every creditor shall cancel the loan he has made to his fellow Israelite. He shall not require payment from his fellow Israelite or brother, because the *Lord's* time for canceling debts has been proclaimed.

The term “bankruptcy” is derived from the Italian term “banca rotta” which translates as “broken bench”. The term alludes to the medieval practice of soldiers breaking a

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merchant's bench on which he sold his wares when he did not honor his debts (*Brief History of Bankruptcy in the United States*, n.d.).

In 1787, the framers of the U.S. Constitution gave the legislative branch the power to enact bankruptcy laws through Article I, Section 8. This section established "… an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States…" (U.S. Constitution). James Madison, known as the "Father of the U.S. Constitution", discussed the inclusion of bankruptcy in *The Federalist Papers* which were written to gain support for the proposed Constitution. Madison declared that:

> The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question (Madison, 1788).

When the Constitution was framed, most states had some type of law in place to address bankruptcy or insolvency. These laws varied in their strictness and regulation. Madison and other framers realized that with the expansion of the interstate commerce system, federal legislation was a necessity. Without uniform laws to address bankruptcy, there would be massive problems with regard to financial insolvency in the future (Tabb, 1995, pp. 3-5).

In his historical overview of bankruptcy, Tabb (1995) indicates that the first U.S. bankruptcy law passed in 1800 primarily in response to the Panic of 1797. Tabb indicates that the narrowly-passed legislation heavily favored the English bankruptcy law

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of 1732 which held the premise that "Relief was not for debtors, but from debtors" (p. 3). This legislation was applicable only in commerce trading and allowed for harsh treatment of debtors. Possible punishments included imprisonment or execution of the debtor along with seizure of assets.

The 1800 law was repealed in 1803 as a result of a push to rescind the law by prominent politicians and citizens. The major objection was that the law heavily favored the creditors. Other objections included: those few debtors who were fortunate to gain discharge only had to pay a fraction of their liabilities; travel to the federal courts was extremely arduous; and the agricultural community believed the law was prejudiced toward mercantile interests (pp. 2-6). The states continued to act as the principal watchdog for bankruptcy proceedings from this period until 1841.

In 1841, the next U.S. bankruptcy law was passed in response to another economic depression in the United States, the Panic of 1837. By this time, imprisonment for debt was no longer allowable under federal law and by the end of the 1840s the states would abolish the practice. The 1841 Act was particularly noteworthy because the legislation allowed for voluntary bankruptcy by the debtor. All persons, not just merchants, were allowed to petition for relief under this Act. The 1841 Act is considered the first modern bankruptcy law, however, it was repealed in 1843 after creditors protested against the minimal dividends received from debtors along with the excessive administrative fees to be paid to the court under which the case was administered (pp. 7-8).

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The Bankruptcy Act of 1867 was enacted as a result of the hard times faced by U.S. citizens after the Panic of 1857 and the American Civil War (1861-1865). One of the main factors in the push for federal regulation was that many states were faced with growing problems in dealing with bankruptcy and were severely limited in their recourse. This was because preexisting debts or debts of nonresident creditors could not be discharged by the states in accordance with U.S. Supreme Court rulings that included *Sturges v. Crowninshield* (1819) and *Ogden v. Saunders* (1827). Another factor was that, after the lengthy and costly Civil War, northern creditors felt limited in their recourse against their southern debtors (pp. 6-8).

The 1867 Act was significant in that it allowed corporations to file for relief from creditors. Also, this Act required those filing a bankruptcy petition to take "… an oath of allegiance to the United States …" (p. 8). This legislation also established the federal district courts as "courts of bankruptcy" and allowed for the courts to appoint registers who were to help the district judge in his administration of the bankruptcy cases. These registers would later be referred to as referees in the 1898 Act and bankruptcy judges in the 1973 Act. Like the Acts of 1800 and 1841, the 1867 Act was also short-lived and repealed in 1878.

After 20 years with no legislation, Congress finally addressed the issue and passed The Bankruptcy Act of 1898 which many consider to be the first permanent federal bankruptcy legislation. Economic depressions in the United States including the stock market crash of 1884 and Panic of 1893 again contributed to the push for federal bankruptcy legislation. The Panic of 1893, considered one of the worst economic crises

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in this nation's history, resulted in massive unemployment along with bank and railroad failures. States were again unable to deal with the growing level of bankruptcies. Tabb observes, "Much of the 1898 Act was directed not at debtor relief, but rather at facilitating the equitable and efficient administration and distribution of the debtor's property to creditors" (p. 11). As such, the 1898 Act created a procedural process for bankruptcy proceedings and gave the U.S. Supreme Court the control to prescribe procedural rules and remedies. The Act was brought to the floor of Congress for repeal in 1902, 1903, 1909 and 1910. Even in the face of opposition, this legislation remained in place but was modified with several amendments throughout the years (Tabb, 1995, pp. 1-14). One of those amendments, the Municipal Bankruptcy Act (49 Stat 798) was passed May 24, 1934 and was the first legislation to address municipal bankruptcy (Lehmann, 1950, p. 241). The Bankruptcy Reform Act of 1978 finally replaced the 1898 legislation. The following paragraphs discuss the municipal bankruptcy legislation.

History of Municipal Bankruptcy

In the early 1800s, municipalities first turned to debt financing, normally in the form of municipal bonds, in order to secure funding for their localities. Municipal bonds are debt obligations issued by states, counties, cities, and other governmental entities to raise funds to finance projects such as schools and roadways. Bonds are categorized as either general obligation bonds (issued with the backing of the "full faith and credit" of the government entity) or revenue bonds (issued with the proceeds of the project, such as a toll bridge, to provide repayment to the bondholders). General obligation bonds were

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the principal debt instruments utilized by municipalities until the late 1930s and early 1940s when usage of special revenue bonds also became popular (Lehmann, 1950, p. 249). Other types of bonds such as moral obligation bonds (bonds backed with a moral, not legal, obligation of the governmental entity along with a debt service reserve requirement) and industrial development bonds (revenue bonds issued by a municipality to purchase land and build facilities in order to stimulate economic development) became popular in the 1970s (Dye & MacManus, 2003, pp. 584-585).

Hillhouse (1936) notes that the exact date of the first municipal bond issuance is unknown; New York City is believed to be the first municipality to issue a bond security in 1812 (p. 31). Most of the early municipal bond issuances were related to railroads since municipalities were pushing for transportation systems in their area (Hillhouse, 1936, p. 34).

In 1839, Mobile, Alabama was the first municipality to default on a municipal bond (Hillhouse, 1936; ACIR, 1973, Spiotto, 1995). The principal amount of the bond was $513,000 (Spiotto, 1995, p. 3). The cities of San Francisco, Philadelphia, Detroit and Chicago also experienced defaults in the 1850s and 1860s as a result of bank failures (Hillhouse, 1936; ACIR, 1973, p. 9). Hillhouse (1936) studied municipal defaults from 1830-1936 and according to him, the "... defaults were almost continuous in good times and bad….only in major depression did the volume swell to anything like dangerous proportions" (p. 38). Cohen (1989) also studied municipal defaults and found that the worst rates of municipal defaults were during four major depression periods in the United States (1837-43; 1873-79; 1893-99; and 1929-37).

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Prior to 1934, the only congressional legislation concerning municipalities was part of the Bankruptcy Amendments of 1910. This particular legislation was not intended to introduce a legal procedure for the municipalities to follow when facing financial woes. Rather, the purpose of the legislation was to expressly exclude municipalities from seeking relief under the Bankruptcy Act of 1898.

Municipalities borrowed heavily during the early 1900s as economic development and prosperity were enjoyed by most communities in the nation. Financing was needed by both the states and localities to keep up with roadway, railway and public improvement needs (Hillhouse, 1936; Lehmann, 1950; Cohen, 1989). If a municipality defaulted, 100 percent of the creditors had to agree to adjust and refund the debt. Bondholders held the right to mandamus (command) the municipality to levy additional taxes in order to receive enough revenues to repay the debt. States were unable to pass legislation that would remedy this situation. According to the U.S. Supreme Court case of *Sturges v. Crowninshield* (1819), this would have been in violation of Article I, Section 10 of the U.S. Constitution, concerning impairment of the obligation of contracts. (Lehmann, pp. 241-242).

In the late 1920s and early 1930s, many municipalities suffered shrinking revenues primarily from the increasing rates of tax delinquency along with decreasing property values. In addition to the loss of revenues, there was an increase in demand for public services due to massive unemployment. Hillhouse (1936) researched the number of defaults from 1932 to 1936 and found the number of defaults depicted in Table 3.1.

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Table 3.1
Growth of Municipal Bond Defaults
As Compiled by *The Bond Buyer*
1932 – 1936

Date	Number of Defaults
November, 1932	678
October, 1933	1493
March, 1934	2049
January, 1935	2716
November, 1935	3251
January, 1936	3159

Source: Hillhouse, 1936, p. 19.

Hillhouse points out that Florida, North Carolina, Texas, Tennessee, New Jersey, New York, Michigan, Massachusetts, and Illinois all experienced the greatest number of municipal bond defaults (p. 18). Alabama, Mississippi, and Oklahoma were also in serious default situations during the same period (p. 27). Further, not one single state escaped the Great Depression without at least one default (p. 24). Southern states were hit especially hard and it was reported that "… defaults cover Dixie like the dew" (Hillhouse, 1936, p. 43).

There was immense public pressure on Congress to enact legislation that would assist municipalities in debt adjustment and help them avoid lawsuits by the bondholders (Lehmann, 1950, p. 241-242). The Sumners-Wilcox Act of 1934 (commonly referred to as the Municipal Bankruptcy Act) passed in May 1934 and immediately became Chapter IX of the Bankruptcy Act of 1898. Although this legislation was intended to provide significant aid to municipalities, it was intended for only a limited period of time and was set to expire on January 1, 1940 (Hillhouse, 1936; Lehmann, 1950; Hempel, 1973).

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According to Lehmann (1950), the 1934 legislation was supposed to "… take from minority creditors of a defaulting municipality or other local governmental unit their power to obstruct orderly debt readjustment" (p. 242). Thus, the legislation gave a willing municipality the right to file a petition of bankruptcy in federal district court. If the entity was insolvent and unable to meet its obligations, the municipality could submit a petition and plan of readjustment which was agreed upon by 51 percent of the bondholders. This could be reduced to 30 percent in the case of drainage, irrigation, reclamation, or levee districts. If state law provided for written approval for the municipality, this also had to accompany the plan. Upon the approval of the petition by the court, all lawsuits and mandamus proceedings would be stayed (pp. 242-244).

During the period of 1934 to 1936, 89 petitions were filed and most of those were still pending under the original Chapter IX legislation when the U.S. Supreme Court declared the legislation unconstitutional in May 1936. The case, *Ashton v. Cameron Water Improvement District No. 1.* (1936), was a 5 to 4 decision by the high court that the bankruptcy legislation was in interference with state sovereignty as granted to the states through the 10th Amendment to the Constitution (Ashton, 1936). The majority ruled that the legislation violated federalism in that the fiscal affairs of the municipality were the responsibility of the State and further "… the Act authorized the States to impair through their own laws the obligations of existing contracts" (Lehmann, 1950, p. 245). The minority of the justices argued that the Act was not unconstitutional since the bankruptcy filing was voluntary and the "… safeguards to state sovereignty were provided in the statute" (p. 245).

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With local government defaults still occurring at a high rate, Congress quickly enacted a revised Municipal Bankruptcy Act in 1937. An important change in the new Act was the inclusion of a composition feature. A composition is an agreement between an insolvent debtor and its creditors whereby creditors, for the sake of immediate payment, agree to accept a payment less than the whole amount of their claims, to be distributed pro rata, in discharge of the whole debt (Municipal Bankruptcy, 1976, p. 1898). This feature was added in order to show that the legislation was voluntary. As a result, it could be considered constitutional and not in violation of state's sovereignty.

Another new requirement was that 51 percent of all creditors, instead of the previous 30 percent requirement, had to accept the composition as filed with the petition for financial relief in the court. This requirement ensured that those creditors in acceptance of the plan were in the majority, rather than the minority. The 1937 Act also differed from the 1934 legislation in that it excluded the county governments from the list of eligible units. The Supreme Court upheld this new Act in April 1938 in the case, *United States vs. Berkins, et. al.* (1938). It found that the Act had been amended to include voluntary filings along with state permission requirements (Lehmann, 1950; Spitz, 1993). It should be noted that Lehmann believes that the Court finding in this case resulted from new justices in the Court who joined with the previous minority on the *Ashton* case (p. 248).

On June 28, 1940, Congress amended the Act to allow for the inclusion of county governments along with a requirement to "… examine all contracts or agreements with fiscal agents or attorneys promoting compositions under the Act to determine whether the

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Agent was being paid by both the petitioner and creditor" (Lehmann, 1950, p. 249). The amendment also extended the date of original retirement on the Act from June 30, 1940 to June 30, 1942. Later, the Act was extended another four years to June 30, 1946 (Lehmann, 1950; Hempel, 1973; Spitz, 1993).

In 1942, another U.S. Supreme Court case, *Faitoute Iron and Steel Company v. City of Asbury Park* (1942), challenged whether the Chapter IX legislation was in violation of the state sovereignty provided for in the U.S. Constitution. In this case, New Jersey had enacted laws in 1933 (N.J. Rev. Stat. §§52:27-34) that allowed municipalities to postpone liability maturity dates and reduce interest rates on municipal obligations if 85 percent of the creditors were in agreement. A dissenting group of creditors challenged this state legislation on the basis that the New Jersey laws impaired the contract obligations of creditors. The U.S. Supreme Court affirmed the lower court's dismissal of the suit. The court found the New Jersey law in accordance with the Constitution and indicated that impairing an obligation normally meant refusing to pay the debt at all. It did not include making alternative provisions, such as reducing payments and lengthening the repayment period, to honor the obligation (Lehmann, 1950; Municipal Bankruptcy, 1976; Spitz, 1993). Lehmann (1950) observed that the court's opinion showed "… the existence of the Municipal Bankruptcy Act did not render invalid state legislation concerning insolvent municipalities where….the federal act depends on its reserving to the state full freedom of action" (p. 252).

Congress made the 1937 Act permanent in 1946 along with several other amendments to this legislation. In response to the *Faitoute Iron and Steel Company v.*

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City of Asbury Park (1942) U.S. Supreme Court case ruling, "…Congress disagreed….with the clear intent of overruling the *Asbury Park* decision, added the proviso to chapter IX prohibiting state laws prescribing method[s] of composition of municipal indebtedness that bind nonconsenting creditors" (Municipal Bankruptcy, 1976, p. 1898). Also, revenue bonds which were new to the municipal financing market in the late 1930s and early 1940s were added to the Act. Further, the language in the Act was broadened to include authorities as eligible governments (Lehmann, 1950; Hempel, 1973; Municipal Bankruptcy, 1976, Spitz, 1993).

Between 1946 and 1976, Chapter IX legislation was virtually unchanged by Congress. In 1970, Congress established a commission to study the bankruptcy laws of the United States in response to the bankruptcy filing of Penn Central, the largest railroad in the United States, and the federal financial intervention afforded to the bankrupt Lockheed Corporation (Advisory Commission on Intergovernmental Relations (ACIR), 1973, p. 1). At that time, the Advisory Commission on Intergovernmental Relations was also studying the effects of financial emergencies in local governments and, in 1973, presented its recommendations on necessary changes for the Municipal Bankruptcy Act to the Commission on Bankruptcy Laws (established by Congress in 1970). Due to the limited usage of Chapter IX since the 1950s, the Commission expressed little interest in revision of Chapter IX (ACIR, 1985, p. 37).

The New York City financial crisis of 1975 brought about an awareness of needed changes in Chapter IX. At that time, "… the principal concern of Congress was the adverse effects of a New York City default on national credit markets" (ACIR, 1985, p.

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38). Further, the present law still specified that 51 percent of the creditors must approve the composition plan prior to filing the bankruptcy petition. This provision was impractical when dealing with a large government such as New York since a large portion of bondholders held bearer bonds (bonds with no registered owners that are traded in the markets on a regular basis). Congress amended Chapter IX in 1976 to:

> permit such filings, without approval of any creditors, provided the government had negotiated in good faith with its creditors and had been unable to get approval of 51%; had determined negotiation was impracticable; or had a reasonable fear that a creditor would attempt to obtain preference for a claim while negotiations were taking place (ACIR, 1985, p. 38).

The 1985 ACIR report cited two other significant amendments made to the Chapter IX law in 1976. The first was when the municipality filed for bankruptcy protection, and the filing "… stays commencement or continuation of all proceedings by creditors to enforce claims and, in effect, transfers those actions….to the federal bankruptcy court" (p. 38). The local government was allowed to continue operations and incur and discharge any new debts, even in the midst of a bankruptcy proceeding. The second amendment related to labor contracts and the local government was given the power to reject any executory contracts (ACIR, 1985; Spitz, 1993).

On November 6, 1978, President Jimmy Carter signed into law the Bankruptcy Reform Act of 1978, which took effect on October 1, 1979 (Tabb, 1995, p. 21). Chapter IX legislation and its related amendments were made part of the 1978 Bankruptcy Code which replaced the Bankruptcy Act of 1898. Also, Chapter IX became known as Chapter

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9 because the 1978 legislation labeled the bankruptcy chapters with Arabic numerals in lieu of Roman numerals utilized in the 1898 Bankruptcy Act.

In 1988, the National League of Cities (NLC), the Government Finance Officers Association (GFOA), and the National Association of Bond Lawyers (NABL) promoted changes to the Chapter 9 legislation which were called "The Municipal Bankruptcy Amendments" (Spiotto, 1995, p. 1141). These changes were necessary since the wording of the 1978 legislation appeared to invalidate contracts with bondholders when an entity became fiscally stressed. Under the 1978 legislation, a ruling could be made to divert special revenues from a municipal entity (e.g., a utility) that were dedicated to the payment of debt service to other municipal uses (e.g., the payment of salaries). The 1988 amendments not only protected bondholder rights, they ensured that "… general failure to pay debts is the criterion for municipal insolvency and eligibility for filing" (Spiotto, 1995, p. 1141).

In 1991, Bridgeport, Connecticut became the largest city to file for bankruptcy protection. The State of Connecticut objected to the filing on the grounds of lack of specific authorization by the state to seek Chapter 9 protection. Although Bridgeport's case was dismissed due to the city not meeting the insolvency requirements, pressure was placed on Congress to enact a requirement for states to specifically authorize their municipalities to receive debt relief under Chapter 9. As part of the Bankruptcy Reform Act of 1994, Congress amended Chapter 9 to require specific state authority in order to file. Prior to that amendment, the legislation was construed as "general authorization" under state law (Park, 2004, pp. 233-234).

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Current Municipal Bankruptcy Law

The primary purpose of Chapter 9 (Adjustment of Debts of a Municipality of the Bankruptcy Code - Title 11 U.S.C.) is to provide protection for a municipality to adjust its debts when the municipality becomes fiscally distressed. The law provides that the municipality may continue operating while it adjusts or refinances its creditor claims with minimum loss to creditors. Like farmers and charitable corporations, a municipality is not subject to an involuntary filing. Due to the voluntary filing status as well as the state permission clause which is discussed in more detail below, the Act does not violate state sovereignty as found by the U.S. Supreme Court in *United States vs. Berkins, et al.*.

Under current law, U.S.C. Title 11, Chapter 1, Section 109 (found in Appendix I), municipalities are allowed to file for bankruptcy protection if they satisfy the five statutory requirements discussed below.

1. <u>Qualification as a Municipality</u>. Municipality, as defined in the code, is "… a political subdivision or public agency or instrumentality of a state" (U.S. Bankruptcy, 1998, p. 2). This definition includes cities, counties, political subdivisions, airport authorities, irrigation districts, other special taxing districts, and certain hospital or education authorities (Laughlin, 2005, p. 38). However, it does not include a sovereign state in the United States. As a result, a state such as Alabama could not file for bankruptcy protection of any kind under the current federal law.
2. <u>State Authorization to File for Bankruptcy</u>. State law must give "specific, written authority for a municipality to file for bankruptcy protection" (U.S. Bankruptcy,

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1998, p. 2). This requirement was changed in the Bankruptcy Reform Act of 1994 which changed the requirement of "general authorization" to "specific authorization" from a state in order to be eligible to file for municipal bankruptcy. Thus, the State must enact legislation for a municipality to file Chapter 9 under their jurisdiction. There is a fairly even mix of states that have passed the legislation compared to those that have not (as shown in Table 1.4 of Chapter I).

3. Insolvency. This requirement is demonstrated when the municipality is "… generally not paying its debts as they become due (unless the debts are in dispute) or the municipality is unable to pay its debts as they become due" (Laughlin, 2005, p. 40). While the first requirement is based on whether the entity has been paying its bills on time, the second is more of a future cash flow examination on whether the municipality will be able to pay its debts in the future. Insolvency has come under heavy scrutiny in the judicial system. The Chapter 9 filing of Bridgeport, Connecticut was denied in 1991 because the courts found that although the city was facing a financial hardship showing a deficit in their operating budget as well as having to cut services, the municipality did not meet the insolvency requirement because it was still paying or was still able to pay its debts. The requirement has also been debated from a political perspective. In the case of the Town of Westlake, Texas in 1997, the municipality filed for Chapter 9 but the Court ruled that the town did not meet the insolvency requirement. Although the town had available funds to pay its liabilities, there was an ongoing dispute between the town's political leaders as to who had the authorization to sign the checks to pay the municipality's bills as they

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came due. Thus, the issue was a political conflict rather than a financial impediment (Laughlin, 2005, p. 42). These instances illustrate that a municipality may not utilize Chapter 9 as a political tool or under false pretenses. Rather, the court has the power to consider the entity's finances from a variety of perspectives to ensure insolvency relief is warranted.

4. Desire to Effect a Plan. A for-profit entity filing for Chapter 11 bankruptcy typically does so in order to reorganize and restructure debt. Normally, a business is allowed to continue to operate while it is in Chapter 11 although it does so under the supervision of the Bankruptcy Court and its appointees. There is a similar provision for Chapter 9 filers, but there is no trustee appointed from the court or any court supervision. This would be in violation of the 10th Amendment to the Constitution. The municipal debtor is in control of the plan and can modify the terms of the existing debt instruments under the provisions of Chapter 9.

5. Negotiations with Creditors**.** In order to file for Chapter 9, a municipality must bargain with its creditors over their claims. According to Laughlin,

> this is an extension of the good faith requirement and is present because bondholders fear that municipalities may file capriciously ....Courts have read this section in conjunction with the requirement of a desire to effect a plan to conclude that the negotiations with creditors must actually work towards a plan for adjustment of debts (Laughlin, 2005, p. 41).

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There are four options for municipalities under this requirement. Each is explained below:

- Agreement of Creditors. A majority of the claims in each class of creditors and the municipality must come to an agreement.
- Cramdown Provisions. If the municipality has made an attempt in good faith to negotiate and cannot receive consent from the creditors to the proposed plan, the cramdown is allowable. Cramdown is defined as the court's enforcement of the reorganization plan despite the objection of some of the creditors. A discussion of the plan between the municipality and the bondholders must be attempted. Typically, the courts do not look favorably on a forced plan where the creditors are not given options.
- Impracticable Negotiation. If negotiation is infeasible due to too many creditors or if a delay in filing would be problematic, the municipality may still file for protection. Such was the case with the Castle Rock Metropolitan District in Colorado with regard its Chapter 9 filing in 1990. The district had four classes of bondholders -- three of which were institutional bondholders and the municipality only negotiated with those bondholders in lieu of all of the bondholder classes. The court found that the municipality met this requirement "… because negotiation with the numerous individual bondholders would have been impracticable" (Laughlin, 2005, p. 43).
- Aggressive Creditor. This is a situation in which the municipality does not believe it can negotiate with its creditors due to a class of creditors or a single

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creditor wanting preferential treatment. Thus, the municipality is allowed under Chapter 9 to file the petition and negotiate their claims at a later date (Laughlin, 2005, p. 43).

Once a municipality satisfies one of the aforementioned options and files the petition in court, an automatic stay goes into effect. This would stop all attempts from creditors to collect their debts. At this stage, creditors are unable to attach claims to either representatives of the municipality or any taxpayers of the municipality (Laughlin, 2005, p. 42). Also, despite the automatic stay, Chapter 9 allows the municipality to choose either to continue or discontinue making payments to bondholders if their bond was from a special revenue bond. A special revenue bond creates a situation where the debt financing is secured through future income of the special entity of the municipality and user charges were pledged as repayment of the financing (e.g., revenues collected from a toll bridge or a water-works board). A special provision of Chapter 9 requires that the operating expenses of the special entity must be deducted first from the revenues and then the bond payments must be made.

After the petition has been filed with the court, motions to dismiss the case are heard. The court can dismiss the case if it finds a lack of good faith or if any of the statutory requirements were not met. For example, a petition from the Etowah Solid Waste Authority discussed in Chapter V was dismissed because the municipality did not have the legal authority to file a Chapter 9 case (*Etowah Solid Waste Disposal Authority*). If the court does not find reasons to dismiss, the municipality would then be required to provide the court with a list of the municipality's 20 largest unsecured creditors. It would

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also be required to post notice of the Chapter 9 proceedings in the regional newspaper at least once a week for a three-week period. Chapter 9 provisions also require an announcement of the proceedings in a financial newspaper that the court designates. This is done to notify the bond dealers and bondholders of the municipality (Park, 2005, p. 238).

A plan for adjustment of debts is normally filed with the courts at the time of the Chapter 9 petition for the bankruptcy. Contrary to other bankruptcy plans such as Chapter 11, only the municipality may file a plan that incorporates classification of claims, treatment of claims, and a disclosure statement within the plan. The disclosure statement which must be approved by the court, basically contains information that allows a typical creditor of the municipality to make an informed decision when considering whether to accept the plan for adjustment of debts presented by the municipality. The disclosure statement which is distributed to all creditors must also include details on the administrative expenses that pertain to the bankruptcy filing, current and future revenue sources of the entity, the outstanding debt of the municipality, cost reduction efforts, and socio-economic factors that led to the financial stress of the municipality. Chapter 9 provisions also mandate that the plan must meet the "Best Interests Test" for the creditors. At the time of the filing of the plan, the plan must provide for payments under the plan to be "... better than the alternative, that is, creditors racing to the court for payment from what small amount of funds is available" (Laughlin, 2005, p. 47). This may involve extension of the maturity date of the liability as well as a change in the interest rate of the debt (Laughlin, 2005, p. 47).

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After the plan and disclosure statement is filed, a period of at least 25 days must pass before a hearing is held. The purpose of the hearing will be to determine whether to accept the plan as presented by the municipality to the court. If the plan is accepted by the debtors and confirmed by the court, the municipality will receive a discharge from its debts and must follow the plan in repayment and reorganization of its liabilities. It is noteworthy that the municipality may not receive a discharge from those debts that were specifically excluded in the plan as well as those debts owed to creditors who had no actual knowledge of the Chapter 9 proceedings. The case is normally closed once the plan has been executed. This closure typically indicates that assets have been conveyed as promised under the plan.

Filings to Date

No master list of municipal bankruptcies was found, so the number of municipal bankruptcies was compiled using available data from literature found in various research sources including the ACIR (1973; 1985), Hempel (1973), Spiotto (1994), Stowe (2002), U.S. Bankruptcy Court Statistics Table F-2 (1990-2005) and Public Access to Court Records (PACER) (1990-2005). The compilation of this bankruptcy data is summarized in Table 3.2.

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Table 3.2
Municipal Bankruptcy Filings, 1938-2005

Period	Number of Municipal Bankruptcies	Average Number of Filings Per Year
1938 – 1939	106	53.0
1940 – 1949	215	21.5
1950 – 1959	31	3.1
1960 – 1969	8	0.8
1970 – 1979	7	0.7
1980 – 1989	43	4.3
1990 – 1999	109	10.9
2000 – 2005	50	8.3
Total	569	8.4

Source: Author's Compilation of Statistics

The municipal bankruptcy petitions identified by this author are categorized in Table 3.3 by the type of municipality filing the petition. Only the filings between 1960 and 2005 are included because this was the only period for which comparably recorded data could be found.

Table 3.3
Classification of Municipal Bankruptcies, 1960-2005

Type of Municipality	Total Number of Filings
County	2
Cities and Towns	32
School Districts	4
Hospital/Healthcare Districts	25
Utility Districts	116
Other	38
Total	217

Source: Author's Compilation of Statistics

Approximately 65 percent of the municipal bankruptcy filings that occurred between 1960 and 2005 were filed by public hospital/healthcare and utility districts. Special districts such as these were created in part to circumvent state constitutional

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limitations on local government borrowing and debt. Many of the hospital/healthcare district bankruptcies were filed in California, Idaho, Louisiana and New Jersey. Stowe (2002) found that a great number of these districts experienced fiscal stress due to decline in rural population, decrease in reimbursement rates by federal health insurance programs, and rising costs for medical personnel and equipment (2002, p. 33).

Regarding the utility districts, Texas, Nebraska, Colorado and Nevada all experienced a large number of bankruptcies. All of these states allow a private entity to set up a special purpose district and gives them the power to levy taxes. Many of these special-purpose districts were established by real estate developers who issued bonds to fund the infrastructure, such as sewer and water, for the development. It was assumed that the bonds would be paid by future property (home) owners through real estate taxes; however, many of these developments had problems from the start. The real estate recession, mandated federal and state environmental treatments for water and sewer systems, and the lack of population to pay the necessary taxes to service the debt all brought severe fiscal stress to these special district governments (Spiotto, 1995, p. 1150; Beckett, 1995, p. 255; Stowe, 2002, pp. 30-32).

For the period 1960 to 2005, the remaining 35 percent (76 filings) were identified as a mixture of local governments. Of these filings, two were filed by county level governments, Orange County, California in 1994 and Greene County, Alabama in 1996. In addition, 32 cities and towns, 4 school districts, and 38 other special authority governments filed for Chapter 9 protection during this period. Of the total filings from 1990 to 2004, shown in Table 1.3, Alabama and Missouri both ranked fourth in total

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filings having nine filings each. Illinois and Oklahoma both had five filings and ranked sixth in total filings.

I identified the municipal filings from 1970 – 2005 utilizing the aforementioned sources and have provided the listing in Appendix II. As was the case with the classification of municipalities, the 1970-2005 filings are the only period for which comparably recorded data could be found. It is relevant to note that 37 of the 209 cases occurring during this time period could not be located within the current U.S. bankruptcy court database (PACER). Lawless and Warren (2005, p. 747) conducted a like-study of business bankruptcy filings using PACER records and the U.S. Bankruptcy Court Statistics and also found discrepancies in the number of filings reported between the two databases. This may be attributable to the implementation of PACER in the various court districts at different time periods from the late 1980s to the 1990s across the United States. Phone calls were made to the six bankruptcy clerks in the bankruptcy districts of Alabama to verify the nine municipal bankruptcies listed in Alabama since this is the specific focus of this research. I relied on PACER to list the available court cases and the U.S. Bankruptcy Court statistics for the other states throughout the nation.

Summary

While rare, municipal bankruptcy filing rates are beginning to escalate nationwide as shown in Table 3.2. Nine municipal bankruptcies have been filed in Alabama since 1990 and were filed by all types of municipalities (county, city, town, utility district, and special authority). Alabama law allows municipalities to file for Chapter 9 protection without further procedures or steps of notification at the state government level. There

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seems to be no indication that Alabama state government officials have considered any of the reform methods suggested by the ACIR in 1973 and 1985.

In light of the increase in bankruptcy filings experienced by Alabama municipalities during the 1990–2004 period, I studied the reform methods enacted by other states to include approval, intervention, prohibits filings, and no statutes. I conducted case studies of the Alabama Chapter 9 filings comparing the various filings to determine if any of these are similar to those financial emergency situations experienced by other states. Also, interviews of political and administrative officials in the City of Millport, Greene County, and City of Prichard were conducted to gain a better understanding of how the municipal bankruptcy affected the respective entities.

The findings of this study contribute significantly to the knowledge base of the public finance field in learning more about financial distress situations. Further, it will serve as a basis to encourage possible reforms for states that do not currently have municipal finance reforms in place. Chapter IV discusses the methodology utilized in the development of the case study and outlines the data collection procedures.

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CHAPTER IV

METHODOLOGY AND APPROACH

This chapter discusses the methods used to collect data on the nine municipal bankruptcy filings of Alabama and the comparative analysis of municipal finance reforms from other states and the Alabama State Department of Education (SDE). The SDE is a state agency that reviews and approves the annual operating budget and financial reports of the local boards of education in Alabama and has the statutory power, as provided in Alabama Acts 95-313 and 2006-196, to intervene in the management of the local government's finances when certain conditions are present. An analysis of the SDE policies and procedures is discussed in Chapter VII. The units of analysis, method of sample selection, and the interview questionnaires used are indicated. The method of analysis is discussed and details regarding the characteristics of the sample are also provided.

Background and Significance

This research investigated the bankruptcy information on the nine Alabama municipalities that filed for Chapter 9 bankruptcy protection during the period 1990 through 2004 (see Table 1.2). These local governments represent a variety of municipal structures covered by Chapter 9 – cities, towns, one county, and authorities. Under the

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purview of the Alabama State Department of Education (SDE), no Alabama local board of education has filed for bankruptcy. In 1995, the SDE implemented financial policies and procedures for the local boards of education. At the time of this writing, this is the only municipal finance oversight or reform in place in Alabama.

As indicated earlier in Chapter III, History of Municipal Bankruptcy, states must explicitly authorize municipal bankruptcy filings, and they can establish the procedures that must be followed prior to and following the filing. A search was conducted of all 50 state statutes and state constitutions for information related to bankruptcy filings. The purpose of this search is to identify states that allowed filings and also to identify the procedures used to deal with to fiscal stress. Some states have enacted straight-forward legislation without the requirement for additional procedures. Other states have enacted additional steps or intervention reforms as suggested by the 1973 ACIR Report. States in this later group require their municipalities to follow certain protocols. This could include consent by the governor, establishment of a financial emergency board, a local resolution to authorize filing, or designating a specific commission within the state administrative structure to oversee the financial intervention of the municipality. The different approaches taken by the various states were listed in Table 1.4. A listing of all state statutes specifically relating to municipal bankruptcy is shown in Appendix III.

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Alabama's statute, AL Code §11-81-3, allows municipalities to file for Chapter 9 protection without further procedures or steps of notification at the state government level. The legislation reads:

> Without limiting the generality of any of the foregoing powers, it is expressly declared that the governing body shall have the power to take all steps and proceedings contemplated or permitted by any act of the Congress of the United States relating to the readjustment of municipal indebtedness, and the State of Alabama hereby gives its assent thereto and hereby authorizes each county, city or town, or municipal authority organized under Article 9, Chapter 47 of this title in the state to proceed under the provisions of the acts for the readjustment of its debts.

The research design developed for this study is based on specific research questions drawn from the literature as well as specific case studies. The following questions guided this study:

1. What were the specific factors that led to the nine municipal bankruptcies in Alabama during 1990–2004?
2. How did the respective filings affect the financial health of specific local governments as well as the state of Alabama?
3. What methods do other states employ in addressing municipal finance in the area of fiscal distress and municipal bankruptcy?
4. What methods does the Alabama State Department of Education employ in addressing fiscal stress for the local boards of education in Alabama?

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Research Design

There were three major elements in this research design. First, I conducted case studies regarding the nine Alabama municipal bankruptcies. Secondly, I performed a comparative analysis relating to how other states address both fiscal stress and municipal bankruptcy in their municipalities. Finally, I considered existing legislation in Alabama that is used by the SDE in addressing fiscal stress in the local boards of education in Alabama. Each phase of this research utilized common research techniques of documentary analysis and interviews of public officials.

Case Studies of Recent Alabama Bankruptcies

This qualitative analysis is based on multiple case studies of the nine municipal bankruptcies that occurred in Alabama from 1990 to 2004. George and Bennett (2004) define the case study approach as "… the detailed examination of an aspect of a historical episode to develop or test historical explanations that may be generalizable to other events" (p. 5). Yin (2003) states that the case study is the preferable method of research when examining present-day events and would normally include direct observation of events as well as interviews of those involved in the events (pp. 7-8). Patton (1990) finds the case study approach quite beneficial when the researcher needs to understand a particular problem or phenomenon in-depth and related information is available to the researcher (p. 54).

Yin (2003) states there are six sources of evidence when conducting a case study. These are: documentation, archival records, interviews, direct observations, participant observation and physical artifacts. Yin describes documentation as forms of

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communication such as letters, minutes of meetings, administrative documents, court documents, and newspaper clippings and articles. Archival records include organizational records such as organizational charts, budgets, financial statements, and personal records. Interviews are conversations among the researcher and key respondents where the researcher will pose questions about certain events as well as inquire of the respondent's opinion of the events. Direct observations are normally passive in nature and are conducted as a field observation of particular behaviors or environmental conditions affecting the case study. Participant observation is when researchers immerse themselves into the particular environment under study and may actually become a participant in the events under investigation. Finally, physical artifacts, such as a technological device, take the form of actual tangible instruments or tools that the researcher collected or observed as part of a field visit (pp. 85-97).

Data Collection

The research design for the case studies included documentary analysis, which is a combination of the documentation and archival records described by Yin (2003). Document analysis using court documents, newspaper articles, state statutes, professional journal articles, and other research sources was performed. I visited the National Archives Depository in Atlanta, Georgia to access the bankruptcy files of each municipal court case held in Alabama between 1990 and 2004. Like Yin (2003, pp. 85-87), it is my contention that the use of public records (e.g., state statutes, bankruptcy records, and other court documents) provided objectivity to this study since these sources were not assembled specifically for this case study. In this particular research, the court records

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did not always provide sufficient background information to "tell the story" of how and why the municipal bankruptcy occurred as well as how the bankruptcy affected the community. Therefore, the newspaper and journal articles collected corroborated the court records and also provided relevancy to this particular research.

Yin (2003) maintains that one of the major strengths of utilizing the case study approach in research is the opportunity to use various sources of evidence (p. 97). I utilized the documentary analysis, both archived and documentation, as a primary source of information in those cases where interviews were not conducted with public officials. When interviews were conducted, the interview transcripts enhanced the documentation analysis. Yin observes that "One of the most important sources of case study information is the interview" (p. 89). Interviews allow one to report and interpret events "… through the eyes of specific interviewees, and well-informed respondents can provide important insights into a situation" (p. 92). With regard to this research design, the interviews allowed the researcher to hear and gain perspective from those public officials who were directly involved in the municipal bankruptcy that affected their community.

I conducted personal interviews with public officials initially involved in or still dealing with the aftermath of the filings by Greene County (1996), the City of Prichard (1999) and the Town of Millport (2004). Interviews were conducted in order to gain a better understanding of the most recent municipal bankruptcies that occurred at the county, city and town levels of government in Alabama.

In accordance with Yin's (2003) evidence collection protocol for case studies, the interviews were accomplished with unstructured, open-ended questions that were based on the literature review. In particular, the interviews were enhanced by the research of

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Baldassare (1998) on the Orange County, California bankruptcy and the Honadle (2003) interviews of state officials involved with fiscal stress and municipal bankruptcies. Further, Patton's (1990) protocol for standardized open-ended interviews was utilized in this research design with a set of questions that were asked of each interview participant in the same sequence with the same wording. Patton states that this interview methodology is appropriate when conducting interviews on the same topic because this type of approach maintains control, reduces the variation in topic, and reduces the possibility of bias (pp. 280-281). The interview questions are found in Appendix IV.

Public officials or those in decision-making or leadership roles are normally considered "elites". This research primarily involved interviewing public officials and other decision-makers. Aberbach and Rockman (2002) state that when conducting elite interviews, open-ended questions give the participants the latitude to openly discuss the issue and elaborate upon the topic, which gives the researcher additional and valuable information (p. 674). Goldstein (2002) maintains that elite interviews yield valuable information for the researcher in that the conversation will ultimately inform and guide the research and might produce additional information for further research (p. 669). In essence, "Elite interviews can provide crucial information about political events that is otherwise unavailable" (Manheim, Rich, Willnat & Brians, 2006, p. 356).

Seidman (1991) states that employing the interview method helps the researcher best understand the outcome and decisions made during a particular event (p. 41). Furthermore, Yin (2003) states that the evidence found through research techniques such as documentary analysis and interviews go beyond what might be found in a conventional historical study (p. 8). In conducting the case studies of the Alabama

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municipal bankruptcies, interviews with public officials provide a perspective on how the particular municipal bankruptcy affected the respective local government. They also provided insight regarding how other local governments in Alabama can avoid future fiscal stress of this nature. The interview participants were chosen because they were involved in the most recent municipal bankruptcies that involved elected public officials.

In accordance with the interview request protocol described by Patton (1980), Seidman (1991), Rubin and Rubin (1995), and Yin (2003), initial contacts with the public officials were made by letter. The letter identified the researcher and the purpose of the research. It indicated the researcher (this author) would be telephoning to set up an appointment for an in-person interview. Also, under the guidelines of the Institutional Review Board of Auburn University, confidentiality was assured to interview participants as provided by federal guidelines in dealing with human subjects. In order to maintain confidentiality, hand-written notes were taken by me during the interview and later transcribed by me utilizing a coding scheme only known to me. The interview questions may be found in Appendix IV.

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Comparative Analysis

The second focus of this research involved consideration of municipal finance reform policies employed in Florida, Georgia, North Carolina, Ohio, Pennsylvania, and Tennessee. The research design for this phase of the study essentially followed the same methodologies as the municipal bankruptcy case studies. I conducted archival research and documentary analysis in the form of state statutes, agency communications, and journal articles. Utilizing the aforementioned initial contact protocol and interview techniques, expert interviews of public officials in each state were conducted in order to gain an in-depth analysis of each policy utilized by the respective state government. These interviews were all conducted by telephone and hand written notes were taken by me and transcribed by me. Interview questions may be found in Appendix V. The six states were chosen for their various approaches in dealing with municipal finance, especially in the area of municipal bankruptcy as shown in Table 1.4.

Utilizing the same documentary analysis techniques that I applied to identify current municipal finance reform methodologies in other states, I analyzed current and archived Alabama documents to determine if any present laws dealt with municipal finance reform. This research identified the Alabama Education Accountability Act (1995) and the School Fiscal Accountability Act (2006) which allows the Alabama Department of Education to intervene in the financial processes of local boards of education that experienced significant fiscal distress. SDE officials were interviewed in-person and were questioned on the application and utilization of such legislation. The same contact and interview procedures described above were applied. Interview questions may be found in Appendix VI.

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Data Analysis

In accordance with Patton (1990), the inductive approach was utilized in this research. Unlike deductive reasoning that begins from a theory base and uses logic to determine what one should find in the real world, the inductive approach begins without preexisting expectations for the subjects or settings under observation. Patton characterizes the inductive approach this way: "… the patterns, themes, and categories of analysis come from the data; they emerge out of the data rather than being imposed on them prior to data collection and analysis" (p. 390). Patton also maintains that interpretation is part of the inductive process which "… involves explaining the findings, answering 'why' questions, attaching significance to particular results, and putting patterns into an analytical framework" (p. 375).

As a result, this research described the related municipal bankruptcies in a chronological order. It also presented key events that led to the municipal bankruptcy. The case studies provided an explanation for the causes of the municipal bankruptcies as well as how those municipal bankruptcies affected the financial health of Alabama.

A comparative analysis of the states' municipal finance reform practices of other states, Florida, Georgia, North Carolina, Pennsylvania, Ohio and Tennessee, and Alabama SDE legislation should provide a template for future municipal finance legislation in Alabama. The theories of lesson drawing by Rose (1993) were used in examining those policies and procedures in other states and the Alabama SDE with the objective of improving current policies and procedures in place for Alabama's local governments. Rose defines a lesson as "a program for action based on a program or programs undertaken in another city, state, or nation, or by the same organization in its

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own past" (p. 21). Rose maintains that lesson drawing occurs either across time or space – or both. He explains that time deals with studying policies enacted in the past for their successes and failures (p. 77). He believes that policies considered for adoption in the past but not implemented should also be re-examined. Such policies may not have been enacted due to a lack of resources or for other reasons that no longer apply. The concept of space is considering policies used by other governmental entities that are similar in resource base, geographical location, and ideology (p. 96). Rose posits that researchers must consider various ways of drawing a lesson either through copying, adaptation, synthesizing, constructing a hybrid, and/or finding inspiration when considering what course of action to take in creating a lesson (p. 30). Finally, Rose maintains that "… the object is to examine a common problem facing two or more governments in order to learn how to develop a program that is applicable to immediate problems at home" (p. 41). Rose illustrates that lesson drawing involves four stages. These include: searching for lessons, abstracting a cause-and-effect model from those lessons, creation of a new program for action, and prospective evaluation on whether the program can be adopted for policy (p. 27).

The laws, rules and regulations enacted by the states to enforce certain fiscal accountability behaviors of their local governments and the particular methods for enforcing those laws were examined. These policies ranged from state approval of debt and annual budgets to the oversight of fiscal affairs by the state through a commission or agency as shown in Table 1.5. The interviews of state public officials involved in those programs and in Alabama's SDE program further illustrated the respective policies and procedures.

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Weaknesses and Limitations

For the case study of the municipal bankruptcies, a documentary analysis of the bankruptcy court documents and newspaper clippings and articles was performed. Where available, audits of financial statements were considered; however, six of the municipalities did not have or did not provide me with the audited financial statements upon request. Thus, an independent party, such as a Certified Public Accountant, did not always certify the financial information and the financial information provided may be inaccurate or incomplete.

Also, this study corroborated these findings with confidential interviews of public officials that were directly involved in the municipal bankruptcy cases. This type of survey research relies on perceptions of individuals which may be biased towards a particular outcome.

Summary

The major focus of this research is on the first two stages of Rose's (1993) lesson drawing model: searching for lessons and isolating cause-and-effect relationships from those lessons. This is accomplished through the analysis of other state government policies and procedures related to fiscal stress, and the Alabama case studies as well as current SDE policies and procedures. With regard to the third and fourth stages, the discussion of lessons learned from the documentary analysis and interviews represents the first steps in development of new policy which might be applicable to Alabama.

In the next three chapters, I present the findings related to each of three major phases of the research. Chapter V discusses findings from the case studies on the municipal bankruptcies in Alabama. Chapter VI presents the comparative analysis of the

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municipal finance reform policies employed in Florida, Georgia, North Carolina, Ohio, Pennsylvania, and Tennessee. Chapter VII includes the analysis of the Alabama State Department of Education policies and the procedures used to secure financial accountability of local school boards in the state.

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CHAPTER V

CASE STUDIES OF MUNICIPAL BANKRUPTCIES IN ALABAMA

This chapter begins the discussion of the major findings of the study. It identifies, discusses, and analyzes the cases that were filed by Alabama municipalities during the 1990 to 2004 timeframe. Specific factors that led to the nine municipal bankruptcies in Alabama as well as what lessons can be drawn from these bankruptcies to avoid future filings in Alabama will be the focus of this chapter.

Alabama Demographics and Background

Alabama is a southeastern state of the United States that has recently enjoyed a revival in its economic development with the building and operation of three international automotive plants (Mercedes, Honda, and Hyundia) since 1990. According to the U.S. Census, the state's population experienced an increase of over 10 percent during 1990-2000 and approximately 2.5 percent increase during 2000-2005 (Census, 2006). The 2002 Census of Governments ranked Alabama 26th in total number of local governments in the state compared to the other 50 states (Census, 2002). The political structure of Alabama includes 67 counties and 460 city and town governments. Also, there are 525 special district governments that include authority-based structure types such as airport authority, housing authority, water and sewer authority, and hospital/health authority. Alabama has 130 school district type governments. Table 5.1 shows the overall local

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government financial condition during the years 1991 and 2003, and the percentage change between these years (Census, 2006).

Table 5.1
Alabama Local Government Financial Condition

Year	1991 in thousands	2003 in thousands	Percentage Increase
Local Government Revenues	$7,674,421	$15,474,503	101.6%
Local Government Expenditures	$8,084,806	$15,900,528	97.0%
Deficit	($410,305)	($426,025)	4.0%

Source: Census, 2006.

As the table highlights, expenditures rose in accordance with the increase in revenues, but in the aggregate, expenditures exceeded resources available for the years shown. Obviously, not all municipalities in Alabama lived beyond their means during this time period. However, the data indicate that some municipalities did experience some level of fiscal stress.

Case Studies of Municipal Bankruptcy in Alabama

According to the Public Access to Court Electronic Records (PACER), nine municipalities filed for Chapter 9 protection in Alabama during the period of 1990 – 2004 (PACER, 2006). The municipalities that filed for Chapter 9 during this time period are shown in Table 5.2.

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Table 5.2
Alabama Chapter 9 Filings 1990 - 2004

Year	Municipality
1991	City of Lipscomb
1992	Town of North Courtland
1994	Alabama State Fair Authority
1996	Greene County
1998	West Walker Water Authority
1999	City of Prichard
2002	West Jefferson Amusement and Public Park Authority
2002	Etowah Solid Waste Authority
2004	Town of Millport

Source: PACER, 2006.

The circumstances related to the fiscal stress in each municipality and its filings are described below.

City of Lipscomb

Lipscomb, Alabama is a small town between Bessemer and Brighton in west Jefferson County of Alabama and was organized in May 1910. The city has experienced population decline of around 20 percent since the 1980s going from approximately 3,741 residents to 2,941 in the 1990s. Lipscomb had experienced financial stress on a number of occasions and is the first city in Alabama to face Chapter 9 bankruptcy (Pratt, 1991).

In 1991, the city filed bankruptcy after it defaulted on bond payments. Farmers Home Administration (FmHA), a federal agency, was the sole bondholder of the $832,000 city's General Obligation bond as well as the $353,000 General Obligation refunding warrant which were both issued in 1979 by the city. The bond was backed by a levied sewer assessment on property owners that they had to pay in order to connect to the sewer and water system. These revenues were supposed to be collected through the

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water and sewer billing system. The warrant was backed by a 1 percent sales tax increase. These issuances were part of the financing for a $3 million sewer project that was initiated in 1979 and both obligations were backed by the full faith and credit of the city. The city had failed to make payments on the loan since 1985. In 1987 and 1988, the FmHA filed suit to collect the delinquent payments on the bond and refunding warrant and was awarded judgments of $23,743.56 and $96,099.20 respectively (City of Lipscomb, 1991, p. 6).

In 1991, the FmHA was planning to file suit against the city again when the city filed for municipal bankruptcy under Chapter 9. It appears that city officials felt cornered into bankruptcy protection since the FmHA "… asked city officials to come to court with the title to the city if they can't come up with the money….where they could be forced to turn over the keys to City Hall, three police cars and its 1976 and 1954 fire trucks" (Staed, 1991, p. A1). At the court proceeding, the judge did not have kind words for the FmHA attorneys and even told the U.S. District Attorney representing the FmHA that "You can't get blood from a turnip….You're not going to repossess this sewer system" (Status Conference, 1991, p. 9). Clearly, the FmHA was frustrated with the lack of timely payment by the city on the outstanding liabilities as well as the inability to obtain accurate and audited financial information on the city's finances since the missed payments in 1985.

Although the sewer project was badly needed according to the bankruptcy documents, many of Lipscomb's residents were unable to pay the additional assessment cost on their monthly water bill. The city was especially unable to collect assessments

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from those homeowners who were receiving welfare assistance. It could not locate a large percentage of property owners who had either abandoned their homes or had moved out of state. The city's largest source of revenues was the water, sewer and garbage collection fees. At the time of the bankruptcy filing, $126,961.64 in delinquent accounts for the uncollected sewer assessments were shown on an unaudited statement of financial position as of September 30, 1990. Furthermore, the city had incurred a deficit in its 1990 Operating Statement with expenditures exceeding revenues by $29,284.79 (Shields, R.L. to FmHA, July 25, 1991, City of Lipscomb Bankruptcy, National Archives Depository).

Another factor in Lipscomb's financial decline was the fact that fewer businesses were operating within the city limits. According to the bankruptcy proceedings, " … the City of Lipscomb has seen approximately a 90 percent reduction in the sales tax just because its business base has gone to Bessemer or Midfield …" (Status Conference, 1991, p. 6). The completion of Interstate 59/20 from Birmingham through west Alabama to Mississippi prompted many businesses to move their business location closer to an interstate access such as that of Bessemer and Midfield. This resulted in empty storefronts in Lipscomb. Residents increasingly frequented businesses outside the city limits and new businesses found the city unattractive. Due to these developments, the city was unable to rely on normal sales tax revenues or the 1 percent increase in sales tax increase allocated for the repayment of the warrant. The revenues from the business license fees also fell.

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Other factors listed in the bankruptcy proceedings included loss of federal revenue sharing in the late 1980s although this fact was not substantiated in the bankruptcy records by actual figures to demonstrate how this affected the city's revenue structure. The city also experienced a cost increase for providing basic municipal services. This was largely attributable to incremental increases in police and fire safety salaries. In the 1980s, the city brought the police department employees under civil service regulations. This increased the officer's salaries and increased medical and insurance benefit expenditures required of the city. Lastly, the city had to make large expenditures from its general fund to maintain and repair the sewer system (City of Lipscomb, 1991, pp. 2-10). These factors, coupled with large uncollected accounts receivable from the water, sewage and garbage fees and loss of sales tax revenues, served to severely degrade the city's financial condition.

According to PACER (2006), the Lipscomb bankruptcy case was closed on December 18, 1992. Under the bankruptcy plan, the final payments were made in December, 1997 (Oliver-Miles, 1997, p. 1B). Lipscomb faced fiscal stress again in November, 2000 with reports of overdue payments to vendors, the Internal Revenue Service and the city personnel health care provider. The newly-elected mayor cited that he believed the city to be approximately $165,000.00 in debt but was uncertain as to the true financial status since financial records and bank statements were reported missing. Also, a preliminary state audit showed over $8,000.00 in city funds were also missing from the city's funds (Bryan, 2000).

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Town of North Courtland

North Courtland is a town in Lawrence County, Alabama and is near the Decatur and Huntsville area. North Courtland was incorporated in June 1981. On December 9, 1992, the town of North Courtland filed for Chapter 9 bankruptcy. North Courtland's financial woes stemmed from a tort judgment on behalf of a former city employee who claimed that his 14th Amendment rights were violated during termination proceedings. The judgment was in the amount of $89,673. Of that amount, $39,673 was for backpay due to wrongful termination and $50,000 was awarded by the court as punitive damages. After the judgment was upheld in the appeals process, the plaintiff (former employee) began garnishment proceedings against the city for the judgment amount (Forrester, 1992, pp. 1-3).

The city council held a meeting on December 8, 1992 and unanimously approved a resolution to file Chapter 9 bankruptcy (Partial Minutes, 1992). At the time of the bankruptcy filing, the liabilities of the town were over $187,000. The only financial statements filed with the bankruptcy court records were the 1994 and 1995 budget projections which showed the following:

	1995	1994
Revenues	$293,179.00	$271,462.00
Expenditures	$289,475.00	$270,071.08
Fund Balance	$ 3,704.00	$ 1,390.92

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Both of these budgets showed a line-item amount of $5,000 towards the plan of adjustment for the respective bankruptcy liabilities (North Courtland, 1993, Exhibit A). The liabilities taken from the bankruptcy proceedings are shown in Table 5.3.

Table 5.3
Summary of North Courtland's Liabilities

Claimant	Amount	Type of Liability
Plaintiff from Lawsuit	$107,115.00	Tort judgment
State of Alabama	$39,220.00	Statutory provision payments
Lawrence County	$11,100.00	Statutory provision payments
Local Vendor	$9,010.00	Payment for paving city streets
Central Bank	$8,800.00	Short term operating loan (incurred September 1992)
Vendor	$6,665.00	Lease payments for office equipment
Local Vendors	$3,680.00	Various
Local CPA	$1,490.00	Payment for year-end compilation
Total	$187,190.00	

Source: Town of North Courtland, Disclosure Statement, 1992.

The town did not carry insurance coverage that would cover tort judgments such as the employee lawsuit. As a result, its only protection from the aforementioned garnishments by the plaintiff was to seek bankruptcy protection. According to the bankruptcy records, the town planned to pay the plaintiff within a six-year period from the date of the bankruptcy. The plaintiff filed many motions to dismiss the Chapter 9 proceedings, but the bankruptcy was affirmed on February 23, 1995 and the case was closed on October 11, 1996 (North Courtland, 1992, pp. 1-9).

Alabama State Fair Authority

The Alabama State Fair Authority, formerly named the Birmingham Fair Authority, was formed under Act No. 215 during the 1947 state legislative session to

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operate the annual state fair and other community events in the Birmingham area (Alabama State Fair Authority, 1994, p. 1). The city council of Birmingham appointed and appropriated funds to the authority's nine-member board. The fairgrounds covered 130 acres in the city's western section and housed an auto racetrack, picnic and play area, a 5,000-seat arena for musical and theatre events, and numerous buildings used for agriculture and animal exhibits at the state fair. The authority filed for Chapter 11 bankruptcy on June 24, 1994 and converted the case to a Chapter 9 bankruptcy on June 23, 1995.

Court documents show that the organization owed nearly 90 entities (individuals, corporations, and governments) over $750,000 in unpaid liabilities, employee claims, and tax claims. The liabilities from the bankruptcy records are shown in Table 5.4.

Table 5.4
Alabama State Fair Authority Liabilities

Claimant	Amount	Type of Liability
Unsecured Creditors	$666,555.59	General operations of the fair
Internal Revenue Service	$31,770.19	Federal withholding taxes
State of Alabama Department of Industrial Relations	$17,586.02	State unemployment taxes
Employee Claims	$11,897.40	Vacation claims
City of Birmingham	$11,512.50	Sales taxes
State of Alabama Department of Revenue	$7,272.94	State withholding taxes for employees
City of Birmingham	$5,029.70	Occupational taxes
Jefferson County Department of Revenue	$3,750.88	Occupational taxes
Total	$755,375.22	

Source: Alabama State Fair Authority, Disclosure Statement, 1994.

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The unsecured creditors owed the most for general operations were First Alabama Bank ($190,000.00), Alabama Power Company ($115,724.37), Haas and Wilkerson ($91,155.14), Birmingham Water and Sewer Board ($46,299.85), S&W Electric Company ($38,979.05), Birmingham Sewer Service Fund ($21,399.06), and Fortune Management ($15,814.90). Furthermore, some of the tax debts, made up mostly of withholding taxes from payroll, were incurred as early as 1991 and were not remitted to the respective governmental authority (Alabama State Fair Authority, 1994, pp. 8-12).

In a strange twist, the authority had received contributions totaling $700,000 from the State of Alabama, Jefferson County, and the City of Birmingham in March 1994 to help with the deteriorating finances of the authority. The Jefferson County Commission assumed that this amount of funds would be sufficient to "… bail them out so they wouldn't have to file bankruptcy…" and was surprised by the Chapter 9 filing (Royer, 1994, p. 201). However, according to authority officials, the contributed funds from the other governments were insufficient to meet all of the current and upcoming payment obligations.

In order to show that the respective funds were expended immediately on obligations, the authority's board issued an itemized disbursement schedule on May 26, 1994. Several of these disbursements were to other governmental entities which included $46,512.00 to the Internal Revenue Service; $20,000.00 to the Birmingham Water Works Board; and $8,000.00 to the Alabama Industrial Relations Board. Other significant payments included $155,626.00 to Ballard Covert Group; $141,288.00 to Alabama Power

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Company; $90,000.00 to Fortune Management; and $56,008.00 to various insurance companies (Alabama State Fair Authority, 1994, Exhibit A).

According to the authority chairman, the fair authority had incurred a loss for every annual fair since 1989 (Dedrick & Garrison, 1994, p. 101). Also, the bankruptcy records indicated that the authority continued to take on debt in order to operate the fair as well as the spring festival and flea market (Alabama State Fair Authority, 1994, pp. 4-5). Fair operations suffered a net loss of $800,000 from the 1993 fall fair. No one from the Birmingham City Council seemed to be aware that the authority was operating this far in the red during this extended period of time (1989-1994). This was despite the fact that the council appropriated funds annually to the authority from the city's budget and had made an additional appropriation in March 1994 in hopes of offsetting the authority's financial demise (Fair Affairs, 1994, p. 801).

On September 27, 1994, Mayor Richard Arrington and the Birmingham City Council voted to take over the Alabama State Fairgrounds. This meant the authority would be abdicated of financial responsibility for the buildings, employee salaries, and maintenance of the fairgrounds. Fairground employees were placed in the city employee system and the buildings, grounds, and related expenses were placed under the umbrella of the city's expenditures (Dedrick, 1994, p. 101). Despite this move, the authority was allowed to retain control of the revenues over the State Fair and Spring Fling as well as the management of the fairgrounds. The city would retain revenues from the racetrack, arena and monthly flea markets. In a show of good faith towards cost reduction, the authority designated management of the events to State Fair Management, Inc. This

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company operated the events with an agreement to remit 10 percent of total admission revenues back to the authority. From this arrangement, the authority received $9,697.00 in 1994 and $26,478.88 in 1995 to be paid towards the bankruptcy liabilities (Alabama State Fair Authority, 1994, p. 15).

In 1996, several newspaper articles pointed out that the city of Birmingham was continuing to appropriate over $600,000 annually to the authority to manage the fairgrounds despite the fact that the city continued to pay for repairs and upkeep of the fairgrounds. As an example, in December 1995, the city paid $240,227 to resurface the racetrack and install new lighting for the racetrack. The city considered these costs necessary for upkeep and maintenance of the fairgrounds. In return, the city received a little over $308,182 in revenue from the fairgrounds in 1995. This meant the operations of the fairgrounds still remained in the red. Further, at the end of 1995, the authority still remained approximately $438,000 in debt from the bankruptcy filing (Dedrick, 1996, p. 17A).

In late 1996, Mayor Arrington felt that the current management agreement with the authority should be terminated and proposed that a private management company assume management of the state fairgrounds. Two years had passed since the authority had filed for bankruptcy and city officials realized that the city was losing money with continued maintenance and upkeep expenditures at the fairgrounds (Dedrick, 1996, p. 10A). The authority ceased operations in 2000 and the Chapter 9 bankruptcy file was closed on January 26, 2004.

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Greene County

Greene County is located in the western section of Alabama close to the Mississippi line and has the smallest population of any county in Alabama. In 1990, the population level was a little over 10,000 and in 2005, the population estimate was 9,661. In addition, current census data indicates that Greene County residents are among the poorest in Alabama with 34.3 percent of individuals living below the poverty level (Census, 2006).

On September 9, 1996, the Greene County Commission passed a resolution to file for bankruptcy and petitioned the bankruptcy court for Chapter 9 protection on September 11, 1996 (Resolution, 1996). State Senator Hank Sanders, representing the 23rd district of Alabama, had recommended Chapter 9 to the commission members in order to restructure their outstanding and overwhelming debt (Sikora, 1996, p. 1A). It is interesting to note that Senator Henry Sanders, a practicing attorney in Selma, Alabama, also was listed as the County Attorney and assisted other counsel in the bankruptcy proceedings of this particular case. Furthermore, Senator Sanders was the sponsor of the Alabama Acts 85-936 and 87-651. These Acts provide for the collection of pari-mutuel racing receipts and additional privilege or license and excise and sales tax by the Greene County Commission. The Commission was to distribute a portion of the revenues collected to other local governments and entities within the county.

When the initial Chapter 9 bankruptcy papers were filed, total claims of $154 million were listed as outstanding obligations. Eighty-seven of those claims were made by individual residents who each claimed a liability on the municipality of approximately

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$1.7 million (per resident) totaling approximately $152 million. Reasons for these claims were unknown and were subsequently dismissed by the court (Confidential Interview with Public Official, March 15, 2007). An Amended Plan of Adjustment of Debts filed with the bankruptcy court on June 16, 1997 showed the amended outstanding obligations total of $3,409,947.96 (Greene County, 1997, Exhibit A).

In 1994, Orange County, California was the first county to file for Chapter 9 protection. Greene County became the second and only other county in the United States to file for bankruptcy with their 1996 filing (Unimpeachable, 1997, p. 2C). Socioeconomic data indicated that roughly 45 percent of the Greene county residents lived below the poverty level and over one-third were receiving governmental benefits (Nossiter, 1996, p. 22). Greene County also had the slowest population growth in Alabama between 1990 and 1995, and experienced the highest unemployment rate in the state, 18.8 percent at the time of the bankruptcy (Greene Bankruptcy, 1996, p. 10A).

Many newspaper articles cited that the audit findings showing mismanagement of public funds and decline in revenues from the Greenetrack racing operation were the main contributing factors for this bankruptcy. The bankruptcy documents filed September 12 indicated that the filing "… was principally the result of declining revenues from the operations of Greenetrack, a dog racing facility located in Greene County, Alabama" (Greene County, 1997, p. 6). The documents made no mention of the audit findings or financial mismanagement of public funds. This is especially noteworthy because the Alabama Examiners of Public Accounts in their 1991-1994 audit report

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issued on August 23, 1996 found that the County Commission had over $1.7 million in mismanaged funds (Sikora, 1996; Nossiter, 1996; Unimpeachable, 1997).

A review of the October 1991-September 1994 audit showed the Examiners cited 27 findings pertaining to state legal compliance, agency operations and inappropriate financial procedures. Sixteen of those findings were repeat findings from previous audits that had not been resolved by the Commission. A brief summary of these findings is found in Table 5.5.

Table 5.5
Summary of Audit Findings for Greene County Commission
October 1991-September 1994 Audit Period

Examiners Finding	Finding cited from previous audits
Payroll journal for 1993-1994 fiscal year was the only journal or ledger provided by the Commission for examination review.	
Expenditure claims for several funds were misplaced, lost, or otherwise unavailable for review.	
The Commission was severely delinquent in filing monthly statements of reappraisal maintenance expenditures with the State Department of Revenue. (Statements are to be filed monthly by 20th of month.)	
Funds were reimbursed from General Fund amounts unaccounted for by amounts reported as expended by General Fund.	
Commission was late in payment of federal income and FICA taxes to the Internal Revenue Service and often payments did not agree with payroll journal and records. IRS filed a lien and demanded payment during this examination period.	
Numerous, questionable, and lengthy long distance calls, appearing to be of personal nature, were made by County Economic Development Office.	

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Table 5.5 (cont.)
Summary of Audit Findings for Greene County Commission
October 1991-September 1994 Audit Period

Gasoline Tax Fund paid for several expenditures deemed unallowable by Code of Alabama 1975, Sections 40-17-75 through 82. Loans from Gasoline Tax Fund were made to General Fund in amount of $50,832 during this audit period. Gasoline Tax Fund monies are restricted to expenditures pertaining to public roads and bridges.	X
County Courthouse Funds, set up under Act 85-936, were loaned to the General Fund for general operations. Unallowable under legislation.	
County sales tax was not properly remitted to the Greene County Hospital Board as required by Act 487 of Alabama (1977).	
General Fund did not reimburse other funds for expenditures made on behalf of other County departments. Checks were written for monthly reimbursements and entered into the accounting system; however, the checks were never actually deposited into the other funds.	
Rental contract not in place between County and the Society of Folk Arts and Culture, a nonprofit organization which occupies a portion of a County-owned building.	
Commission did not publish semi-annual financial statements as required by Code of Alabama, 1975, Section 11-3-21.	X
Budgets were not properly prepared, approved and disclosed in the Commission minutes as required by Code of Alabama 1975, Section 11-8-3.	X
Deficit fund balances found in several of County's funds. Code of Alabama 1975, Section 11-8-3 prohibits this practice.	X
County wrote 1665 insufficient fund checks and incurred bank charges for insufficient fund fees totaling $20,368 during this audit period. Code of Alabama 1975, Section 11-8-10 prohibits issuance of checks until funds are available for payment.	X
Annual payment required under Act 118, Acts of Alabama 1969, page 395 to the Greene County Board of Education has not been paid since the 1988-1989 fiscal year. Annual payment is to be $4000.	X
Travel advances and mileage payments to Commissioners not properly documented nor settled in a timely manner.	X

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Table 5.5 (cont.)
Summary of Audit Findings for Greene County Commission
October 1991-September 1994 Audit Period

Disbursement claims had severe documentation problems. Lack of material receipt; numbered claims missing; payments made from duplicate invoices; no invoice or other documentation to support disbursements found in examination.	X
Loans made from restricted special revenue funds to the General Fund. $50,832 due to the Gasoline Fund and $185,000 due to the RRR Gasoline Fund from this examination period.	X
Distributions of county beer tax to other municipal agencies, set up under Act 88-627 of Alabama, were not made in a timely manner. $86,217 due to the other agencies during this audit period.	X
Distributions of pari-mutuel racing receipts, set up under Act 85-936 of Alabama, were not made in a timely manner. Some payments were owed and some overpaid by Commission. $90,150 due to other agencies and $11,167 overpaid to agencies during this audit period.	X
Reservations of fund balances were not accurately reflected in Commission's books and records.	X
Commission did not comply with all provisions of the Alabama Competitive Bid Law and could not provide bids or copies of state bids for several purchases.	X

Source: State of Alabama Examiner of Accounts, Report on the Greene County Commission, 1996, pp. A-K.

As a result of these findings, the Examiners of Public Accounts charged county commission officials with $766,916.66 in mismanagement of governmental funds for the 1991-1994 fiscal periods. These charges stemmed from unsettled travel advances, payments made without supporting documentation, unauthorized temporary loans or restricted monies from certain special revenue funds, insufficient check charges, unauthorized purchases from special revenue monies, and failure to redistribute all county sales tax and beer tax received by the commission to the appropriate agencies. Further, the Examiners noted that charges totaling almost $2,000,000 from previous

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audits were still outstanding and had not been remitted by the county commission members. The county commission members declined to pay the charges and a hearing before the Chief Examiner of the Public Accounts with county officials occurred on March 8, 1996. The Chief Examiner made a ruling on August 13, 1996 that the county commission public officials and employees had not provided any reason why the charges should not be repaid and the commission was liable for such repayment of the amounts listed in the audit report provided by the Examiners (Report on the Greene County Commission, 1996, pp. A-K; Jones, R.L.to Greene County Commission, January 5, 1996, August 13, 1996, Report on the Greene County Commission, Report No. 90-064, Alabama Department of Archives and History).

In a subsequent audit of the Greene County Commission covering the period October 1994 through September 1997, 14 findings were noted by the Examiners with 11 of these findings being from previous audits. These findings were the same nature as those shown in Table 5.5. However, the Examiners did note that the commission was no longer delinquent on remitting federal income and FICA taxes withholdings to the IRS. The Examiners found that insufficient fund charges were incurred in the amount of $11,475 for the 1994-1995 fiscal year alone; travel reimbursement forms were often inaccurate; accounting records contained limited information and were often found to be inaccurate or unreliable for examination purposes; General Fund and other special revenue fund expenditure claims and documentation to support the expenditures were misplaced, lost or otherwise unavailable for review; travel advances were not properly documented or itemized by the public officials; and sales and beer tax were not always

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remitted on a timely basis to other government agencies as provided for in the legislation (Report on the Greene County Commission, 1998, pp. A-G). Since the commission was under Chapter 9 bankruptcy, it appears that the Examiners did not require the commission to appear before the Chief Examiner to answer to these findings.

It is interesting to note that the 1994-1997 examination referenced to transfer of ownership by the Greene Group of the Greenetrack greyhound racing facility in Greene County to the county government and the Greenetrack employees. The agreement was interpreted by the Examiners as a shared ownership between the Greene County government and the track employees. The Examiners noted that no legal authority under current Alabama legislation provided for this type of ownership transfer nor did the county government have the legislative authority to operate a pari-mutuel facility (1998, p. B). The track was offered to the county government as an alternative to closing the facility altogether (Confidential Interview with Public Official, March 15, 2007).

A discussion of the future audits, conducted by the Examiners, of the Greene County Commission will be forthcoming in Chapter VIII, Analysis of Findings.

I compiled the information shown in Table 5.6 from Exhibit A of the Chapter 9 bankruptcy records, an in-depth analysis of the audits, research of Alabama Acts 77-487, 85-936, 88-627, 87-651, Code of Alabama Chapter 11, and personal conversations with personnel from the Alabama Examiners of Public Accounts and State of Alabama Department of Revenue concerning statutory tax receipts and disbursements. Liabilities totaling $3,409,947.96 are summarized in Table 5.6.

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Table 5.6
Greene County Commission Liabilities
As Shown in Disclosure Statement

Claimant	Amount	Type of Liability
Courthouse Bond Issue	$1,015,000.00	GFO Bond Issue for new courthouse.
Internal Revenue Service (IRS)	$519,000.00	Past-due withholding taxes of employees and related FICA payments. IRS had placed a lien on the Commission.
Greene County Gasoline Fund	$346,616.00	General Fund owed this fund for 7-cent gasoline tax revenues received and not used for the construction, improvement, maintenance and supervision of highways, bridges and streets and for retirement of related bonds. Commission had used the funds inappropriately for landfill expenditures.
Greene County RRR Fund	$250,000.00	General Fund owed this fund for the 3-cent gasoline tax revenue for the construction of high density unpaved roads or for the reconstruction, resurfacing, restoration, and rehabilitation of paved county roads.
Greene County Hospital	$236,641.11	Established under Alabama Act 77-487, Act 85-936 and Act 88-627. Portion of the sales tax, pari-mutuel tax, and beer tax should have been remitted by the Commission to hospital.
Greene County Board of Education	$172,271.00	Established under Alabama Act 77-487, Act 85-936 and Act 88-627. Portion of the sales tax, pari-mutuel tax, and beer tax should have been remitted by the Commission to Board of Education.
Greene County Courthouse Fund	$137,650.00	Established under Alabama Act 85-936. Portion of the pari-mutuel tax should have been remitted by the Commission to the restricted fund. Revenues from this fund were also improperly loaned to the General Fund of the Commission.
Merchants and Farmers Bank	$129,000.00	Grant Anticipation Note
Caterpillar Financial Services	$77,173.98	Equipment Lease Creditor

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Table 5.6 (continued)
Greene County Commission Liabilities
As Shown in Disclosure Statement

Greene County Reappraisal Fund	$70,240.51	Reappraisal expenditures were initially paid from General Fund and reimbursed from Reappraisal Fund. Reimbursements from the Reappraisal fund exceeded actual expenditures made by the General Fund.
Community Services Program	$66,865.69	Established under Alabama Act 77-487 and Act 88-627. Portion of the sales tax and beer tax should have been remitted by the Commission to government unit.
Ford Motor Credit	$47,602.92	Equipment/vehicle lease creditor
Greene County Industrial Development Board	$42,000.00	Established under Alabama Act 77-487, 85-936 and Act 88-627. Portion of the sales tax, pari-mutuel and beer tax should have been remitted by the Commission to government unit.
Thompson Tractor	$41,700.86	Equipment lease creditor
Roberts and Son, Inc.	$38,000.00	Provided road and bridge services.
Case Credit	$37,555.65	Equipment lease creditor
State of Alabama Department of Revenue	$37,000.00	Past-due withholding taxes of employees and statutory payments to state.
Town of Union	$35,406.69	Established under Alabama Act 77-487, 85-936 and Act 88-627. Portion of the sales tax, pari-mutuel and beer tax should have been remitted by the Commission to government unit.
S.T. Bunn	$35,114.87	Road and bridge services contractor.
Unsecured Creditors	$24,728.98	General Operations
Town of Boligee	$15,396.39	Established under Alabama Act 77-487, 85-936 and Act 88-627. Portion of the sales tax, pari-mutuel and beer tax should have been remitted by the Commission to government unit.
Greene County Health Department	$9,904.84	Established under Alabama Act 77-487, 85-936 and Act 88-627. Portion of the sales tax, pari-mutuel and beer tax should have been remitted by the Commission to government unit.
Gemini Consultants	$7,466.68	Equipment lease creditor

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Table 5.6 (continued)
Greene County Commission Liabilities
As Shown in Disclosure Statement

West Alabama Health Services	$6,901.27	Established under Alabama Act 77-487, 85-936 and Act 88-627. Portion of the sales tax, pari-mutuel and beer tax should have been remitted by the Commission to government unit.
Town of Forkland	$6,848.42	Established under Alabama Act 77-487, 85-936 and Act 88-627. Portion of the sales tax, pari-mutuel and beer tax should have been remitted by the Commission to government unit.
Other Governmental Entities	$3,862.10	Portion of sales tax, pari-mutuel and beer tax should have been remitted to units.
Total Liabilities	$3,409,947.96	

Source: Greene County Commission, Disclosure Statement, 1997.

Beyond the mismanagement of municipal funds, the county's problems were compounded as the commission increasingly relied on the tax revenue paid from Greenetrack, a privately-owned dog racing track which opened in 1977. The revenue collections were a major source of revenues for the commission. During early operations when the dog track was prosperous, this business entity accounted for over one-third of Greene County's revenue in its annual budget. From 1977 through 1993, the Commission received approximately $35 million in revenue from the dog racetrack (Sikora, 1996; Greene Bankruptcy, 1997, p. 10A). Greene County benefited greatly from the track's presence in not only the generation of tax revenues but also in the employment of its residents. The introduction of dog racing in Birmingham in 1992 and the opening of the Philadelphia, Mississippi casinos in 1994 caused the track to suffer greatly. The financial reports indicate that the track received $98 million in wagers (bets) during the

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1988 fiscal year. The figure dropped dramatically to $24 million in 1994 (Bolton, 1996, p. 1D).

Bankruptcy records indicated the revenues depicted in Table 5.7 were disbursed to Greene County for the years 1990 – 1996.

Table 5.7
Revenues from GreeneTrack Received by Greene County
1990 – 1996

Year	Revenue Amount
1990	$908,000
1991	$812,000
1992	$576,000
1993	$222,000
1994	$187,600
1995	$60,400
1996	$14,400

Source: Greene County Commission, Disclosure Statement, 1997, Exhibit 8.

Greene County experienced a reduction of almost $900,000 in tax revenues in a six-year period. I made a request to the commission for the financial statements and budgets from these years to review the impact of the loss of revenues on the governmental services provided by the county; however, these reports were not made available.

As a result of the audit findings and the subsequent municipal bankruptcy, Citizens for a Better Greene County, a biracial citizens group, formed to address the financial mismanagement by the commission as well as the state of economic affairs in the county. The group was instrumental in bringing public attention to the financial mismanagement. This resulted in a grand jury investigation of the commission members. The grand jury twice called for the impeachment of the Chairman and two commission members; however, the district attorney and the State Attorney General stated that

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"…impeachment was not possible under state law because the alleged misuse occurred in a prior term…"(Unimpeachable, 1997, p. 2C).

Despite the immense financial stress in the local government, the county paid off its $3 million in debt and the bankruptcy case was closed on October 21, 1999. Furthermore, Greene County did not miss debt service payments on the $1.2 million bond issue for the new county courthouse which is projected to be paid in full in 2010 (Shah, 1997, pp.1-2).

West Walker Water Authority

West Walker Water Authority serviced 260 rural customers in the Walker, Fayette and Tuscaloosa County areas. The authority controlled approximately 40 miles of water lines and related equipment. User fees accounted for 100 percent of its revenue base. The authority filed for Chapter 9 bankruptcy protection on June 9, 1998. At the time of the filing, the authority owed $400,000 to the U.S. Department of Agriculture, Rural Economic and Community Development as well as $42,000 in short-term liabilities to various vendors. The authority did not have sufficient revenues to sustain its operations and make liability payments (West Walker, 1998). The authority was subsequently sold to the Oakman Water Works in Oakman, Alabama. As a result of the sale, Oakman Water Works also inherited the related liabilities of the authority (Confidential Interview with public official, June 16, 2006).

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City of Prichard

Prichard, Alabama is located in southwest Alabama and is considered a suburb of Mobile. On October 5, 1999, the City of Prichard became the first Alabama city with a population over 20,000 to file for Chapter 9 bankruptcy protection (Mitchell, 1999). At the time of the bankruptcy, Prichard's population numbered 28,633 persons with a per capita income of $10,626. Only 50 percent of the population was employed (Census, 2006).

Incorporated in 1925, Prichard is a suburb of Mobile, Alabama. According to the bankruptcy documents, Prichard had experienced financial stress and economic deterioration since the 1960s. Court documents note, "News reports tell us that the City was beginning to have financial problems as far back as 1964, when the Mayor expressed concern that the City would have a deficit by year-end" (City of Prichard Disclosure Statement, 1999, p. 4). Further, "… a review of CPA audits indicates that the City had a general fund deficit in 1974….ever since 1973, the City's liabilities have exceeded their assets" (1999, p. 5). It appears that city leadership basically ignored these financial problems until the late 1990s.

In an interview with a public official, I was told officials seemed to be hesitant to admit to the financial problems since they did not want the city to publicly declare bankruptcy "… while on their watch …" or during their elected term of office. In an unusual turn of events, the Mobile County Commission contacted and actually hired bankruptcy attorneys and certified public accountants to come to Prichard and assess their financial condition. Further, the Mobile County Commission pressed the mayor and city

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council members of the need to file for bankruptcy protection. The mayor and two members agreed immediately; however, three of the council members were strongly against the bankruptcy filing and publicly decried the commission's involvement (Confidential Interview with Public Official, March 27, 2007).

Once a thriving city of 45,000, Prichard's population had declined since the 1970s to approximately 28,000 in the 2005 census report (Census, 2006). According to Watson, Handley and Hassett (2005), Prichard was a booming commercial entity in the 1960s with the state's fifth largest resident population. Its economic base was strong due to the industrial jobs in the Mobile area and a busy retail shopping center in downtown Prichard. However, in the late 1960s, many of Prichard's white residents relocated to the newly-formed western suburbs of Mobile and the population decreased continuously. In the bankruptcy records, resident relocation, lack of the industrial tax base, and businesses leaving the city and abandoning their offices/factories are mentioned as having a negative impact on the city's revenues and economic development. At the time of the bankruptcy, 35.5 percent of the population was considered below the poverty level and 43 percent were classified as either a minor (18 or younger) or 65 years or older (Census, 2006).

Although Prichard officials sheltered the city's financial woes through Chapter 9 in 1999, this was not the first time the city used legal channels to resolve its financial problems. In 1985, Prichard took its financial problems to court in an unorthodox manner. Many vendors were threatening litigation against the city for unpaid liabilities, and the city asked the Mobile Circuit Court for assistance in dealing with the impending lawsuits. The judge assisted Prichard in developing a plan where the city would pay the

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liabilities in chronological order and the state would deposit $300,000 annually from the city's sales tax receipts. The plan was called the Lasner Fund. Vendors had to agree to this arrangement and at the time of the bankruptcy, $731,000 was still in the fund as unpaid liabilities. The original fund balance was not known by city officials; however, it was believed that the original fund liabilities had been paid in full. The fund balance at the time of bankruptcy was from new liabilities sheltered within the fund (City of Prichard Disclosure Statement, 1999, pp. 5-8; Exhibit VI; Confidential Interview with Public Official, March 28, 2007).

In 1990, a University of South Alabama study found Prichard's per capita income was $5,014 in 1987 – the lowest in the nation for cities with populations over 25,000. Interestingly enough, the study was conducted under a grant by the State of Alabama to help assess Prichard's financial condition and was the only state government action taken during the financial decline of Prichard. The study recommended immediate action by the city government towards addressing its financial stress and that a strategic plan be put in place to avert bankruptcy (Watson, Handley & Hassett, 2005). It appears that the strategic plan was never developed nor did the city leadership take any steps to avoid the bankruptcy court.

When Jesse Norwood was elected mayor in 1992, many expected that he would stabilize the city's finances. However, neither the council nor the mayor worked together to handle the financial problems of the city government. The 15 percent reduction in actual revenues received compared to the 1998 forecast should have been a red flag for city officials. In fact, the 1999 revenue receipts were over 25 percent less than the 1998

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budgeted amount. Further, "The confrontational relationship….resulted in a passed budget being used for multiple years….because the Mayor and City Council's inability to agree on what should be an entirely new budget" (City of Prichard Disclosure Statement, 1999, pp. 5-7). As a testament of the lack of accountability and awareness of the gravity of the situation, the city council had agreed to give the city police and firefighter employees a raise. This action further impacted the budget deficit.

When the bankruptcy was finally filed with the court, the city had written $1.1 million in checks to pay its debts but only had a fraction of that amount in the city bank account. Also, $600,000 had been collected in payroll deductions (income and social security taxes and employee deductions) since March 1999 but had not been remitted to the federal government and other agencies. Actual liabilities shown in the bankruptcy records amounted to $4,884,830.00 (City of Prichard, 1999, Exhibit IX, pp. 1-5; Mitchell, 1999; Confidential Interview with Public Official, February 22, 2007, March 28, 2007).

Three factors seemed to have contributed to Prichard's bankruptcy. These include economic decline, political turmoil and lack of financial leadership. In essence, the bankruptcy records point to this fact stating:

> The combination of a deteriorating tax base and a long-standing lack of cooperation between the office of the Mayor and City Council, and a continuing lack of accurate and timely internal financial balance sheet information, precipitated the bankruptcy of the City (City of Prichard Disclosure Statement, 1999, p. 8).

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It is further noted that "The financial crisis in Prichard did not originate in 1999….the City has survived, for the most part, on a payroll-to-payroll basis, little emphasis has been placed on the true and accurate financial condition of the City" (p. 8).

From the bankruptcy records, it is evident that Prichard's revenues and expenditures had been out of sync for several years. The data for the 1996-1999 periods are provided in Table 5.8.

Table 5.8
Prichard's 1996-1999
Schedule of Actual Revenues and Expenditures

Year	Revenues	Expenditures	Difference
1996	$7,786,852	$9,286,307	($1,499,455)
1997	$7,920,965	$9,012,131	($1,091,166)
1998	$8,112,904	$9,992,048	($1,879,144)
1999	$8,129,120	$10,571,444	($2,442,324)
Total	$31,949,841	$38,861,930	($6,912,089)

Source: Prichard, 1999, Exhibit V, pp. 1-8.

Further, Exhibit V in the bankruptcy records documented a $1.4 million increase in expenditures between FY 1993 and FY 1994 and this trend continued through 1999. It also mentioned that there were no internal financial documents available for review for the 1994 period so it could not be determined why the expenditures increased so dramatically and why the trend continued through 1998. The pay increase for the fire and police department occurred in 1998 (Prichard, 1999, Exhibit V, p. 6).

For the fiscal year 1999, Prichard's audited financial statements showed a $1,236,519 deficit in the fund balance for the governmental funds and related liabilities of $3,442,555 (City of Prichard Audit, 2001, p. 3). Furthermore, the financial audit noted that the city had not maintained proper financial records and the auditors could not

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determine true fund balances in the general and special revenue funds. This fact was further corroborated by those individuals who were hired by the bankruptcy attorneys to sort through the financial mismanagement and determine an accurate financial picture (Confidential Interview with Public Official, February 22, 2007).

Auditors cited 21 findings and questionable costs for the 1998-1999 fiscal period alone. A summary of the most significant audit findings is shown in Table 5.9.

Table 5.9
Summary of Prichard's Audit Findings
Fiscal Year 1998-1999

Finding	Financial Impact
Under Alabama law, the city is required to adopt and adhere to a general fund budget. City exceeded the approved general fund budget.	City exceeded budget by $1,070,587
Under Alabama law, the finance director is to maintain a system of accounts to provide reliable financial information to the council and mayor. Finance director failed to maintain a balanced and complete general ledger for the city, including the failure to record all transactions necessary for financial analysis and audit. Situation has existed for number of years.	Not known
Under Alabama law, the finance director is to insure that funds are available for expenditure before obligating the City for the expenditure. Finance director prepared checks for payment of payroll tax liabilities, pension deductions and other expenditures without funds available for payment.	Total of insufficient fund checks was $1,069,663
Generally accepted accounting principles require that the unfunded pension liability be disclosed on the face of the general purpose financial statements. City has not obtained an actuarial computation for several years. (Over 12 years according to interview of public official.)	Total unfunded pension liability estimated to be $20,000,000
City is required to disburse funds only for expenditures approved in amount and for specific budget line items. Finance department did not properly code expenditures as to appropriate budget line items. Finance department coded accounts to budget line items that had budget surplus in order to keep the appearance of proper spending during fiscal year.	Not known

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Table 5.9 (continued)
Summary of Prichard's Audit Findings
Fiscal Year 1998-1999

Under Alabama law, the finance director is to approve those items for expenditure only upon ascertaining that the money has been appropriated and allotted and that an unexpended and unencumbered balance is available to meet the expenditure. Finance director expended travel funds for the Mayor where there no funds available in the Mayor's travel line item in the budget.	Travel expenses of the Mayor totaled $1501
Under Alabama law, the finance director should only disburse funds upon receiving proper documentation for the expenditures. Of the 49 sample items, 26 payments were made without proper documentation.	Total undocumented costs found through this audit were $81,040
City is required to maintain detailed property records showing date acquired, original costs, and location of assets. The City does not maintain property records. This condition has existed for several years.	Not known
Bank accounts were not reconciled monthly and should be included in the general ledger. Several bank accounts were inactive and had not been reconciled or closed. Finance department did not feel it necessary to reconcile the accounts of the City.	Not known
Travel expenses were not properly documented. Actual receipts and tickets were not required to be turned in prior to travel expense being paid out of city fund.	$9,941 in undocumented travel expenses found
Expenditures of federal funds require proper documentation of the expenditure including purchase orders and invoices detailing the expenditure. City failed to provide proper documentation or invoices to document the expenditure. Auditors cited example or two instances where $7,150 and $3,025 were paid for vehicles with no documentation or identification numbers included on the invoice or payment documents.	Total questioned costs found were $16,067 without any supporting documentation
City failed to monitor federal or state pass-through grants as provided for in the grant agreement as a condition of receiving the grant.	Total expenditures for the year were $400,757

Source: City of Prichard Audit Report, 2001, pp. 40-65.

City officials admitted that the pension payments had not been made by the city for years and the unfunded liability for the plan was over $20 million at the time of the

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bankruptcy. As of this writing, the plan is still unfunded by approximately $16 million (Confidential Interview with Public Official, March 28, 2007). The pension plan, called the City of Prichard Municipal Employees Pension and Relief Fund, was created through Alabama legislation in 1956 and administered by a Board of Pensions. It is a single-employer defined benefit pension plan and has been under-funded since 1975 (Prichard, 1999, Exhibit VIII). Main problems for the pension plan stemmed from multiple legislative acts at the request of the Pension Board to increase employer contributions, inclusion of overtime and unpaid accumulated sick, comp and vacation leave in the calculation of pension benefits and lack of annual actuary reports on the funding of the plan (Exhibit VIII, pp. 10-14).

As mentioned previously, at the time of the bankruptcy the liabilities in Exhibit IX of the Disclosure Statement were $4,884,830 prior to negotiation. These obligations are shown in Table 5.10.

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Table 5.10
City of Prichard Liabilities
As Shown in Disclosure Statement

Creditor	Amount	Type of Liability
Regions Bank	$1,339,338	Municipal bond for municipal complex
Unsecured Creditors	$972,734	General operation expenses
Lasner Fund (Undisputed)	$730,903	Unpaid liabilities of city
Internal Revenue Service	$439,647	Unpaid withholding taxes and FICA taxes
Lasner Fund (Disputed)	$400,000	Disputed
Pension Fund (not part of underfunded amount)	$369,205	City's payment for the 1999 fiscal period
Alabama Power	$294,269	Unpaid utility bills
State of Alabama	$102,350	Unpaid withholding taxes and statutory payments.
Compass Bank	$91,618	Real estate loan
Banc One	$75,091	Fire trucks
Citicorp	$69,675	Radios
Total	$4,884,830	

Source: City of Prichard Disclosure Statement, 1999, Exhibit IX, pp. 2-3.

Prichard prevailed over its mounting debt and closed its bankruptcy case on December 1, 2002. Final payments on the bankruptcy as well as the Lasner Fund liabilities are to be completed by the end of the 2007 fiscal year. This is notable as the bankruptcy plan of adjustment did not forecast this to occur until 2008 or later. No audit findings or questionable costs have been found by independent auditors for the 2004 fiscal period forward (City of Prichard 2007 State of the City Address, March 28, 2007). A change in city leadership, including the Mayor and the City Council, was effected when a Mobile County Circuit Court removed Mayor Norwood from his position in March 2000 after he was found guilty of willful neglect of duty in a public office. His conviction stemmed from mismanagement of city funds. In June 2000, the Alabama

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Department of Examiners of Public Accounts ruled that Norwood would have to remit $3.4 million in fines from the Prichard bankruptcy. This amount was based on city expenditures in excess of budgeted appropriations, IRS interest and penalty payments from the delayed payments on behalf of employees as well as the lost interest accruals on the employee's retirement funds (Norwood, 2000). This amount has not been paid to date.

Prichard's Mayor and City Council are presently working together under an operating budget. They have hired competent and knowledgeable professionals in administrative positions, and they are implementing the city's first comprehensive strategic plan. Furthermore, the City has received over $8 million in state and local grants and is slated to be the site for a new motor sports park and FedEx facility in the near future. Downtown revitalization efforts are underway and appropriate financial oversight is being accomplished by city officials (Confidential Interview with Public Official, March 28, 2007).

West Jefferson Amusement Public Park and Authority

In an effort to revive the local economy and bring theme-park enthusiasts to Alabama, the West Jefferson Amusement Public Park and Authority was created in September 1995 by 11 local municipalities in the west Jefferson County area. The authority was composed of seven cities (Adamsville, Bessemer, Birmingham, Brighton, Fairfield, Hueytown, and Lipscomb) and four towns (Maytown, North Johns, Sylvan Springs, and Vance) (West Jefferson, 2002, p. 6). The authority was authorized under

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Alabama Act 96-320 under the provisions of Code of Alabama 1975, Section 11-47-210. The incorporation documents show the mayors of Bessemer, Fairfield, and Adamsville as the original incorporators.

According to Fairfield's mayor and chairman of the authority, Larry Langford, the authority's primary undertaking was to develop a theme park named VisionLand, located in Bessemer, Alabama. The authority also expected to build a water park to be operated alongside VisionLand. Future plans included construction of a retail outlet center, multi-entertainment center called the E-Zone, and an aquarium on the 520 acre complex in Bessemer (Kamenetsky, 1996, p. 1).

In 1996, the authority issued $60 million in revenue bonds to build and equip the amusement park. The park opened in 1998 and issued an additional $5 million in bonds to finish construction and fund improvements to VisionLand. In 1999, $90 million in bonds were issued to refund the 1996 and 1998 bond issuances as well as to fund more improvements. Approximately 10 percent of the 1999 bond proceeds were to be deposited in a Project Development Fund for future improvements. Park revenues were to be the primary source of the repayment of the bonds. In addition, 11 municipalities signed a Funding Agreement in 1997 in order to support the authority. The total of the annual payment from these municipalities was $2,952,360. It was to be paid through the 2007 fiscal year. As taken from the Disclosure Statement filed with the Chapter 9 proceeding, the commitment by each municipality is shown in Table 5.11.

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Table 5.11
West Jefferson Amusement Public Park and Authority
Annual Pledges by Municipalities

Municipality	Annual Funding Requirement
Bessemer	$1,200,000
Birmingham	$1,000,000
Fairfield	$400,000
Hueytown	$152,800
Adamsville	$100,000
Brighton	$45,180
Lipscomb	$28,920
Sylvan Springs	$14,700
Maytown	$6,510
Vance	$2,480
North Johns	$1,770
Total	$2,952,360

Source: West Jefferson, 2002, Disclosure Statement, p. 8.

Nine of the eleven municipalities secured their funding agreement through their anticipated ad valorem taxes, while Birmingham and Maytown did not pledge their ad valorem taxes. The full faith and credit of each municipality was assured as a repayment for the bond issuance (West Jefferson, 2002, p. 9).

When VisionLand opened in 1998, it was met with great anticipation of increased tourism-related revenues to be experienced by all of the authority member governments. However, by the end of 1998 the park drew only 400,000 visitors – 50,000 less than forecasted. The authority decided to replace the general management of the park (Theme Parks Concepts, Inc.) in an attempt to revive interest in the amusement park (Mollis, 1998, p. 29). Park revenues continued to miss projections in the following years and other factors such as malfunctioning attractions, accidents to visitors, and low visibility and lack of easy access through the Alabama interstate system all seemed to

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contribute to the failing venture. Management of the park was replaced again in 2000. In an attempt to resuscitate the deteriorating financial outlook in 2002, the authority took over the management of the amusement park (West Jefferson, 2002, pp. 13-14).

The expansion plans for the outlet center and the E-Zone were plagued with tax and environmental issues. The Watermark Place, an outlet center, was constructed in 1998 adjacent to VisionLand and opened in 2000. The authority had hoped to attract economic development with a reduction in sales tax for shoppers (from 8 percent to 4 percent) and assumed that Bessemer and Jefferson County would forego their share of the sales tax revenues in order to offer this retail outlet to shoppers and potential retail establishments. However, neither local government had agreed to this arrangement. Only 36 retail tenants signed lease agreements. Furthermore, the E-Zone property was initially designed to be an entertainment complex including a bowling center, a multi-screen movie theater, a sports bar and several dining establishments. In 2001, this project was marred with environmental issues and the Alabama Department of Environmental Management issued two violations. These related to storm-water runoff and possible erosion on the E-Zone construction site and the authority was unable to commence construction as planned. Due to the lack of funds, no action was ever taken on the aquarium (West Jefferson, 2002, pp. 10-12).

On June 4, 2002, the authority filed for bankruptcy. At the time of bankruptcy, the entity owed approximately $100 million. Of this amount, $90 million was owed to bondholders and $10 million to creditors. Furthermore, the authority had initially defaulted on the principal and interest payments of the bonds in 2000. It had only made

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one partial payment to the bondholders in the amount of $844,000. The bonds were unrated, tax-exempt, revenue bonds with terms ranging from 7 to 30 years with various contract rates of 6 to 8 percent (Sigo, 2002, p. 37). Bondholders proceeded with litigation against the authority in 2001 and one bondholder, Massachusetts Assets Financing Corporation, filed a motion for the court to appoint a federal receiver over the authority's finances in April 2002 (West Jefferson, 2002, p. 14). N'Ovation Park Management was listed as the top creditor and claimed that it was owed over $2.75 million in past-due management fees (Goldman & Ellis, 2002).

It is apparent that the park had seen its share of financial woes since it opened in 1998. Many were caused by mismanagement along with lack of communication. For example, the authority attempted to issue another $10 million in bonds in 2000 in order to pay $4 million to over 700 vendors, owed from the previous summer's park operation. They planned to keep $6 million as a cushion for the park's operating budget. Mayors of the member municipalities were quoted as being unaware that the authority was pursuing this route of financing. They were being kept in the dark with regard to the decision making of the park's management, despite the fact that the municipalities had been making scheduled payments to the authority (Nicholson, 2000, pp. 1-3; Goldman & Ellis, 2002).

At the time of the bankruptcy petition, three of the member municipalities (Lipscomb, Maytown and Vance) had not paid their 2001 balances to the park and Bessemer still had an outstanding balance (West Jefferson, 2002, p. 10). Bessemer's government did propose to keep the park afloat with an additional appropriation.

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However, once officials learned that the funds would be going straight to the bondholders, they discontinued this offer (Bryan, 2002). Finally, after the bankruptcy filing, many municipalities immediately made an effort to pull out of the funding agreement (Ellaby, 2002; Goldman & Ellis, 2002).

In late 2002, the amusement park was sold to the San Diego-based Team Pro Parks LLC for $5.25 million. The original asking price from the authority was $25 million (Alabama, 2002, p. 1). Although the park was sold, the bondholders are still attempting to receive payment from the municipal members of the Authority per the funding agreement. The original funding agreement shown in Table 5.11 was still to be enforced. It called for the municipal members to pay a total of $2.9 million each year through 2007, even if the park was sold. In September, 2002, the city of Birmingham filed objections with the court over this continuing liability and Bessemer's City Council voted unanimously to end payments despite the legal agreement (Niolet & Bryan, 2002). In July 2003, a federal court ordered the City of Birmingham to pay $1 million plus interest to the bondholders for defaulting on its share of the bond payment (Judge, 2003). Adamsville opted to pay out their portion of the arrangement and chose to abide by the original funding agreement (Ellaby, 2002). The park continues to operate today under new owners and the bankruptcy proceedings are still not closed as of this date.

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Etowah Solid Waste Authority

Etowah County is located in the northeast corner of Alabama. Etowah's population is approximately 103,000 and has not seen much growth over the past ten years, according to the U.S. Census data (Census, 2006). The main cities in Etowah County are Gadsden, Attalla, Southside, Sardis, and Rainbow City. Etowah Solid Waste Authority was established in 1993 by the Etowah County Commission to handle garbage pickup and landfill operations for the county. Although the commission appointed the management positions, the authority operated independently of the commission. In January 2002, four individuals (Authority Administrator Brian McKee, his wife, Jennifer McKee, Crenshaw County Probate Judge Dwight Faulk and Crenshaw County Administrator Linda Williamson) were found guilty of mail fraud and money laundering by a federal court. At the time of their conviction, the four had defrauded the authority in the amount of $1.4 million during the time frame of 1995-2000. Insurance coverage only covered $100,000 of this loss (Dedrick, 2002).

Etowah Solid Waste Authority filed for Chapter 9 bankruptcy protection on June 25, 2002 (Etowah, 2002). The bankruptcy records reflect the financial status of the authority as depicted in Table 5.12.

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Table 5.12
Etowah Solid Waste Authority
Financial Status As Shown in Disclosure Statement

Assets		Liabilities	
Cash and Cash Equivalents	51,500.00	Wages and Benefits Payable	113,284.20
Accounts Receivable	71,173.06	ADEM Fines Payable	500,000.00
Restitution in Criminal Case, U.S. vs. McKee	1,009,109.46	Vendors Payable	61,941.03
Inventory	50,000.00	Revenue Bonds Payable	744,041.66
Property, Plant & Equipment	212,100.00	Notes Payable	143,755.44
Total Assets	$1,393,882.52	Total Liabilities	$1,863,022.33

Source: Etowah Solid Waste Authority, 2002, Schedules A – F.

From these records, the authority indicated a deficit of $469,139.81. Without the restitution amount included, this deficit would have been $1,478,249.17. At the time of the bankruptcy in 2002, the convictions of the four individuals were being appealed (Etowah, 2002, p. 8).

Since the Etowah Solid Waste Authority did not have requisite authority to file for Chapter 9 protection under Alabama law, the case was dismissed in October 2002 by a federal court (Etowah, 2002, p. 8). The landfill, equipment and sales and contract list of the authority were sold to Waste Management, a private firm, in December 2002. The authority operated until September 2002 and closed the landfill and terminated garbage pickup with more than $1 million in debts. At the time of this research, the authority was still hoping to collect over $1.4 million in restitution from the four individuals (Powell, 2004).

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Millport

Millport, Alabama, located in Lamar County, is a small northern Alabama town close to the Mississippi line. Millport was incorporated on February 28, 1887. According to the U.S. Census, the population is just over 1,000 individuals and has been declining since 1980 (Census, 2006). Millport filed for Chapter 9 protection on December 14, 2004. It appears that two factors contributed to the filing of bankruptcy. The first factor was that the town administration changed after the mayor who had served over 20 years was defeated in the October election. The new mayor, a retired banker, immediately realized the financial stress the community was facing. Upon taking office, the incoming mayor found that the former administration had failed to adhere to proper financial management policies and procedures which included creating and operating within a budget and properly using and accounting for revenues and expenditures of the town. Overdrawn bank accounts, bounced checks, and above average water and sewer user fees to maintain the chemical levels of the water and sewer system in accordance with EPA and health standards were contributing to the fiscal decline of the town (Confidential Interview with Public Official, March 12, 2007; Walton, 2004).

The town was unable to make payments on revenue bonds that were issued in 1993 to secure a loan from the U.S. Department of Agriculture's (USDA) Rural Electricity Service for a sewer and water system upgrade in the community. The original issuance amount of the revenue bond was $2,081,000. The unpaid amount was $2,010,000 at the time of the filing. On May 26, 2004, the USDA entered a motion in federal court to place the municipality into a receivership due to the default on the bond

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indenture (Millport Auditor's Report, 2004, p. 1). The financial audits of the town's financial statements for the 2000, 2001, and 2002 fiscal years all made mention of the town's failure to meet the financial obligations of the outstanding bonds as well as noncompliance with the bond covenants. No mention was made as to why the default had occurred or what action was being taken by the town administration (Millport Auditor's Report, 2004, pp. 16-17; 2002, pp. 22-23).

In a letter from the U.S. Department of Justice dated January 18, 2005, the U.S. District Attorney stated that Millport had defaulted several times on the bond and had not submitted any audited financial statements for the 2003 and 2004 fiscal years as required by the bond issuance. Furthermore, the USDA cited the former administration for violation of the bond ordinances by expending the special revenue funds from the sewer and water system for city expenditures rather than solely for the systems' operating expenses and bond payments (Peeples, L.C. to Millport Administration, January 18, 2005, Town of Millport Bankruptcy File, Millport, Alabama).

The town also had two outstanding general obligation bonds in the amount of $435,000 and $820,000. These general obligation bonds were issued in order to renovate the Tom Bevill Civic Center and to refund a 1993 bond issuance and refinance the debt at a lower interest rate (Millport, 2004, pp. 5-6). The former mayor had also signed an agreement with an engineering firm to plan for beautification improvements to the town and a cultural arts center and the town owed an outstanding balance of $192,225.96 for this service (Floyd, T.N. to Millport Administration, December 9, 2003, Town of Millport Bankruptcy, Millport, Alabama). Other notable liabilities included $45,990.98

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which was past due to Waste Management for garbage and waste pickup service; $20,000.00 owed to the town clerk for funds borrowed from the clerk's personal savings by the former administration; $14,784.00 balance owed on office furniture purchased to furnish the new Town Hall and library; $6,862.26 owed to Alabama Power for utility services; and $8,781.28 owed to a chemical vendor that furnished chemicals for the town water and sewer system in order to keep the water levels at health standards. The total amount of outstanding obligations at the time of the bankruptcy filing was $3,505,993.58. After negotiation with creditors, the amended amount was reduced to $2,705,012.86 (Millport List of Creditors, 2004, pp. 1-6).

Additional analysis of the town's general fund operating statements for the 1999-2004 periods showed that $19,942.60 for insufficient funds and bank overdrafts had been paid by the former administration during the period of 1999-2004. An additional $2,390.34 was paid by the Water/Sewer fund in insufficient fund charges during the same time period. Almost $13,000.00 was advanced by the bank on the town's overdraft line of credit for the 2003 fiscal period alone. Finally, no budget was adopted by the town administration. Therefore, no legal document existed that showed how the former administration planned to allocate resources and meet obligations (Millport Auditor's Report, 2004, p. 23). The current administration noted that Alabama law does not require a legally adopted budget for town municipalities; however, the new administration is following the practice of adopting an operating budget and preparing a budgetary comparison schedule to inform the town administration, council, and public on how public funds are received, allocated, and expended. The administration and council are

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also proactively attempting to cut unnecessary expenditures as well as deal with the outstanding liabilities of the former administration (Confidential Interview with Public Official, March 12, 2007).

This bankruptcy case settlement included a requirement for the town to pay the USDA an additional $137,000 in interest and penalties and to continue to make payment in accordance with the original bond ordinances. The total amount covered by the settlement with the USDA was $2,147,000. The general obligation bondholders agreed to receive 8 percent of the monthly sales tax collections for a period of 40 years beginning in November, 2006. Since the bondholders agreed to receive a lesser amount, the parties retain an interest in the town hall municipal building which would convey only upon sale of the building or insurance settlement through property damage. This left a balance of approximately $112,000 due to other parties. The town agreed to pay $12,000 annually towards this balance by reserving $1,000 monthly throughout the fiscal year and making payment in January (Confidential Public Official Interview, March 12, 2007).

The second factor which was a major contributor to this particular bankruptcy was economic decline. Millport had suffered a great deal due to loss of jobs and population decline. According to the disclosure statement filed with the bankruptcy petition, "Millport experienced a decline in population of 16.08 percent since the 1980 census report" (Millport, 2004, Article II). This decline in population is expected to continue due to the loss of available employment in the local area. Weyerhaeuser Company, a plywood manufacturing facility, closed a portion of its facilities in the Millport community in 2003 contributing to the loss of 450 jobs. Other companies closed within a

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25-mile radius of Millport within the past 10 years, creating a further loss of 2,175 jobs (Millport, 2004, Article II). This economic downtown did not fare well for the town's sales tax revenue, and it declined by approximately 20 percent from the 2000 to the 2004 fiscal periods. The sales tax revenue receipts for the 2000 to 2004 fiscal periods are shown in Table 5.13.

Table 5.13
Millport Sales Tax Revenues, 2000-2004

Fiscal Year	Sales Tax Receipts
2000	$149,709.05
2001	$129,324.08
2002	$147,391.40
2003	$124,897.01
2004	$121,583.73

Source: Lamar County Revenue Commissioner, Personal Communication, 6/30/2005.

A survey taken in July 2005 for grant application purposes, showed that approximately two-thirds of Millport's population at or below the median income level for the state of Alabama. Furthermore, Millport's property taxes have been stagnant during this time period as the only new increase in property value assessments were due to reappraisal. The last new home construction occurred in 1994. Total net taxes assessed by the town dropped 4 percent and 7 percent for the 2001 and 2002 fiscal year, respectively, and have only recently exceeded the 2000 assessed amount (Confidential Interview with Public Official, March 13, 2007).

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Summary of Case Studies

Nine Alabama municipalities filed for Chapter 9 protection during 1990-2004. This included one county government, two city governments, two town governments, and four special district governments. These municipalities were not the first in Alabama to face dire fiscal stress. As an example, Brownville and Roosevelt City, two former west Jefferson County municipalities, were dissolved and annexed into Birmingham in the 1980s due to overwhelming debt and an inability to provide the requisite services their residents required (Pratt, 1991, p. C1). However, the nine local governments discussed in this case study are the only ones in Alabama that have filed for Chapter 9 bankruptcy protection in federal bankruptcy court.

In analyzing the nine municipal bankruptcies that occurred in Alabama, these case studies found the overall contributing factors tended to be financial mismanagement by municipal administrators and the economic decline of the municipalities from loss of businesses and demographic changes. In the cases where financial mismanagement was evident, several warning signals were available to government officials. These were either ignored or local officials were ill-prepared to deal with the problems. For example, the decline in revenues from Greenetrack as well as the recurring audit findings could have reasonably been addressed by Greene County administrators. Also, the decline in revenues for Lipscomb, Alabama State Fair Authority, Prichard, West Walker Water Authority and Millport were evident and the warning signals were apparent.

Either neglect or a lack of oversight by the government administrators and officials appeared prevalent in all of the cases. This was most evident with regard to the

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Alabama State Fair Authority, Etowah Solid Waste Authority, Greene County, Prichard, Millport and West Jefferson Amusement Park Authority cases.

North Courtland's tort judgment severely crippled the city's finances. The lack of insurance towards such incidents shows how municipalities are often unprepared for such events.

The economic decline of many of the municipalities, such as Lipscomb, Prichard and Millport highlights the inability of local governments to deal with financial stress and displays how they are unprepared to handle a reduction in tax revenues or an increase in services resulting from demographic changes in their communities. Local governments are normally without recourse in this situation, but "rainy day funds" and strategic planning by government officials could be vital to fostering continued financial health in light of these changes.

As to the VisionLand venture, the concept of increased tourism, economic development and revitalization of West Jefferson County seemed to be the predominant idea in planning for VisionLand and the other entertainment venues. However, lack of financial management, oversight, communication and strategic planning appears to have contributed to its failure. Even as VisionLand was opening its doors, many industry experts questioned whether the venture could compete with Six Flags over Georgia and WhiteWater Parks in Atlanta, Georgia (Kamenetsky, 1996, pp. 1-2). Other publicly-financed entertainment ventures, such as SuperSplash Adventure Water Park in Texas and the MegaStar Amphitheater in Oklahoma also failed and, like VisionLand, had to

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close their facilities before paying their municipal bond issues in full (Goldman & Ellis, 2002). Perhaps these entertainment ventures are best left up to private entrepreneurs.

The lack of a legally adopted budget was notable in most of these case studies. The Code of Alabama does not require an Alabama city or town to legally adopt a budget. A legitimate and legal budget is critical in that it serves as a guide to public officials in receiving and expending public funds. The budget can also be used as a benchmarking tool in assessing present and previous financial condition of the local government. Finally, it can serve as a measure of accountability for citizens and higher levels of government.

At the state level, it appears that the state did make attempts to help, but not intervene directly, in these particular cases. In 1990, the state awarded a grant to the University of South Alabama to assess Prichard's financial condition (Watson, Handley & Hassett, 2005). The study, conducted by the university, recommended immediate action by the city in addressing its fiscal stress. One of its recommendations was that a strategic plan to be put in place to avert municipal bankruptcy. Prichard filed bankruptcy in 1999. Another example of state assistance occurred in March 1994 when the state, along with Jefferson County and Birmingham, made a one-time collective contribution of $700,000 to the Alabama State Fair Authority to help with its mounting liabilities. The authority used the funds to pay outstanding liabilities but still filed bankruptcy in June 1994.

As to whether Alabama policymakers had any direct knowledge of the fiscal stress or related municipal bankruptcies, numerous findings of the audit from the Greene

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County Commission were repeat findings reported by the Examiners of Public Accounts. The Examiners noted almost $2,000,000 in charges of mismanaged public funds for Greene County. These charges were still outstanding at the hearing before the Chief Examiner of Public Accounts that took place in Montgomery on March 8, 1996. This is notable in that the Examiners are under the direction of the Legislative Committee of Public Accounts, a committee made up of five members from the House of Representatives and 5 members of the Alabama Senate. The Lieutenant Governor is the Chairman of this committee and the Speaker of the House is the Vice-Chairman. Further, Senator Hank Sanders, currently serving his 7th term in the Alabama Senate, was one of the attorneys retained by the county for the municipal bankruptcy.

The bankruptcy of the West Jefferson Amusement Public Park and Authority involved over $100 million in liabilities. The authority was able to sell VisionLand for only $5.25 million, a fraction of the amount owed to bondholders and vendors. In order for the authority to have requisite authority under state law to file for Chapter 9 protection, Alabama lawmakers passed and Governor Siegelman signed legislation to change the wording of the Alabama Code §11-81-3 from “governing body” to “municipal authority” (Alabama Act 2001-959, p. 839).

It is apparent that state officials, both elected and appointed, failed in their oversight responsibilities for the majority of these costly municipal bankruptcies. A discussion of these findings as well as possible reforms that could be implemented by Alabama state officials is contained in Chapter VIII of this research.

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Charles Lindblom once said "Much of politics is economics, and [most of economics is also politics]" (Lindblom, 1977). The case studies of the Alabama municipal bankruptcies seem to reinforce Lindblom's logic. It is difficult to separate politics and economics from each other when dealing with local government financial management.

Chapter VI provides a comparative analysis of methodologies presently in place within six states to address municipal fiscal stress and municipal bankruptcy. Chapter VII discusses the current legislation in place for Alabama local education agencies (LEA) and administered by the State Board of Education and State Department of Education as directed by the Alabama Education Accountability Act in 1995 and School Fiscal Accountability Act of 2006.

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CHAPTER VI

COMPARATIVE ANALYSIS OF STATES MUNICIPAL FINANCE REFORM METHODOLOGIES

This chapter discusses the municipal finance reform methodologies for fiscal stress and municipal bankruptcy employed by six states - Florida, Georgia, North Carolina, Ohio, Pennsylvania and Tennessee. All are located east of the Mississippi River and three are contiguous to Alabama. The states were chosen because of their location and because they have a variety of statutes in place for local governments when facing municipal bankruptcy and fiscal stress as shown in Table 1.5 in Chapter I of this research.

The ACIR (1973) found that the first mention of states intervening in local fiscal management began in the 1800s when over 25 percent of local governments defaulted on their bonds. The first state take over of a local government occurred in 1921 in Manchester, New Hampshire (Coe, 2007a, p. 2).

Florida

Florida created the *Local Government Financial Emergencies Act* in 1979 to preserve, promote and protect the fiscal solvency of the state's local government entities. This Act has been amended several times since 1979 with the most recent amendment enacted in 2006. In 2004, the Florida Senate renamed the legislation *Local*

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Governmental Entity and District School Board Financial Emergencies Act (Senate Bill 708, 2004). The legislation serves to assist Florida's municipalities in: providing essential services to their citizens without interruption; meeting their financial obligations; and improving local financial management procedures. This legislation, found in Part V of Chapter 218 of Florida Statutes, covers all local governments, charter schools and school district boards (Confidential Interview with Public Official, March 29, 2007). Section 218.503(1) of the Florida Statutes, states that these entities shall be subject to review and oversight by the Governor or the Commissioner of Education when any of the following conditions occurs within the particular governmental entity:

a. Failure within the same fiscal year in which due to pay short-term loans or failure to make bond debt service or other long-term payments when due, as a result of a lack of funds.

b. Failure to pay uncontested claims from creditors within 90 days after the claim is presented, as a result of a lack of funds.

c. Failure to transfer at the appropriate time, due to lack of funds:

    1. Taxes withheld on the income of employees; or
    2. Employer and employee contributions for
        a) Federal social security; or
        b) Any pension, retirement, or benefit plan of an employee

d. Failure for one pay period to pay, due to lack of funds:

    1. Wages and salaries owed to employees; or
    2. Retirement benefits owed to former employees.

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e. An unreserved or total fund balance or retained earnings deficit, or unrestricted or total net assets deficit, as reported on the balance sheet or statement of net assets on the general purpose or fund financial statements, for which sufficient resources of the local governmental entity, as reported on the balance sheet or statement of net assets on the general purpose or fund financial statements, are not available to cover the deficit. Resources available to cover reported deficits include net assets that are not otherwise restricted by federal, state, or local laws, bond covenants, and contractual constraints. Fixed or capital assets, the disposal of which would impair the ability of a local governmental entity to carry out its functions, are not considered resources available to cover reported deficits (Florida Statutes §218.5).

Section 218.503(2) states that the local government entity must notify the Governor and the Florida Legislative Auditing Committee when one or more of the aforementioned conditions have occurred or will occur in the near future. Further, Section 218.39(5) requires that independent certified public accountants, retained as auditors by the local government to audit their respective financial accounts and records, perform the 14 financial condition assessment procedures prescribed by the Florida Auditor General. These financial condition assessment procedures are commonly referred to as financial indicators and are ratios or trends that the Auditor General has adapted from the International City Management Association (1994), Dr. Kenneth Brown in conjunction with Government Finance Officers Association (GFOA, 1993), and other states' financial condition assessment procedures for their local governments, primarily Ohio and New York (Local Government Entity, 2006, p.2). If the independent auditor notes a

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deterioration of financial condition in the respective local government, the auditor must notify the local government management and document the presence of fiscal stress in the auditor's management letter along with a description of the related conditions of fiscal stress (Rules of the Auditor General, 2006, pp. 4-5). Finally, any state-level agency that determines that one of the aforementioned conditions of fiscal stress has occurred must notify the Governor or Commissioner of Education along with the Legislative Auditing Committee within 30 days after the event (Confidential Interview with Public Official, March 29, 2007).

Once the notification is made to the Governor or Commissioner of Education, the local government or school board is contacted by the respective executive office to determine what actions have been taken or will be taken to resolve the fiscal stress in the local government. For counties, municipalities or special districts in Florida, the Governor assigned responsibility to the Chief Inspector General (CIG) for determining if state assistance is necessary to assist the local government in dealing with the fiscal stress. Oversight of the financial status of the education related boards are handled by the Florida Commissioner of Education. If state assistance is warranted, the local government or school board would be declared in a state of financial emergency and the respective officer has the authority to implement measures to resolve the financial emergency. Both the CIG and the Commissioner of Education has the authority to implement the following measures, according to Section 218.503(3):

a. Approval and review of the local government's budget
b. Authorize a state loan to the local government entity

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c. Prohibit the local government from issuing any new bonds, notes, certificates of indebtedness, or any other form of debt

d. Inspect and review records, information, reports, and assets of the local government

e. Consult with public officials and auditors of the local government along with state officials to determine what steps are necessary to bring the accounting records, accounting systems, financial procedures, and reports into compliance with state requirements

f. Provide technical assistance to the local government

g. Establish a financial emergency board to review the operations and records of the local government and to make reports to the Governor/CIG or Commissioner of Education for action necessary to be undertaken. The Governor, or Commissioner, will appoint the board members and select a chair. The financial emergency board has the power to:

    1. Review records, reports, and assets of the local government
    2. Consult with local officials to determine what steps are necessary to bring the accounting records, accounting systems, financial procedures and reports into compliance with state requirements
    3. Review the operations, management, efficiency, productivity, and financing of the local government
    4. Make recommendations and reports for necessary action to the Governor or Commissioner of Education

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h. Require and approve a plan, prepared by the local officials in conjunction with the appropriate state officials, to prescribe appropriate actions to be undertaken in order to no longer be under financial emergency status. The plan must include payment of past due obligations designated as priority, which necessitated the financial emergency status initially; establishment of priority or zero-based budgeting so that items unaffordable under the local government's current revenue structure are eliminated; prohibition of services that can only be sustained with nonrecurring revenues (Florida Statute Section 218.503(3))

As to the municipalities, the *Inspector General Act* (94-235) created the Office of the Chief Inspector General (CIG) to be housed in the Office of the Governor. The role of the CIG is to "…be responsible for promoting accountability, integrity, and efficiency in the agencies under the jurisdiction of the Governor" (Office of the Chief Inspector General, 1994, p.1). According to a confidential interview with a public official, the financial crisis experienced in Miami during the 1990s prompted the legislature to create the CIG as well as the Governor to designate oversight of the local governments that meet the aforementioned criteria in Section 218.503(1) of the Florida Statutes to the CIG.

The CIG works closely with members of the Office of State Auditor, the Department of Financial Services and the Joint Legislative Auditing Committee to determine whether the municipality meets the conditions and requires state assistance. Also, the CIG staff reviews the annual audit reports and provides advice and assistance to local governments on an as-needed basis. Finally, in 2004 a Financial Emergency Oversight Committee was formed by the CIG to advise the CIG on local government

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financial emergencies as well as to assist in the review of the financial reports of local governments that are undergoing fiscal stress. This committee is made up of representatives of Florida state agencies and includes members from the Office of State Auditor, Financial Services, and Joint Legislative Auditing Committee along with staff from the Environmental Protection, Community Affairs, Revenue and Financial Services, Office of Policy and Budget, and Office of Tourism, Trade and Economic Development (Confidential Interview with Public Official, April 3, 2007; Annual Report, 2006, p. 25).

When the Office of the Chief Inspector General was created in 1994, 13 local governments met the conditions for fiscal stress and were being monitored by the state (1994, p. 10). Entities considered in "financial emergency" status with state oversight of the financial operations of the municipality are highlighted in each annual report of the CIG. The details and background of the respective fiscal stress as well as the progress being made by the municipal entity are discussed in the report.

In the latest report, the 2005-2005 Annual Report of the CIG, 53 local government entities, consisting of 20 municipalities and 33 special districts, were considered as financial emergencies and were undergoing monitoring by the state. Further, 39 additional local governments were in the process of being evaluated by the CIG to determine if the entities met the financial emergency status and whether state assistance was warranted (2006, pp. 28-29). The majority of these local governments have experienced fiscal stress due to socioeconomic factors such as loss of industry, unemployment and increase in demand for services. Also, political problems within the

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communities have contributed to the financial problems (Confidential Interview with Public Official, April 3, 2007).

Concerning municipal bankruptcy protection, all local governments must apply to the Governor (or Commissioner of Education in the case of school boards) for approval to file Chapter 9. This is normally only permitted after all aforementioned steps have taken place and the Financial Emergency Oversight Committee has determined that bankruptcy protection is the only viable option left to the municipality. No Florida municipality has filed for bankruptcy since 1995 which is mainly considered due to the oversight of the CIG (Confidential Interview with Public Official, April 3, 2007).

Georgia

Georgia is one of three states in the United States that expressly prohibits any of its local governments to file for Chapter 9 protection. Georgia Code §36-80-5 states:

> (a) No county, municipality, school district, authority, division, instrumentality, political subdivision, or public body corporate created under the Constitution or laws of this state shall be authorized to file a petition for relief from payment of its debts as they mature or a petition for composition of its debts under any federal statute providing for such relief or composition or otherwise to take advantage of any federal statute providing for the adjustment of debts of political subdivisions and public agencies and instrumentalities.
>
> (b) No chief executive, mayor, board of commissioners, city council, board of trustees, or other governmental officer, governing body, or organization shall be empowered to cause or authorize the filing by or on behalf of any county,

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> municipality, school district, authority, division, instrumentality, political subdivision, or public body corporate created under the Constitution or laws of this state of any petition for relief from payment of its debts as they mature or a petition for composition of its debts under any federal statute providing for such relief or composition or otherwise to take advantage of any federal statute providing for the adjustment of debts of political subdivisions and public agencies and instrumentalities (Georgia Code §36-80-5).

Although Georgia law prohibits municipal bankruptcy, Georgia does have programs in place at the state level to monitor financial health in local governments; however, the state does not normally intervene in the financial affairs of the municipality nor offer any emergency financial assistance.

The Department of Community Affairs and the Department of Audits and Accounts provide technical assistance to local governments in dealing with audit findings, financial accounting practices and state and federal regulations but do not normally travel to the site of the local government in order provide technical assistance or review the financial records. Normally, when a municipality undergoes major financial problems, the municipality will dissolve and transfer its assets and related liabilities to the county within which the municipality exists under Georgia Code §36-68-1. The county government is then responsible for providing the essential public services to the citizenry (Confidential Interview with Public Official, April 25, 2007).

In 1991, Georgia amended the Georgia Code to require each local government to submit an annual report of local government finances to the Department of Community

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Affairs. The annual report must include "… revenues, expenditures, assets, and debts of all funds and agencies of the local government and any other such information as may be reasonable requested by the department" (Confidential Interview with Public Official, April 25, 2007; GA Code §36-81-8). These reports provide important information which is used by state and local government policy makers to better understand and evaluate local government operations and service delivery strategies. Further, the receipt of annual financial information from the local government is mandated in order to receive any state appropriated funds from the Department of Community Affairs (DCA). The DCA then compiles the information and issues two annual reports from the financial information and other related municipal information. These reports, which can be found on the Internet, are *Georgia Local Government Finance [Year] County/Consolidated Government Fiscal Planning Guide* and [Year] *Local Government Finance Highlights.* Reports dating back to 1996 are available through the DCA website. The *Fiscal Planning Guide* is a larger report and shows average and per capita amounts for revenues, expenditures, and liability categories. Users of this report can compare local governments that are similar in population size and locality. The other annual report, *Local Government Finance Highlights,* is more consolidated and provides an overview of the financial data found in the *Fiscal Planning Guide* and also shows trend data for the last five years of fiscal operations (Confidential Interview with Public Official, April 26, 2007).

In 1994, Georgia instituted the requirement that all local governments submit their audited financial statements to the State Auditor for review to ensure that state and

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federal regulations along with generally accepted accounting principles and auditing standards are being followed by the local governments. Those local governments with populations of 1,500 plus (according to the latest Census) or $300,000 or more in expenditures are required to submit audits on an annual basis. Local governments that do not meet the aforementioned requirements must have an audit performed every two years in lieu of annually. Audit reports are due to the State Auditor within 180 days after the fiscal year end of the local government. Further, if the local government fails to receive an audit, the State Auditor shall inquire of the local government as to the status of the audited financial report and send a copy of the inquiry letter to the Georgia General Assembly members who represent the constituents of that particular local government. The State Auditor will publish notice in the newspaper of general circulation that the respective local government has failed or refused to file an audit report or correct audit deficiencies as required by state law for those local governments who: fail, refuse or neglect to have an annual audit performed; fail to submit a copy of the annual audit report; or fail to correct any audit findings noted by either the State Auditor or the local government auditor. This notice (which is required to appear twice or more) shall be in a prominent advertisement or news article and should not be buried within the legal notices. No state agency is allowed to approve or transmit any state grant funds to a local government that has failed to submit audits to the State Auditor within the previous five-year period (Confidential Interview with Public Official, April 26, 2007; Georgia Code §36-81-7).

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In 1993, the Georgia Assembly required that local governments that are authorized to operate under general statute, local law or local constitutional amendment register with the Department of Community Affairs (DCA) on an annual basis. This registration process allows a continuing record of viable local governments operating in Georgia as well as records the local government's financial data that is to be registered in the DCA website within 180 days of the local government's fiscal year end (Report of Registered Authority Finances). Also, as result of this 1993 legislation, the legal existence of 188 local governments was terminated on July 1, 1995 by the General Assembly for lack of registration with the DCA. The General Assembly continues to review the annual report to assess whether further local governments should be dissolved. Seven additional local governments have been dissolved since the initial termination process in 1995 (Higdon, Jim, personal communication, March 9, 1995; Confidential Interview with Public Official, April 25, 2007).

In 1995, the Georgia Assembly also created the Georgia Future Communities Commission (HR 324). The purpose of the Commission was to issue a report to the General Assembly, the Governor and the Lieutenant Governor with proposals for legislation "… improving the future of Georgia's communities and the citizens residing therein" (1995, p. 3). It was to "… examine governmental, social, and economic issues confronting local governments….to develop specific proposals to ensure that all of Georgia's local governments become catalysts for economic prosperity" (1995, p. 2). Its report of recommendations was due during the 1996 legislation session. The Commission was extended via legislation (HR 987, 1997) in the 1997 legislative session

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and issued its final report to the General Assembly in January, 1998. It was entitled *A Strategy for Promoting Georgia's Future Prosperity.*

The Commission was made up of nine private sector members appointed by the Georgia Chamber of Commerce; ten members of the Georgia General Assembly (five appointed by the House Speaker and five appointed by the President of the Senate); five county officials appointed by the Association County Commissioners of Georgia; one county constitutional officer appointed by the County Officers Association of Georgia; and five municipal officials appointed by the Georgia Municipal Association. Commission members did not receive any pay for their services except for those members of the General Assembly who received allowances as normally provided when legislative members served on interim legislative committees (1995, pp. 3-4).

The commission considered one if its guiding principles to be "… encouraging accountable, responsive, and understandable local government and cost effective, financially sound service delivery systems …" in all of the Georgia municipalities (GFCC, 1998, p. 4). Among the commission's recommendations was a uniform chart of accounts for the local governments to employ in their accounting systems. The Commission heard from many state and local officials in their review of current financial practices (1996-1997) and found that a common complaint was the lack of comparability in financial and service delivery presentation in the annual reports of the local governments. Thus, the Commission recommended that local governments be encouraged to account for and report on the use of financial resources in a consistent and uniform format along with following generally accepted accounting principles and state

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and federal regulations (2001, pp. 1-3). This would mean that all local government accounting records, audited financial reports, and related state agency reports submitted by the local government would be comparable, consistent and uniform (p. 1). As such, the Georgia Assembly passed House Bill 491 during the 1997 session of the Georgia Assembly requiring:

> Provide minimum budget, accounting, and auditing requirements for local governments so as to provide local taxpayers with an opportunity to gain information concerning the purposes for which local revenues are proposed to be spent and actually spent and to assist local governments in generally improving local financial management practices….provide a mechanism through which appropriate information may be collected to assist state and local policy makers in carrying out their lawful responsibilities….to provide for the collection and reporting of information so as to assist local taxpayers and local policy makers in understanding and evaluating local government service delivery and operations (1997, pp. 1-2).

This legislation required that the Uniform Chart of Accounts be adopted and put into effect by December 31, 1998. A subsequent revision of the Chart of Accounts was necessary due to GASB 34 implementation in 2001 and was revised by the Department of Community Affairs (DCA) and Department of Audits and Accounts in 2001 (Confidential Interview with Public Official, April 26, 2007).

The Commission also recommended that the Department of Community Affairs (DCA) be responsible for compiling information on each local government to "… assist

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local taxpayers and local policy makers in understanding and evaluating local government services and operations …" which could serve as a benchmarking tool to "…foster accountability and productivity improvement in cities and counties throughout Georgia" (Community Indicators History). HB 491 (1997) amended GA Code §36-81-8 to give the DCA the responsibility of creating an annual community indicators report for those local governments in Georgia with expenditures of $250,000 or more. This report is published annually on the DCA website and is created based on the data received by local governments in their financial reports and other reports submitted to the DCA.

The last major municipal finance legislation in Georgia passed during the 2001 General Assembly session under House Bill 75. This legislation amended Georgia Code §36-82-10 to include a requirement that local governments submit an annual report of indebtedness to the DCA. Any issuance of public debt that was $1,000,000 or more was to be reported to the DCA. This included general obligation bonds, revenue bonds, or any other bonds, notes, certificates of participation, or other such obligations. This legislation excluded any debt that would be retired within a 12 month period. Further, the filed report was to include a detailed description of purpose(s) for the debt issuance as well as the term of issue and true net interest costs to the municipal entity (Confidential Interview with Public Official, April 26, 2007; Georgia Code §36-82-10).

North Carolina

In 1931, North Carolina's General Assembly established the Local Government Commission (LGC) to address fiscal stress problems in local governments caused by the Great Depression. At that time, over 62 counties, 152 cities and towns, and 200 special

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districts were in default on their outstanding municipal bond issuances. The *Local Government Finances Act*, North Carolina General Statute §159-3, created the LGC to provide technical assistance to local governments and public authorities in North Carolina.

According to §159-3, the LCG is to be composed of nine members. These members include the State Treasurer, the Secretary of State, the State Auditor, the Secretary of Revenue, three members appointed by the Governor, one member appointed by the General Assembly upon the recommendation of the Senate President Pro Tempore, and one member appointed by the General Assembly upon the recommendation of the Speaker of the House. As to the gubernatorial appointees, one must be a representative of the city governments. The respective appointee must have served or be currently serving as a mayor or member of a governing council of a North Carolina city. The other gubernatorial appointee represents the counties and must have served or be currently serving as a member of a North Carolina county commission. The State Treasurer serves as Chairman and appoints the Secretary of the Commission, who will direct the LCG administrative department, currently called the State and Local Government Finance Division, housed in the State Treasurer's office. The LCG meets on a quarterly basis in Raleigh. The Executive Committee of the LCG, made up of the State Auditor, State Treasurer, Secretary of State, and State Secretary of Revenue, meets on a monthly basis (North Carolina Statute §159-3).

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Essentially, the LCG focuses on three aspects of local government finance:

1. Approval of local government proposed borrowing of funds.
2. Making the sales arrangements of debt or bonds on behalf of the local government.
3. Reviewing, monitoring and regulation of the annual financial reporting and auditing of local governments (The Role of the Local Government Commission, 2004, pp. 1-2).

The State and Local Government Finance Division, housed in the State Treasurer's office, has three sections – The Debt Management Division; The Fiscal Management Division; and the Capital Facilities Division. The Debt Management Division and Fiscal Management Division address the fiscal management concerns of the local governments. The regulatory authority for these divisions is derived from *The Local Government Budget and Fiscal Control Act* (§159 Subchapter III) and the *Local Government Bond Act* (§159 Subchapter IV). Both of these Acts were enacted in 1971 (Confidential Interview with Public Official, March 29, 2007).

The Debt Management Division approves and handles the sale and delivery of all local government debt issuances. Each proposed borrowing is reviewed by this division and a determination made on the affordability and feasibility of the proposed borrowing. The division must also approve the form of financing. Additionally, this division maintains the bond records and register of the bonds and monitors repayment of debt service payments by local governments. If a unit of government fails to pay any installment of principal or interest on its outstanding debt, which includes general

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obligation bonds, special revenue bonds, bond anticipation notes, tax anticipation notes, or revenue anticipation notes, and remains in default for 90 days, the Commission has the statutory powers to investigate the municipality's fiscal affairs, consult with the municipality governing management, and negotiate with its creditors to work out a plan for repayment of the debt.

The LCG can order a local government to raise taxes or other revenues in adequate amounts to make the necessary debt service payments. The Commission will enter an order to the local government to enact the plan within 90 days, and if met with resistance by the local government, the Commission may request a court order enforcing the plan of adjustment. Once the local government is under the plan of refinancing, the Commission has the authority to require periodic reports on the municipality's fiscal affairs and must review and approve the annual budget ordinance submitted by the municipality to the Secretary of the Commission (Deputy State Treasurer). The Secretary may recommend changes to the budget; those changes must be implemented by the local governing officials before adoption of the local budget can take place (North Carolina Statute §159-176). The Commission will remain involved until the municipality has made satisfactory progress towards repayment of debt payments under the refinancing plan (Confidential Interview with Public Official, March 29, 2007).

The Fiscal Management Division monitors and analyzes the financial and accounting practices of the local governments. This division derives its statutory authority from *The Local Government Budget and Fiscal Control Act* (1973) which prescribes fiscal and accounting standards for local governments and authorities. The

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legislation addresses preparation of the annual budget ordinance, fiscal and internal controls, accounting systems, capital reserve requirements, financial reporting, annual audits and related requirements, investments, and risk management. This division also monitors the fiscal health of the local governments as well as provides technical assistance and training to local governments and the certified public accountants retained by those local governments for accounting and auditing services. In the area of fiscal health monitoring, the local government must submit its annual Comprehensive Annual Financial Report (CAFR) to the Commission and the staff will input the financial data into a database where statistical trends are analyzed and historical data are maintained (2004, pp. 1-6).

An interesting note concerning the LGC is the requirement that local governments submit their audit contract, which shows the entities' auditor selection, to the LGC for approval as well as the related billing costs of the audit at the end of the audit engagement. The final payment to the auditor is allowable only after the LGC approves the annual financial report of the municipality and if the audit was conducted under governmental auditing standards. Audit contracts are provided through the LGC website and are updated annually for new governmental and auditing standards. The audits are to be completed by October 31 which is four months after the normal fiscal year for North Carolina local governments. Further, the local government is to send two copies of the audit to the LGC for extensive review. If another state agency, such as the Department of Transportation, requires the annual audited financial report, it is normally forwarded by

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the LGC after the review process is complete and all financial requirements have been met on a satisfactory basis (State Treasurer Policies Manual, 2003, pp. 11-14).

In a phone interview with public officials, it was noted that North Carolina's local government bond rating is AAA and this is not matched by any other state in the United States, as of the date of this research. At present, over 1,000 municipalities submit their annual audited financial reports to the LGC for review and an average of 200 municipalities receive warning letters from the LGC each year. Items of concern noted during reviews are normally: a qualified auditor's opinion, the general fund balance does not have enough available cash on hand (must be 9% or greater), deficit fund balances, overspending the budget, problems with internal controls, and property tax collections below 90% of current assessed taxes for the fiscal year. Normally, municipalities will request immediate assistance from the LGC or their respective auditors on how to address the financial concern and avoid state involvement. Also, the LGC compiles all of the municipal financial data, as taken from the audited financial reports, to benchmark financial patterns for the municipalities which is maintained on the State Treasurer's website since 1994 and is entitled *North Carolina County and Municipal Financial Information* (Confidential Interview with Public Officials, March 29, 2007).

According to the public officials interviewed, only four municipalities (three cities and one water and sewer authority) have undergone state financial intervention procedures administered by the LCG since the 1980s. Of these four municipalities, only the water and sewer authority filed Chapter 9 bankruptcy because there was no other option due to the overwhelming liabilities of the entity. The other three entities' financial

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problems were largely due to a mixture of poor financial management, fraud, and political problems. In those three cases, the LGC actually implemented the operating budgets as well as made all of the financial decisions for the entities while the municipalities were under intervention (Confidential Interview with Public Officials, March 29, 2007).

Coe (2007b) considers North Carolina's municipal finance procedures to be a model for other states to emulate in their local government finance reforms. Coe found that North Carolina had the most local governments with the highest bond rating of all of the credit rating agencies (p. 1). He attributes this to the state reviews and approval of local debt issuances and the strong state oversight of local financial management. As far as the approval of local debt issuances, Coe found that North Carolina is the "…only state legally responsible for the issuance of all local government debt" (p. 3). He reiterates the facts described by the public officials I interviewed. In addition, he found that each of the three cities under state intervention was returned to local government financial control within a year of the intervention (p. 2).

Ohio

In 1979, Ohio adopted legislation entitled *Local Fiscal Emergencies* in response to the Cleveland, Ohio bond anticipation note default that occurred in 1978 (ACIR, 1985; Hildreth, 1998; Beckett-Camarata, 2004). Initially, the legislation only addressed fiscal problems for Ohio's cities. On September 3, 1996, Ohio House Bill 462 was enacted to

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amend the fiscal emergency legislation to include counties and townships (State Bulletin 96-018). The legislative intent is to:

> Declare it to be a public policy and public purpose of the state to require fiscal integrity of municipal corporations, counties, and townships so that they may provide for the health, safety, and welfare of their citizens; pay when due principal and interest on their debt obligations; meet financial obligations to their employees, vendors, and suppliers; and provide for proper financial accounting procedures, budgeting, and taxing practices (State Bulletin 96-018, p. 1).

Under the 1996 legislation, there are three legal definitions for three stages of fiscal problems in local governments. These are:

1. Fiscal Watch/Fiscal Monitoring – the initial stage of fiscal distress. This stage was added, under the 1996 legislation, to encourage municipalities to seek guidance and assistance from the Office of State Auditor in order to avoid the other two stages of fiscal distress. (Monitored factors will be discussed below.)
2. Fiscal Stress – declared when one of the fiscal watch/fiscal monitoring factors is present and the municipality is unable to fund services due to a decrease in resources or an increase in demands for resources.
3. Fiscal Emergency – reserved for the most severe financial problems and necessitates the Governor appointing a Financial and Planning Supervision Commission (FPSC) to oversee the entity's financial matters (Confidential Interview with Public Official, March 27, 2007; Ohio Code; Beckett-Camarata, 2004).

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The state auditor, who is independently elected to office, has the responsibility to certify that a local government is experiencing fiscal problems. Ohio's State Auditor's office is unique in that this office is legally charged with auditing all public entities in Ohio. This includes cities, villages, schools, universities, counties, townships, and state agencies, boards and commissions. Municipalities with 5,000 or more residents are required to have an annual audit performed by the State Auditor's office whereas those with less than 5,000 receive an annual audit of the financial statements every two years. The State Auditor's office employs over 700 auditors and is one of the largest accounting offices in the United States. The goal of the State Auditor of Ohio is to provide accountability and integrity in public spending in all levels of government (Confidential Interview with Public Official, March 27, 2007).

Chapter 118 of the Ohio Revised Code details the state regulatory action when a local government in Ohio is experiencing financial problems. According to the State Auditor's website, if a local government experiences any of the following conditions, this places the local government under fiscal watch:

1. All accounts that were due and payable from the General Fund for more than 30 days, less the year-end balance of the General Fund, exceeded one-twelfth of the general budget for the year.
2. All accounts that were due and payable from all funds for more than 30 days, less the year-end balance in these funds, exceeds one-twelfth of the available revenue for the preceding fiscal year from these funds.

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3. Total deficit funds, less the total of any balances in the General Fund and in any special fund that may be transferred to meet such deficits, exceeds one-twelfth of the total General Fund budget for that year and the receipts to those deficit funds during that year (other than transfers from the General Fund).
4. Money and marketable investments, less outstanding checks, less total positive fund balances of general fund and special funds, exceeds one-twelfth of the total amount received during the preceding fiscal year.
5. Based on an examination of a financial forecast approved by the legislative authority, the auditor of state certifies that the general fund deficit at the end of the current fiscal year will exceed one-twelfth of the general fund revenue from the preceding fiscal year (State of Ohio Local Government Fact Sheet).

According to Ohio Revised Code §118.021:

> a fiscal watch review shall be initiated by a written request to the auditor of state from the mayor of the municipal corporation, or the presiding officer of the legislative authority of the municipal corporation when authorized by a majority of the members of the legislative authority; from a board of county commissioners, or the county executive of a county formed under Chapter 302 of the Revised Code; or from a board of township trustees; or may be initiated by the auditor of state (Ohio Code).

The Governor can also request that the municipality be considered for fiscal watch.

When the Office of the State Auditor is contacted, the Auditor will acknowledge receipt of the request and commences a review of the entity finances. Once the

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municipality is determined to be under fiscal watch, the Code provides that the Auditor of State may provide technical and support services to the entity and the related costs are paid out of the Auditor of State's budget funded by the State of Ohio. Thus, the municipality does not bear any related costs for technical or support services. The fiscal watch is lifted if the State Auditor determines that the aforementioned conditions are no longer present and the municipality is able to operate on a fiscally sound basis or if the State Auditor declares the municipality in a fiscal emergency status (Confidential Interview with Public Official, March 27, 2007; Local Government Fact Sheet; Ohio Code §118.023).

Fiscal stress status is normally utilized as a secondary warning system. It signifies that the municipality not only meets at least one of the five aforementioned financial conditions that triggered the fiscal watch, the municipality also is unable to fund current service delivery needs either due to a decrease in expected revenues or an increase in demand for current services (Confidential Interview with Public Official, March 27, 2007; Beckett-Camarata, 2004, p. 619).

Financial emergency status is declared when the municipality meets the same conditions of fiscal watch; however, the fraction is changed to one-sixth in lieu of the one-twelfth found under fiscal watch. Also, the condition must exist for at least 120 days (four months) after the fiscal period ends. Further, the State Auditor's website notes that the presence of the following three conditions necessitates an immediate fiscal emergency to be declared in an Ohio local government:

1. Existence of a debt obligation for more than 30 days.

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2. Failure, due to lack of funds, to meet all employee payroll within 30 days of when payroll payment is due unless two-thirds of employees have agreed, in writing, to a delay in payment up to 90 days.
3. County budget commission increases the county's inside millage rates which necessitates a reduction in taxation rates for other taxing districts. Ohio's constitutional tax limitations require that the County Budget Commission annually approve each political subdivision's proposed taxation rates and ascertain that all levies are within constitutional limits (Local Government Fact Sheet; Ohio Code §5705.31).

Any municipality declared to be in financial emergency status is immediately placed under the oversight supervision of the Financial Planning and Supervision Commission (FPSC), under Ohio state law.

A separate commission is formed with respect to each municipality that meets the financial emergency conditions as set forth in the state statutes. Further, each FPSC is considered to be an agency of the state, is funded by the state, and is made up of seven members, which include:

1. State Treasurer
2. State Director of the Office of Budget and Management
3. Mayor (City); President of the Board of County Commissioners (County); or Member of the Board of Township Trustees (Town) [depending on the municipality under fiscal emergency]

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4. Presiding officer of the legislative authority of the municipal corporation – City Council President (City); County Auditor (both County and Town)
5. Three citizen members – the Governor selects the citizen members from a list jointly prepared and submitted by Numbers 3 and 4 (above). These nominees must:
    a. have an understanding of financial matters, financial management or business operations;
    b. have five years or more experience in the private sector in one of the following: management of a business or financial enterprise, public accounting, management consulting or other professional activity;
    c. reside, work or conduct their professional activity within the municipality under fiscal emergency;
    d. not have held an elective public office within the past five year period nor plan to become a candidate for public office for the duration of the commission (Auditor of State Bulletin 96-018, 1996).

The Auditor of State is the financial advisor to the FPSC. The Auditor of State designates office staff of the Auditor of State office to provide ongoing technical support and advice as requested by the commission. This staff also reviews the fiscally stressed municipal entity's current accounting system and financial reporting, determines what changes or improvements are necessary, and notifies the commission members of their findings in this area. Finally, upon request by the FPSC, accounting and budget personnel from any state agency may be temporarily reassigned to the municipal

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government location of the financial emergency to assist in financial management (Introduction to Fiscal Emergency, 2004, pp. 2-4).

According to *An Introduction to Fiscal Emergency,* a handbook written by the State Auditor's office given to newly appointed FPSC members:

> The primary function of the commission is to assist in the preparation of a long-range financial plan designed to remedy the government's financial problems. The plan is intended to be a detailed, step-by-step guide agreed to and accepted by both the local government and commission. Once the plan is in place, the role of the commission is to insure that the plan is followed (p. 2).

Within a period of 120 days after the initial meeting of the commission, the municipality political leadership (mayor, county commission, or township trustees) must submit to the FPSC a detailed financial plan that was approved by ordinance or resolution. This plan addresses the following actions to be taken by the local government to:

1. Eliminate all fiscal emergency conditions that are shown to exist through the analysis done by the Auditor of State's office;
2. Satisfy any judgments, past due accounts payable, and all past due and payable payroll and related fringe benefits;
3. Eliminate the deficits in all deficit funds;
4. Restore to construction funds and other special funds any monies that were used for purposes not within the purposes of such funds, or borrowed from construction funds by the purchase of debt obligations of the local government

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with the monies of such funds, or missing from the construction funds or special funds and not accounted for;

5. Balance the budgets, avoid future deficits in any funds, and maintain current payments of payroll, fringe benefits, and all accounts;
6. Avoid any fiscal emergency condition in the future;
7. Restore the ability of the local government to market long-term general obligation bonds under provisions of applicable law (Introduction to Fiscal Emergency, 2004, pp. 5-6).

The plan should also include a reasonable timetable to complete these actions and discuss:

1. Any planned debt obligations that the local government intends to issue along with assurance that state constitutional debt limitations will be observed;
2. Make recommendations for cost reductions or revenue increases to achieve balanced budgets;
3. Require the local government to establish monthly levels of expenditures and encumbrances in accordance with the plan;
4. Provide for the monitoring and approval of such encumbrances and related expenditures;
5. Require related justification documentation for departure from any of the said plan (Introduction to Financial Emergency, 2004, pp. 6-7).

If the commission does not approve the proposed plan, it must notify the local government political authority as to the reasons for its rejection and the respective

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authority has 30 additional days to submit another plan for approval. If the local government fails to submit a financial plan, the entity is restricted in its expenditures from its general fund. The restriction limitation is capped at 85 percent of the prior fiscal-year expenditures for the same month, unless the commission authorizes a higher percentage. Once the plan is approved and adopted by the respective legislative authority (city, county, or town), it is filed with the commission as well as the Auditor of State's office (Ohio Code §118.07; Introduction to Fiscal Emergency, 2004, pp. 5-8).

According to the handbook, each FPSC must make an annual report as to the progress of the local government and its financial recovery, or lack of recovery, to the Speaker of the House of Representatives and the President of the Senate by the first day of April. Interim or additional reports may be requested by members or committees of the Ohio General Assembly on a case-by-case basis. The commission may also make reports to the legislature to request specific legislation to assist the local government in enhancing their local revenue sources or financing options (Introduction to Fiscal Emergency, 2004, p. 17).

A FPSC continues to supervise and monitor the local government's financial affairs until the local government has met the following four conditions:

1. Planned for and is in the process of implementing, within a two-year period, an effective financial accounting and reporting system. This system must meet requirements as set forth in §118.10 which states "… to record and report its fiscal activities on an accurate, current, and continuous basis in order to facilitate the effective management of the affairs of the municipal corporation, county,

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or township …" (§118.10B).

2. Corrected and eliminated, or is the process of correcting and eliminating, all of the fiscal emergency conditions that existed at the time of the fiscal emergency declaration by the Auditor of State and no new fiscal emergency conditions have occurred since that time.
3. Met all of the objectives of the financial plan as set forth by the commission.
4. Submitted a five-year financial forecast, created in accordance with the Auditor of State standards, to the Auditor's office for review and receive an opinion from the Auditor that finds the forecast to be in compliance (Introduction to Fiscal Emergency, 2004, p. 18).

When all of these conditions are met, the local government, the Governor, or the commission have the power to submit a formal written request to the Auditor of State for an updated analysis of the local government financial conditions. Once the Auditor's office determines that the local government no longer meets the conditions as set forth in the fiscal watch or financial emergency legislation, the financial emergency may be lifted. When the financial emergency is lifted, the commission is terminated and the Auditor of State, the Governor and the budget commission will be notified. The commission's final step in this process is to submit a final report of its activities from inception to termination to the Auditor of State (Introduction to Fiscal Emergency, 2004, pp. 18-19).

Although the fiscal emergency status is lifted on the local government, the Auditor of State is required to monitor the progress of the entity to ensure that all of the

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fiscal emergency conditions have been corrected and eliminated. If all of the conditions have not been successfully corrected and eliminated within a two-year period, the Auditor may re-declare the entity to be under fiscal emergency and reconvene the FPSC (2004, p. 19).

As mentioned previously, this state-administered program to assess and assist local governments in financial straits was created in response to the financial stress experienced by Cleveland, Ohio in 1978. However, it was the City of Niles, Ohio that was the first municipality to be placed under fiscal emergency on January 3, 1980. Since the legislation has been enacted, many Ohio local governments and school districts have been placed in fiscal monitoring and the fiscal emergency status as directed in Ohio Code Chapter 118. Table 6.1 shows the number of entities that have been placed in each category along with the number released. No municipality has been placed in the fiscal stress category.

Table 6.1
Numbers of Ohio Local Governments/School Districts
In Fiscal Watch or Fiscal Emergency
1980-2006

Declared in Fiscal Watch	Released from Fiscal Watch	Declared as Fiscal Emergency	Released from Fiscal Emergency
15 Local Governments 37 School Districts	11 Local Governments 21 School Districts	44 Local Governments 27 School Districts	27 Local Governments 19 School Districts
52 Total	32 Total	71 Total	46 Total

Source: Confidential Interview with Public Official, March 27, 2007; Ohio State Auditor's Website

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In 1998, the Office of the Ohio State Auditor was awarded the GFOA *Award for Excellence* for its aggressive dealing with fiscal stress in local governments (Confidential Interview with Public Official, March 27, 2007; Coe, 2007a). The current State Auditor, elected in 2006, is the first Certified Public Accountant to serve as Ohio's Auditor of the State and plans to continue an aggressive approach to financial monitoring and review of public finances at all levels of government in Ohio (Confidential Interview with Public Official, March 27, 2007).

Pennsylvania

The General Assembly of Pennsylvania passed Act 47 of 1987 Public Law 246, entitled *Financially Distressed Municipalities Act*, in order to development legislation to address municipal fiscal distress and to:

> Foster fiscal integrity of municipalities so that they provide for the health, safety and welfare of their citizens; pay due principal and interest on their debt obligations when due; meet financial obligations to their employees, vendors, and suppliers; and provide for proper financial accounting procedures, budgeting and taxing practices (Municipalities Financial Recovery Act, 2001, p. 1).

The Act is commonly referred to as simply Act 47 and the *Pennsylvania Legislator's Municipal Deskbook* points to the legislation being spurred by the structural unemployment experienced in Pennsylvania in the early 1980s which caused massive economic distress in many southwestern communities in the state. This economic deterioration was directly attributed to the decline in the American steel industry in the early 1980s (2006, p. 185).

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Due to the financial troubles experienced by Philadelphia in the early 1990s, new legislation was enacted to address Philadelphia's particular fiscal distress, *Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class* (Act 6 of 1991). As such, Philadelphia is the only Pennsylvania municipality not subject to Act 47 (2006, p. 186). Act 47 shows 11 criteria that indicate municipal financial distress in Pennsylvania's local governments. These are:

1. The municipality has shown a deficit over a three-year period, with a deficit of one percent or greater in the previous fiscal years.
2. Expenditures have exceeded revenues for a period of three years or more.
3. A default on principal or interest on bonds or notes due has occurred or the municipality has missed payments on its rentals due any authority.
4. Payroll due to the municipal employees has been missed for the last 30 days or more.
5. Failure to make required payments to judgment creditors within a 30-day period after judgment was recorded by the judicial system.
6. The municipality has failed to forward taxes withheld on the income of employees or has failed to transfer related employee/employer Social Security contributions within a 30-day period of the due date.
7. The municipality has accumulated and has operated for each of the two successive years a deficit equal to five percent or more of its revenues.
8. The municipality has failed to make the budgeted payment of its minimum municipal obligations under the Municipal Pension Plan Funding Standard and

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Recovery Act (Pennsylvania Public Law 1005, 1984) with respect to a pension fund during the fiscal year for which the payment was budgeted and has failed to take action within that time period to make required payments.

9. A municipality has attempted to negotiate resolution or adjustment of a claim in excess of 30 percent against a fund or budget and has failed to reach an agreement with creditors.
10. A municipality has filed for Chapter 9 bankruptcy protection and has filed a municipal debt readjustment plan pursuant to the Chapter 9 of the U.S. Bankruptcy Code requirements.
11. The municipality has experienced a decrease in quantified level of municipal service from the preceding fiscal year which has resulted from the municipality reaching its legal limit in levying real estate taxes for general purposes (Municipalities Financial Recovery Act, 2001, p. 6).

If at least one of the aforementioned conditions is present in a local government, the Pennsylvania Department of Community and Economic Development Center for Local Government Services has the statutory power to investigate the finances of the municipality; declare the municipality as being under financial distress; and appoint a coordinator to prepare and administer a plan designed to relieve the current financial distress conditions found in the municipality (pp. 6-9).

Prior to 1992, the Community and Economic Development staff was given the statutory requirement to monitor the annual fiscal data of the municipalities and submit a request for determination of financial distress to the Commissioner. The on-line

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instrument that the staff utilized is the Survey of Financial Condition that would be completed by both municipal and county governments and is due in mid-March of each fiscal year. This filing is required by Act 47 and assists the Center in identifying communities which may be in financial distress. Those communities that do not meet the statutory and department indicators are contacted by staff to determine if technical assistance, grants or loans are warranted for the present financial circumstances, as indicated in the survey filed with the Department. These surveys are also used to compile annual reports of local and county government financial information and are displayed on the Internet on the Department's website in a database that the public, legislative and investment officials can easily access and use to make a determination as to the respective local government's financial condition (Confidential Interview with Public Official, March 26, 2007).

In 1992, the legislation was amended to allow for interest groups within the respective Pennsylvania community to request that the Secretary of Community and Economic Development analyze the municipality's finances to determine if financial distress was present. With the amended legislation, nine additional groups were given the right to make a request to the Secretary. These groups, as classified by the legislation, can submit a request to the Secretary on a form supplied on-line by the Department. They are:

1. Chief executive of any municipality.

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2. The governing body of the municipality after passing a resolution by a majority vote of the governing body after a special public meeting which is openly advertised to the public, as provided by law.
3. A creditor with a matured claim to whom the municipality owes $10,000 or more. The creditor must agree in writing to suspend pending actions and any additional legal action against the municipality to collect the debt, or any part of it, for a period of nine months or until the municipality adopts a plan pursuant to Act 47, whichever occurs first. (The filing of a Chapter 9 bankruptcy claim by the municipality cancels this obligation.)
4. Ten percent of the number of electors of the municipality that voted at the last municipal election may petition to the Department alleging that the local government is under fiscal distress.
5. Ten percent or more of the beneficiaries of a pension fund may petition the Department for a determination. (The municipality in question must have missed its minimum obligation payment as required under the Municipal Pension Plan Funding Standard and Recovery Act.)
6. Ten percent of the employees of the municipality who have not received compensation for over 30 days from the time of a missed payroll.
7. Trustees or paying fiscal agents of a municipal bond indenture.
8. The elected auditors, appointed independent auditors or elected controllers of a municipality if they have a reason to believe the municipality is in a state of financial distress.

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9. A trustee or actuary of a municipal pension fund, if the municipality has not made the timely deposit of its minimum obligation payment as required under the Municipal Pension Plan funding Standard and Recovery Act (Confidential Interview with Public Official, March 26, 2007; Municipalities Financial Recovery Act, 2001, pp. 7-8).

After the request is made, the Secretary has a 30-day period to make an investigation into the financial affairs of the municipality, schedule a public hearing to be held within the county of the subject municipality, and make a determination as to whether the municipality meets the financial distress criteria set forth by the legislation. The public hearing is to hear testimony from those petitioners who requested that the Secretary make a determination on the municipal's fiscal stress.

Once a determination has been made that the municipality is indeed under financial distress, the Secretary shall appoint a coordinator to be assigned to the municipality. The coordinator's principal duty is to prepare a plan unique to the distressed municipality to deal with the related financial problems of the local government. As stated under Act 47, the appointed coordinator:

1. May be an employee of the Department of Economic and Community Affairs or private consultant or consultant firm.
2. Shall not be an elected or appointed public official or an employee of the municipality.
3. Shall be experienced in municipal administration and financial management.

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4. May not run for an elected office of the municipality or its coterminous political subdivisions within two years after the final adoption of the plan of recovery.

A mixture of departmental employees and private consulting firms has been utilized in the past when appointing a coordinator. The coordinator has broad powers including full access to all of the municipal records and the ability to apply for grants and loans on behalf of the municipality. Further, the coordinator can seek a subpoena in the Court of Common Pleas (county district court under the Pennsylvania Unified Judicial System) to compel testimony of the municipality's public officials and employees and furnish all requested records and documents (Confidential Interview with Public Official, March 26, 2007; Municipalities Financial Recovery Act, 2001, p. 9).

As stated previously, the plan is created by the coordinator and functions as the fiscal plan of recovery for the distressed municipality. The coordinator has a 90-day period to formulate and deliver the plan: to the municipal clerk for public inspection, the Secretary of the Community and Economic Development, each member of the municipal governing body, the mayor, the chief financial officer of the municipality, the solicitor (legal counsel) of the municipal governing body, and all parties who initially petitioned the secretary for a fiscal distress determination (Municipalities Financial Recovery Act, 2001, pp. 10-11).

Normally, the plan will include:

1. Projections of revenues and expenditures for the current fiscal year and the following two years assuming the continuation of present operations.

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2. Recommendations as to how to satisfy judgments; handle past due payables (including vendor payments, payroll and fringe benefits); eliminate deficits; restore funds used for purposes other than those specifically authorized under law; balance the budget; avoid fiscal emergencies in the future; enhance the ability of the municipality to negotiate new general obligation bonds, lease rentals, and tax and revenue anticipation borrowing; propose changes in the accounting and automation procedures that would improve the municipality's financial reporting; and reduce debt due on specific claims.
3. Possible changes in collective bargaining agreements and changes in the staffing levels and organization layout and functions.
4. Recommended changes in municipal ordinances and rules.
5. Recommendations for special audits or further studies of financial matters.
6. Analysis of the fiscal distress conditions still in existence and whether filing Chapter 9 federal bankruptcy is deemed appropriate.
7. Analysis of whether the economic conditions of the municipality are so severe that consideration should be given as whether the municipality should consolidate or merge with an adjacent municipality or municipalities.
8. Analysis of whether functional consolidation of or privatization of existing municipal services is appropriate and recommendations for where and how this could be accomplished by the municipality.
9. A capital budget which addresses the infrastructure deficiencies of the municipality.

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10. Recommendations for greater use of the economic and community development programs offered by the State of Pennsylvania Department of Community and Economic Development (Municipalities Financial Recovery Act, 2001, p. 10).

After the plan is submitted to the municipal clerk and the other aforementioned parties, the plan is filed for public inspection in the municipal office. Notice that the related plan is available for public inspection is published in the local newspapers with an indication that written comments from the public inspection are to be made within a 15-day period after the filing. The coordinator is to review the comments and make revisions to the plan based on the written comments that the coordinator deems to hold value. After the revisions are made, the coordinator will hold a public meeting no later than 20 days after the filing of the plan and within a five day period of the close of comments from the public. The public meeting is for the coordinator to present the revised plan and take additional comments on the plan from the public as well as from members of the municipality's political governing body and appointed officials. The coordinator presides over the public meeting (Municipal Financial Recovery Act, 2001, pp. 11-12). Creditors and the governing body of the municipality may either reject or propose additional changes to the plan within a 10-day period after the public meeting. However, the revisions to be made and final version of the plan are at the sole discretion of the coordinator.

Within 25 days of the coordinator's public meeting, the municipal governing body must both enact an ordinance to implement the coordinator's plan or reject the plan and submit their respective financial recovery plan to the Secretary of the Department of

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Community and Economic Development. The Secretary makes the determination whether the plan submitted by the local officials merits implementation as submitted or whether the plan is to be revised. Until revised, future financial assistance by the Department will be withheld until the plan is revised (Municipalities Financial Recovery Act, 2001, pp. 11 – 13).

If the coordinator's plan is accepted and implemented by the municipality, the coordinator is responsible for overseeing its implementation. The coordinator notifies creditors, collective bargaining units and other parties who will be affected by the plan. The coordinator discusses with each party how they will be affected by the plan. Further, the coordinator can remain on-site or turn the implementation process over to the chief executive officer of the municipality or a designated person chosen by the local governing body and the coordinator. The Department is to receive monthly status reports on the financial recovery of the municipality under the plan.

Those municipalities who do not adopt or implement a plan that appropriately addresses the financial distress as determined by the Secretary will be barred from receiving a grant, loan, entitlement or payment from state agencies until an acceptable plan is submitted and implemented. The monetary funds held back will be held in escrow at the state level until the Secretary notifies the agencies of a different status. Certain exceptions apply such as capital projects already under contract and in progress, funds received by the municipality from a declaration of a disaster (either by the State or federal government), and pension fund disbursements.

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In order to have the financial distress status lifted, the Secretary can make a determination based on the fiscal monitoring performed on an annual basis by the Department or the municipality may petition the Secretary. The determination is normally based on whether fiscal distress conditions have been corrected and the plan of recovery has been implemented successfully. Evidence considered includes the monthly status reports submitted by the coordinator to the department, whether deficits still exist in the municipality's funds, whether all debts issued to finance the deficits are retired, and whether the municipality has operated for at least one fiscal year under a positive current operating fund balance (Municipalities Financial Recovery Act, 2001, p. 15).

At the date of this research, the Secretary had previously determined that 18 Pennsylvania municipalities in financial distress and had implemented financial recovery plans under Act 47 which was implemented in 1987. Five of these municipalities had the financial distress status rescinded and were no longer under the direction of an appointed coordinator. No municipality had filed for Chapter 9 bankruptcy since 1987. The legislation was put into place so that the state could proactively monitor the fiscal health of the municipalities and also avoid municipal bankruptcy. Various financial recovery plans for many of these municipalities can be found through the Department of Community and Economic Development website. The plans normally cover five-year forecasts and a related review of debt service, personnel and fringe benefits, core revenues and available sources, and operating position of the respective municipality (Confidential Interview with Public Official, March 26, 2007; Municipal Financial Recovery Program, 2007).

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Finally, in 2006 the Governor's Early Intervention Program was established to provide grants and resources to local governments that develop and implement multi-year financial management plans. The program was in response to the extreme financial crisis being experienced by Philadelphia (considered under fiscal stress status in 2003). Its main objective was to encourage and assist local governments in implementing multi-year financial plans to avert fiscal stress. The guiding philosophy of the plan is essentially expenditure reduction, revenue enhancement, long-term community and economic development strategies for tax base stabilization, adoption of best management practices to achieve operating efficiencies, and pursuit of inter-governmental cost-sharing strategies (2006, p. 2). The amount appropriated in the fiscal year 2006 for the implementation of this program in the Department of Community and Economic Development was $750,000 (Early Intervention Program Guidelines, 2006, pp.1-3).

Tennessee

Tennessee does not have a statute in place to address municipal bankruptcy. The 1994 amendment to the Chapter 9 federal legislation indicates that states must "specifically authorize" municipal bankruptcy in order for a local government to seek protection under this legislation. As a result, Tennessee local governments do not have the requisite authority to file for Chapter 9 protection. In 1997, the Mercer Utility District in Madison County, Tennessee, filed for bankruptcy. The case was dismissed by the court due to lack of state authority. Copperhill, Tennessee was the last municipality to file for Chapter 9 protection in 1988 and this was largely due to loss of industry and

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economic decline (Confidential Interview with Public Official, March 23, 2007; March 28, 2007).

Although Tennessee does not allow its municipalities to file for Chapter 9 protection, the state government has been actively involved in municipal finance since the Great Depression. In 1937, the State of Tennessee General Assembly created the Division of Local Finance to be housed in the Comptroller of the Treasury. The stated goal of the Department is to "…assist local governments in Tennessee, through the application of legislative regulations, in their efforts to maintain a financially secure environment for themselves and, consequently, for the State" (Goals and Objectives). This division is involved in all facets of Tennessee municipal finance which includes review and approval of local government proposals for issuance of short-term debt along with review and approval of all annual operating budgets for those local governments with outstanding debt. The first legislation for this office was enacted in 1937 under Tennessee Code §4-3-305.

As amended to date, the Statutory Code gives the Division the authority to approve all operating budgets of cities and counties that have short-term debt outstanding at the end of the year as well as to approve all operating budgets of utility districts and emergency communication districts that have any type of debt outstanding at the end of the fiscal year. If a budget is not submitted for approval by the Division of Local Finance within five months of the fiscal year start date, the Director is required to publish notice of this fact in the state newspapers for two weeks stating that the budget has not been submitted, has not been approved, and that the local government is operating without

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state approval. Further, all county and local governments must submit an audited financial report at the end of each fiscal year. These financial statements will then be reviewed by the Division for findings and compared with the submitted budget for beginning fund balances. Like Georgia, the Division of Local Finance utilizes a uniform chart of accounts for all local governments in Tennessee to allow for easy comparison among the local government finances and also to benchmark financial indicators for public officials at the local and state levels (Confidential Interview with Public Official, March 28, 2007; Tennessee Code §4-3-305; §9-21-404).

The *Cash Basis Law of 1937* was also enacted to address financial stress in Tennessee local governments. This legislation was placed in the Tennessee Code Title 9 Chapter 11 Section 9 and allows municipalities who are experiencing financial hardship to issue general obligation bonds "… in order that the fiscal affairs of the counties and cities in the state may be placed on a cash basis" (Tennessee Code §9-11-103). In an interview with public officials, it was noted that only three Tennessee counties have used this section of the Code since the 1980s and all the debt issued under this legislation has since been retired. In order to utilize this statutory provision, the local government must file a statement showing in detail the indebtedness of the local entity along with the proposed further indebtedness for approval by the Division of Local Finance. All of the bonds issued under this provision must be general obligation bonds, and an additional ad valorem tax must be levied on all taxable property within the local government's district in order to assist in the payment of the principal and interest of the bonds. The term "cash basis" comes from the requirement found in §9-11-113 of the statute that

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requires the unit to prepare its annual operating budget for the current fiscal year and for all fiscal years of the outstanding bond issue on a cash basis. This means that all current expenditures, including the bond principal and interest payment along with any current cash deficit, must be planned to be expended through the available revenues for the corresponding fiscal years. This budget must be submitted three weeks prior to adoption at the local government level and the Director of the Division of Local Finance has the authority to direct the local government to adjust its estimates or to make additional tax levies in order to meet current and upcoming obligations (Confidential Interview with Public Official, March 23, 2007; Tennessee Code §9-11-108-116).

In 1966, Title 9 Chapter 13 Section 100 was enacted to provide relief to local governments that faced financial problems as a direct result of a court-ordered change in the assessment of railroad properties in Tennessee. The State Board of Equalization, in conjunction with the Division of Local Finance, was given the authority to loan state funds appropriated for this purpose. In an interview with local officials, it was stated that no local government had actually utilized this statutory provision. Also, in 1984, the legislature enacted further legislation entitled *Loans to Local Subdivisions in Emergencies* to address a financial problem faced by Polk County, a poor county in eastern Tennessee. The financial stress of the county was directly related to the bankruptcy of a company located in the area that normally contributed over 60 percent or more to the property tax base. When it filed for bankruptcy, the county immediately faced a severe shortfall in its major revenue source and the state legislature provided a

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mechanism under which the state would act as a guarantee for any bank loans made to any local government facing the same situation. However, according to state officials, no county or local government actually ever used that section of Code due to the fact "… that no local government wanted to give up their sovereignty" (Confidential Interview with Public Officials, March 23, 2007; March 27, 2007; §9-13-101—106; §9-13-201---212).

Another municipal finance practice is found in Title 9 Chapter 21 Part 8 of the Tennessee Code. This statute requires that any tax anticipation notes issued by local governments must not only be approved by the Division of Local Finance prior to issuance but also repaid from the current fiscal years' taxes and revenues by the end of the fiscal year. This is to insure that the interperiod equity is maintained by the local government so that current service expenditures are covered under current revenues and not passed through to the next fiscal operating period (Guide for the Issuance of Notes, 2003, p. 42; Confidential Interview with Public Official, March 28, 2007).

Summary

In conclusion, the states analyzed in this chapter employ a variety of municipal finance reform methodologies. Although Georgia and Tennessee do not allow their local governments to file for municipal bankruptcy, as required under federal law, these states employ proactive measures to avoid fiscal stress in local governments. Georgia specifically prohibits municipal bankruptcy in its statutes (Georgia Code §36-80-5) and Tennessee did not amend its statutes after the 1994 amendment to the federal legislation so municipalities will have to contact state authorities in the event of major fiscal

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problems (Confidential Interview with Public Officials, April 26, 2007; March 23, 2007). The other four states, Florida, North Carolina, Ohio and Pennsylvania, all have proactive measures in place to avoid municipal bankruptcy and fiscal stress. Although these four states allow a municipality to file for Chapter 9 protection, it is only permissible after additional steps have taken place and normally at the approval of the governor and/or the financial supervisory board put into place by the state to monitor the fiscal stress of the municipality. In addition, all of the six states employ a review of the annual audited financial statements of the municipalities. They all apply some type of financial condition assessment procedure to monitor the trends of the finances and socioeconomic data of the municipalities. North Carolina requires the local governments to file semi-annual reports on revenues and investments with the State Treasurer. Tennessee and North Carolina approve and monitor the debt issuances of their local governments in order to make certain that the municipality is able to sustain future payments and live within its financial means (Confidential Interview with Public Officials; March 28, 2007, March 29, 2007).

With regard to transparency, Georgia, North Carolina, and Pennsylvania publish annual reports on the state and trends of the local government finances within that state for the fiscal year. Ohio publishes local audits performed on the State Auditor's website. Ohio is unique in that the state requires the school systems to prepare and publish a five-year forecast of their finances. Currently, this requirement only pertains to the education boards; however, discussion has occurred in mandating this requirement for local governments as well (Confidential Interview with Public Official, March 27, 2007).

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Finally, Florida, Ohio, and Pennsylvania publish information on their websites about those municipalities under state intervention. The information provided normally includes the date of declaration of fiscal emergency as well as the amount of defaults and deficit amounts. Pennsylvania also publishes the Internet link to the municipal's financial recovery plan which provides a financial overview as well as a five year financial forecast for the municipality.

Chapter VII contains a discussion of the State of Alabama Department of Education (SDE) legislation and procedures employed by the SDE in monitoring the finances of the local boards of education in Alabama. Chapter VIII concludes this research with a discussion of the findings and addresses the research questions of this study.

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CHAPTER VII

ALABAMA LOCAL BOARDS OF EDUCATION
ANALYSIS OF FISCAL ACCOUNTABILITY LEGISLATION

This chapter discusses the current rules and procedures and as provided under Alabama legislation and the Alabama State Board of Education and which affects the Alabama local school boards of education (LEA) in dealing with their financial condition. To date, no Alabama LEA has filed for municipal bankruptcy and the State Department of Education (SDE) enforces financial rules and procedures that allow for the Department to place the LEA under financial intervention if the local board is deemed to be in an unsound fiscal position. Also the SDE approves all bond issuances prior to being issued and monitors the timely payments of principal and interest to the bondholders (Confidential Interview with SDE official, March 22, 2007). This legislation is the only legislation in Alabama law that has a proactive and reactive municipal finance methodology in place for a local government in Alabama.

Background of the Alabama State Department of Education

In 1854, the Legislature of Alabama established the first provision for public schools in Alabama under Acts of Alabama 1853-54, No. 6, Article II, Section 3. The legislation also provided for a Superintendent of Education who was to be elected by the

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General Assembly of Alabama and serve for two years (Alabama Archives Agency History Record).

In order to fund the public school programs, the Alabama Constitution of 1868 authorized a poll-tax to be levied upon Alabama inhabitants to be placed in the General School Fund. At the same time, the Legislature gave itself the authority to levy an annual tax on all railroad, navigation, banking, and insurance corporations for the maintenance of public schools in Alabama (Constitution of 1868, XI, Section 13). Since that time, the Legislature has enacted several additional tax levies in order to fund the public education system of Alabama.

In 1901, the Alabama Legislature passed and the electorate ratified the Constitution of 1901 which states in Article XIV, Section 256:

> The Legislature shall establish, organize, and maintain a liberal system of public schools throughout the state for the benefit of the children thereof between the ages of seven and 21 years.

Additionally, the 1901 Constitution originally provided that the State Superintendent of Education was to be elected by popular vote every four years by the state electorate (Alabama Archives Agency History Record).

In 1919, Act No. 442 of the Alabama Legislature established the State Department of Education and the State Board of Education. This legislation also enabled the State Superintendent to make the annual apportionment of school funds to the counties; explain the true intent and meaning of the school laws, and of the rules and regulations of the State Board of Education; execute the educational policy of the State

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Board of Education; prepare and publish the school laws of the State; receive and examine all reports required under the regulations of the State Board of Education; and examine the expenditures, business methods, and accounts of county and city boards of education. In 1969, the Alabama Legislature amended the 1901 Constitution to allow the State Board of Education to appoint the State Superintendent of Education who is referred to as the Chief State School Officer (Alabama Archives Agency History Record).

Currently, there are 130 local school systems in Alabama that operate under local boards of education referred to as Local Education Agencies (LEA). Of the 130 systems, 67 are county boards of education, 62 are city boards and one is a fine arts school in Birmingham. Of the boards of education, all of the county board members are elected and 40 counties elect the respective Superintendent of Education with the remaining 27 superintendents being appointed by the elected board of education. Eleven city boards of education are elected with the remaining 50 being appointed by the municipal governing body. All of the 61 city boards of education have their Superintendent of Education appointed by the board or by the municipal governing body (Alabama Education Annual Report, 2004, p. 2).

Furthermore, the Education Trust Fund of Alabama, which funds all of the public education programs in Alabama administered by the 130 LEA boards, is currently the largest operating fund of the State of Alabama. Annual appropriations are made by the Legislature for this fund and for the fiscal year 2007, total appropriations for the fund were $7,071,153,457 with $4,326,983,369 of that amount earmarked for the LEA boards

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(State of Alabama Education Trust Fund, 2007, p. 1). Revenues for this fund are from the state individual and corporate income tax, sales tax, utility tax, use tax, beer tax and county licenses, hydroelectric companies tax, insurance company licenses and premium tax, utility gross receipts tax and utility use service tax (State Taxes and Other Sources).

Fiscal Accountability

In 1995, the Alabama Legislature adopted an accountability law, *Alabama Education Accountability Act,* for Alabama public schools under Act 95-313. Governor Fob James signed the legislation into law on July 7, 1995 and this legislation was to take effect for the 1995-1996 academic year which began August 1, 1995. This legislation requires Alabama public school systems to be accountable for student achievement, student safety and financial performance. The purpose of the legislation is

> To establish an accountability plan which shall be overseen by the State Board of Education….to provide for state intervention of a school or local board of education based on….financial instability; to provide for financial accountability in allocation of funds to schools, to require local budgets and financial statements that are cost centered, program and fund based; to provide for intervention and a method of release from state intervention (Accountability Plan, 1995, pp. 1-2).

Section 4 of the legislation specifically addresses the financial accountability that is mandated of the 130 local education agencies in Alabama.

In this section, the legislation gives the State Board of Education the right to "… require, approve, and audit budgets, financial statements and other reports which may be deemed necessary to assess the financial stability of each local board of education"

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(Accountability Plan, 1995, p. 13). When an LEA submits a fiscally unsound budget, the SDE will provide assistance to the LEA to revise and submit a new budget for approval by the SDE. If during the assistance period, the State Superintendent of Education makes the determination that the LEA is in an unsound fiscal position, the Superintendent may appoint a person or team of persons to advise the day-to-day financial operations of the LEA. After a period of time if the LEA has not improved its financial status, the Superintendent may petition the State Board of Education for the direct control (intervention) of the fiscal operations of the LEA. Upon approval of the petition by the State Board, the Superintendent will appoint a Chief Financial Officer (CFO) to manage the fiscal operations of the LEA. This person, normally an SDE employee or contracted financial professional, must give bond with a surety company and normally reports directly to the State Superintendent on the financial affairs of the LEA during the intervention process. The appointed CFO does not have to receive approval from the local Superintendent of Education to expend monies and has a fiduciary responsibility to the State Superintendent of Education as well as to the LEA Board and Superintendent. In order to be released from intervention, the LEA may petition the State Board of Education if improvement in the financial condition of the LEA has occurred. The State Board of Education will conduct a hearing on the matter and make a final determination on whether the LEA can be released from state intervention (Accountability Act, 1995, pp. 13-16).

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Further analysis of the Alabama Code Section 16-6B-4 shows that

> The State Superintendent of Education, directly or indirectly through the chief financial officer, may direct or approve such actions as may in his or her judgment be necessary to: (1) Prevent further deterioration in the financial condition of the local board; (2) restore the local board of education to financial stability; and (3) enforce compliance with statutory, regulatory, or other binding legal standards or requirements relating to the fiscal operation of the local board of education (Code of Alabama, 1975).

The 1995 legislation also calls for the LEA to present an annual accountability report to the public which should include annual budgets and financial statements as well as the amount of foundation program funds or vocational/technical education funds, or both, earned and expended by the LEA. In addition, the State Board of Education may direct the system to publish additional financial information or reports that would keep the public informed about the financial condition of each school and local education agency. These reports are to be released to the media, the parent-teacher organization at each school, the legislative members who represent that specific district, and the State Superintendent of Education. All reports are to be complete and ready for public viewing within 90 days after the end of the fiscal year, November 1 (1995, pp. 17-18).

The Foundation Program, as set up through this legislation, is the funding mechanism whereby the LEAs receive their state funding/allocations from the State Department of Education, as determined by the Alabama Legislature each fiscal year. These funds are allotted to the LEAs in 12 monthly installments and administered by the

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State Department of Education. This program was initiated through Act 95-313 and is computed through four categories for each public school in Alabama. These categories are salaries, fringe benefits, classroom instructional support, and other expense costs for foundation program units. The allocation for the salaries and related fringe benefit units are based on the average daily membership of the school population which is taken in the school year the first 20 days after Labor Day. These units also include instructional support in the allocation for principal, assistant principals, librarians, and counselors for the respective school and LEA. Classroom instructional support, as defined in this legislation, includes "…funds appropriated for instructional supplies, library enhancement, textbooks, technology, and professional development of school personnel" (1995, p. 19). Supplies, library enhancement, technology, and professional development were to be based on a rate appropriated per teacher unit, while textbooks are based on a rate per student (1995, pp. 20-21). Other expenses were categorized as funds used to pay for support personnel, including child nutrition program workers.

An important caveat of this 1995 legislation was that the teachers and principals of each respective school were to be involved with the preparation and monitoring of the school budget in order to participate in decisions on how classroom instructional materials are allocated and expended and also to be held accountable for spending decisions. The legislation specifically states

> The legislature realizes that teachers and principals cannot be held accountable unless they have the authority to use resources provided them by legislative appropriations. As each school's budget is developed, local boards of education

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shall ensure principals and classroom teachers are given the opportunity to participate in decisions concerning the appropriate use and expenditure of classroom instructional support funds. Where the principal and teachers have not been granted the right to have direct input in the development of their school's budget or are restrained in the expenditure of instructional support funds, they may petition the State Superintendent of Education for relief (Accountability Act, 1995, pp. 19-20).

In order to receive these foundation program funds, each LEA must meet conditions as set forth by the State Board of Education. Some of these conditions include: provide a 180 day school year, provide the equivalent of at least 10 district mills of local ad valorem tax support, adopt a salary schedule that the reflects at least 100 percent of the state minimum salary schedule, meet federally mandated maintenance of effort requirements, spend all calculated salaries for foundation program units for instructional salaries, budget classroom instructional support at the school level, continue operations at all area vocational centers in existence in fiscal year 1995, and distribute foundation program allocated funds based on current year student population and programs needed to serve the current year students (State Board of Education, Chapter 290-2-1, pp. 13-16).

In order to receive state funds, LEAs are also required to prepare budgets and financial statements that meet SDE reporting requirements. These requirements direct the LEA to maintain accounting records and follow generally accepted accounting principles and internal control procedures. The LEA is also required to provide annual accountability reports to the public and be audited in accordance with state laws, federal

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laws/regulations and SDE auditing standards. Finally, the local superintendent is required to provide monthly financial reports and other financial information to the local board of education (Chapter 290-2-1, p. 16).

If any of these requirements are not met, the State Superintendent has the authority to withhold state funds from the LEAs and impose penalties against the local boards for offenses that may include failure to operate schools for the 180 minimum day operating period; deficit spending as directed in Alabama Code Section 16-13-144; assigning a teacher to teach a subject for which the individual is not properly certified (p. 17). For the deficit spending, the Alabama Code states that:

> No local board of education shall spend or obligate itself to spend more money in any fiscal year than the estimate of income available to that board of education for that year, plus balances on hand at the beginning of the fiscal year, which estimate shall be approved by the State Superintendent of Education, if the excess expenditure or excess obligation to spend results in a deficit for that fiscal year, except as provided in Section 16-13-145. The estimate of income shall include estimates of income from revenue receipts from all sources and estimates of nonrevenue receipts from all sources, but excluding all funds derived from loans other than loans obtained by the issuance of school warrants authorized by the laws of the state. This section shall not apply to any fiscal year where there is proration of education funds going to local boards of education. No funds shall be transferred by any board of education from salary allocations to any other

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> expenditure or for any other purpose. In times of proration, salaries shall not be subject to proration (Code of Alabama, 1975, §16-13-144).

Further,

> If a local board of education in any fiscal year violates this section, the State Superintendent of Education shall reduce in the succeeding fiscal year the allotment from the Foundation Program Fund to which the local board of education is otherwise entitled an amount equal to one-fourth of the deficit (Code of Alabama, 1975, §16-13-144b).

In addition, the State Superintendent may waive part or all of a penalty if the LEA makes an effort to remove the deficit and has implemented a financial plan to avoid all deficit spending in the future. Also:

> If any local superintendent at any time makes a financial statement to his or her local board of education or to the State Superintendent of Education in which the superintendent purposely misrepresents the amount of the deficit or obligations outstanding of his or her local board of education, he or she shall be guilty of a misdemeanor and punishable by a fine of not less than one hundred dollars ($100) and not more than five hundred dollars ($500) (Code of Alabama, 1975, §16-13-144).

As a former Local Education Agency accountant with the State Department of Education, my position was directly involved with the implementation of this legislation in 1995-1998. I was part of a team under the direction of the Assistant State Superintendent of Education for Administrative and Financial Services. This team was

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made up of education specialists, contract personnel who formerly worked in a LEA administrative capacity, technology personnel, and accounting personnel. When requested by a LEA or directed by the Assistant State Superintendent, members of the team would travel to LEA sites throughout the state to provide assistance. The accounting members would assist in budget preparation, financial compilations, teach budgeting, accounting, and usage of accounting computer program classes to school and system support personnel, and provide technical assistance.

Although the 1995 legislation did not specifically state the methodology the State Superintendent would use to determine that a LEA or school system was fiscally unsound, an interview with SDE officials showed that a deficit in the General Fund balance of financial statements submitted to the SDE for review normally signaled the need for financial assessment. Also, when a system experienced a decline in the number of state units appropriated to the LEA through the annual legislative appropriation, this would put the system on a "watch" list to view whether the Board made the appropriate reductions in teacher units, etc. since the loss of funding would necessitate this action. In addition, many local boards or local superintendents requested the State Superintendent to send SDE staff to provide on-site technical assistance (Confidential Interview with Public Officials, March 22, 2007).

After implementation of this accountability legislation in December 1995, the SDE immediately identified nine school systems that were experiencing financial problems. Except for the Macon County Board of Education, all of these school systems reported a General Fund deficit on their year-end financial statements submitted to the

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SDE. The financial statements were dated September 30, 1995 and typically submitted to the SDE by December 1, 1995. Macon County did not submit a financial statement as of this date; however, the entity's previous year financial statements showed a General Fund deficit. Also, Conecuh County showed a General Fund balance of $221.00 and requested a financial review by the SDE. Thus, in December 1995, the SDE staff began a financial assessment of 10 school systems. The school systems that were assessed and the related action taken by the SDE are shown in Table 7.1.

Table 7.1
State Board of Education
1995 Financial Intervention

School System (LEA)	Financial Assessment	Financial Advisor Appointed	State Board Authorized Financial Intervention	State Superintendent Appointed Chief Financial Officer
Barbour County	Adopted Plan to restore financial stability.	Yes	Yes	
Conecuh County	Requested assistance due to $221 balance in GF at year-end.			
Henry County	Making progress in eliminating deficit.			
Macon County	Did not submit financial statements		Yes	Yes
Marshall County	Adopted plan to restore financial stability.	Yes	Yes	
Randolph County	Adopted plan to restore financial stability.	Yes	Yes	

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Table 7.1 (cont.)
State Board of Education
1995 Financial Intervention

Walker County	Making progress in eliminating deficit.			
Wilcox County	Uncertain of financial position.		Yes	Yes
Attalla City	Making progress in eliminating deficit.			
Fairfield City	Requested assistance by the SDE to determine financial position and assist financial personnel.	Yes		

Source: (Confidential Interview with Public Officials, March 22, 2007)

In the following fiscal year (1996-1997), these 10 school systems remained under monitoring by the SDE, and six other school systems were also under financial review. These systems were Greene County, Morgan County, Perry County, Sumter County, Birmingham City and Bessemer City. Since the legislation was enacted in 1995, fourteen school systems have undergone financial intervention by the SDE and have since been released per the system's attainment of better fiscal condition. These systems are: Barbour County, Bessemer City, Birmingham City, Dale County, Fairfield City, Greene County, Jackson County Jefferson County, Lanett City, Lawrence County, Macon County, Marshall County, Randolph County, and Wilcox County. It is important to note that Barbour County has undergone financial intervention by the SDE twice since the

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1995 legislation. Also, Wilcox County was the first LEA to undergo financial intervention by the SDE with Macon County being the second.

In 2003, the Rules of the State Board of Education Chapter 290-2-5 pertaining to Chief School Finance Officers was amended to take effect on June 12, 2003. These rules clarified the duties and responsibilities of the Chief School Finance Officers (CFO) as well as the qualifications for the CFO position. In essence, the qualifications required that any individual to be hired by the local board of education in this capacity to have at least three years experience in a business-related field with either:

- A baccalaureate degree in a business-related curriculum including at least 9 semester hours of accounting
- A Master's of Business Administration (MBA)
- A baccalaureate degree in a concentration other than a business-related curriculum with at least 24 semester hours of business-related courses of which 18 hours towards specific accounting-related and business-related courses

An individual who has an active license as a Certified Public Accountant (CPA) may also qualify for the CFO position (290-2-5-.03, 2003, pp. 58-58.02).

For those CFO individuals who were already employed in the position for three years on June 30, 2003, those individuals may be certified by the State Superintendent of Education as a Certified Chief School Finance Officer (CCSFO) even if they do not meet the aforementioned requirements if the individual attends and passes certification courses for the Alabama School Business Official's Certification Program, normally provided by Alabama Association of School Officials (AASBO) and sponsored by the University of

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Alabama (State Board of Education, 2003; ASSBO Certificate Program). Further, the local superintendent and local board of education must recommend the individual for certification by the State Superintendent of Education. Once certified, the CFO must receive at least 18 hours of approved CPE credits during each fiscal year. Any hours in excess of 18 hours may be carried over to the next fiscal year. Only under extenuating circumstances, such as serious illness of the CFO, can the annual requirement be extended to six months after the end of the fiscal year and until the requirements are met, the CFO must be placed on probation. Further, if the CFO does not meet the CPE requirements, the State Superintendent may revoke or suspend the certification of the CFO. Finally, if a CFO has demonstrated gross negligence or incompetence, the state superintendent may put the CFO on probation for up to one year. Upon demonstration that satisfactory improvement in performance has been achieved, reinstatement of the CFO by the State Superintendent may be requested (State Board of Education, 2003, pp. 58.03-58.05).

In 2006, legislation was introduced in the Alabama House of Representatives called the *School Fiscal Accountability Act* (Act 2006-196). This Act was signed into law by Governor Bob Riley on March 9, 2006 and became effective on July 1, 2006. The purpose of this legislation was to "… clarify the fiscal responsibilities of the State Superintendent of Education, local superintendents of education, boards of education, and chief school financial officers…" (2006, p. 2). The 1995 legislation was not specific in its wording on how the SDE could determine an unsound fiscal position. The wording found in Code of Alabama Section 16-13-144 pertaining to deficit spending provides

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some clarification but this legislation was necessary to specifically address the fiscal duties and responsibilities of the related personnel (Confidential Interview with Public Official, March 22, 2007).

A major change in this legislation was that Act 2006-196 replaced the term *fiscally unsound budget* with the term *fiscally unsound financial reports.* This allows the SDE to make a determination on the financial position of a LEA when it submits its prior-year financial statements instead of analyzing its budgetary accounts (2006-196, p. 15). Normally, budgetary accounts are prepared based on estimates of beginning fund balances rather than an actual fund balance as would be shown in the annual financial statement by the LEA. Another important requirement under this legislation was the proactive requirement of the LEA to develop a plan to establish and maintain a one-month minimum operating balance to utilize as a reserve fund (Act 2006-196, p. 13).

Section 2 of the legislation requires a local superintendent and local board of education to adopt fiscal management policies which comply with generally accepted accounting principles. These policies must include, but are not limited to:

1. Regular reconciliation of bank statements
2. Maintenance of fixed assets inventory
3. Deposit of incoming funds
4. Review of monthly revenues and expenditures (Act 2006-196, pp. 2-3).

The legislation also addresses the hiring and responsibilities of the Chief School Financial Officer to be employed by the LEA to administer the financial policies and procedures of the local board as addressed in Chapter 290-2-5 of the Rules of the State

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Board of Education. Specifically, the legislation states that the LEA board, in consultation with the local superintendent, shall appoint a CFO who will be an employee of the board. If the position is vacant for more than 30 days and the LEA is not actively seeking to fill the position, the State Superintendent may designate a CFO for a period of not more than one year until the LEA appoints a person who meets the necessary qualifications. Also, the SDE may appoint a CFO if the position has been vacant for more than 60 days, despite whether the LEA is actively seeking a qualified applicant (2006-196, pp. 5-6).

Although the CFO will have a fiduciary responsibility to the local board, the individual is to work directly under the Superintendent and must be bonded in an amount to be determined by the SDE. Further, under the legislation, the CFO is to perform duties which normally include the verification of receipts of funds to which the LEA is entitled to by law, payments of all funds upon the written order of the local superintendent, keep an accurate record of all receipts and expenditures, and provide a reporting on the records to the local superintendent and local board of education. Further, the CFO is to make reports to the SDE, as required by law and by the local board of education (Act 2006-196, pp. 6-8).

The new requirements indicate that the CFO should personally notify in writing each board member and the local superintendent of any financial transaction made on behalf of the local board of education which the CFO deems to be non-routine, unusual, without legal authorization, or not in compliance with the fiscal management policies of the board. The notification must be recorded in the minutes of the local board's meeting

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by the President of the local board of education. The SDE provides a form (Notification Required by AL 2006-196, 2006) on its website for the CFO to fill out and give to each member of the local board of education as well as the local superintendent (Act 2006-196, p. 7).

Further, the 2006 legislation requires the local superintendent to prepare certain reports for the local boards of education. These reports include monthly financial statements showing the financial status of the LEA, monthly reports showing all receipts and sources of receipts, monthly reports of expenditures with itemized categories, annual projected budget, monthly and/or quarterly reports showing the expenditure related to such projected budget, annual report on the fixed assets inventory of the LEA, and financial information to participate in national statistical studies on education. All of this information, along with additional information required by the SDE for the particular LEA, shall be submitted either in writing or electronically via the Internet upload to the Chief Education Financial Officer by the 15th day of the month following the presentation to the local board of education (Act 2006-196, pp. 8-9).

The Chief Education Financial Officer position is a new position instituted under Act 2006-196. Essentially, this individual is an employee of the SDE who will oversee the collection and analysis of these financial reports made by the local board of education and will direct SDE staff to provide assistance to those school systems whose financial position is deteriorating. This individual is to be a Certified Public Accountant or have equivalent experience as determined by the State Superintendent, have held positions in educational or governmental finance, and shall complete the certification program

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described previously. This legislation also directs that the Chief Education Financial Officer of the SDE may employ internal auditors to analyze the financial documents submitted by the local boards and these individuals are to hold a bachelor's degree in accounting or finance and have experience in educational or governmental finance (2006-196, pp. 3-4).

An important aspect of the 2006 legislation includes the instruction and training of local superintendents on subjects including finance, instruction and legal requirements of Alabama education laws and regulations. Local superintendents will be required to pass competency tests after training administered by the SDE (2006-196, pp. 4-5). As required in the previous 1995 legislation, all financial documents of the local education agencies are considered public documents and should be made available to the public. The 2006 legislation specifically states that "An annual budget and monthly financial statements with supporting spreadsheets….shall be made available to the general public at the local school system internet site" (2006-196, p. 9). Finally, the annual audit required of the local board's accounting books, records, and statements was mentioned in the legislation. Normally, the Examiners of Public Accounts are to audit the county boards of education, the City of Birmingham local board of education, and City of Tuscaloosa local board of education. The other respective boards are to be audited by independent certified public accountants. The 2006 legislation requires that any city which has been under any financial form of intervention by the SDE shall be audited by the Department of Examiners of Public Accounts for three years after such intervention takes place. Further, a local board of education may request an audit by the Examiners if

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the local superintendent or CFO is terminated, replaced through election, or resigns. As well, the local board may also request an audit by the Examiners if the board feels that it is in the best interest of the school system (2006-196, pp. 11-12).

Finally, this legislation addressed the possible penalties for failing to comply with this legislation. Specifically,

> If an employee or official of a local board of education deliberately, willfully, or wantonly fails to provide the local board of education, the State Department of Education, the State Superintendent of Education, or the Chief Education Financial Officer with accurate information required pursuant to this Chapter or pursuant to the regulations of the State Department of Education or State Board of Education or if the employee knowingly, willfully, or wantonly provides inaccurate information, the employee is guilty of a Class A misdemeanor (2006-196, p. 13).

To date, no such penalties have been enforced by the SDE. Also, the legislation amended some of the intervention procedures as required under 95-313. Specifically, the State Superintendent will still provide SDE staff to provide assistance to the local boards of education upon the submittal of a fiscally unsound financial report (replaced the term *budget* in 95-313). If the State Superintendent deems that the LEA is an unsound fiscal position while assistance is being provided, the Superintendent can still assign a financial advisor to advise the day-to-day financial operations. If after a reasonable time has passed and the State Superintendent determines that the LEA is still in an unsound fiscal

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position, the State Superintendent may request permission from the State Board of Education to take direct fiscal control of the local board of education. However, Alabama Act 2006-196 states:

> If the request is granted, the State Superintendent shall present to the State Board of Education, a proposal for the implementation of management controls necessary to restore the local system to a sound financial condition (2006, p. 16).

Essentially, the State Superintendent must have a strategic plan to alleviate the financial stress of the LEA.

Summary

To date, no LEA has been under fiscal intervention since the implementation of Alabama Act 2006-196. According to SDE officials, the 14 LEA school boards that were placed under financial intervention by the SDE in various time frames between 1995 and 2005 have been released. The SDE is placing an emphasis on the certification of the local board CFO; approximately 15 percent of those employed in the CFO position have yet to be certified by the SDE at the time of this writing.

Presently, the policies and procedures implemented by the SDE are the only municipal finance reform in Alabama in regard to oversight of municipal finances and financial condition. This municipal legislation will be discussed further in Chapter VIII with regard to comparing the current SDE policies and procedures to the other state municipal reform methodologies studied in an attempt to determine the best alternatives for municipal finance reform for Alabama local governments.

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CHAPTER VIII

RESULTS AND DISCUSSION

Chapter V discussed the case studies of the nine municipal bankruptcies of Alabama. These case studies showed the overall contributing factors for these municipal bankruptcies to be financial mismanagement by municipal administrators and the economic decline of the municipalities due to the loss of businesses and demographic changes. Chapters VI discussed the various municipal finance methodologies employed by six states to address fiscal stress and avoid municipal bankruptcy. Those states studied are Florida, Georgia, North Carolina, Ohio, Pennsylvania and Tennessee. By considering current legislation already enacted in Alabama, Chapter VII discussed the policies and procedures administered by the Alabama State Department of Education to address the financial condition of local boards of education. This legislation is the only municipal finance reform legislation enacted in Alabama to date. This chapter restates the research problems and discusses the overall findings of Chapters V, VI, and VII.

Summary and Discussion of the Results

The findings of this study contribute significantly to the knowledge base of the public finance field through understanding the factors that contributed to municipal financial distress situations as well as encouraging possible reforms for states that do not

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have municipal finance reforms in place. The following research questions guided this study:

1. What were the specific factors that led to the nine municipal bankruptcies in Alabama during 1990–2004?
2. How did the respective filings affect the financial health of these local governments as well as the state of Alabama?
3. What methods do other states employ in addressing municipal fiscal distress and municipal bankruptcy?
4. What methods does the Alabama State Department of Education employ in addressing fiscal stress for the local boards of education in Alabama?

Causes of Alabama Municipal Bankruptcies

Chapter V discussed nine municipal bankruptcies occurring in Alabama from 1990 through 2004. These are the only municipal bankruptcies, to date, that have occurred in Alabama. A mixture of causes was discovered through court records, confidential interviews, and related news documents on these bankruptcies. The case studies confirm the findings of the Advisory Commission on Intergovernmental Relations (ACIR, 1973, 1985), Martin (1982), Rubin (1982), Baldassare (1998), Frank and Dluhy (2003), Park (2004) and Watson, Handley and Hassett (2005) that financial mismanagement is a leading cause of municipal bankruptcy. Such mismanagement was found in eight of the nine cases. The causes, as found in this research, are compiled and shown in Table 8.1.

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Table 8.1
Comparative Analysis of Causes Found in Case Studies
of Alabama Municipal Bankruptcies

Municipal Bankruptcies	Financial Management Problems	Economic Decline	Unaddressed Audit Findings	Lack of Oversight by Primary Government	Other Causes (Fraud, Legal Judgment)
City of Lipscomb 1991	X	X			
Town of North Courtland 1992	X				X
Alabama State Fair Authority 1994	X	X		X	
Greene County 1996	X	X	X		
West Walker Water Authority 1998	X	X			
City of Prichard 1999	X	X	X		
West Jefferson Amusement Public Park and Authority 2002	X			X	
Etowah Solid Waste Authority 2002				X	X
Town of Millport 2004	X	X	X		

Source: See Chapter V.

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The overall contributing factors to the municipal bankruptcies in Alabama were financial mismanagement by municipal administrators and the economic decline of the municipalities due to the loss of businesses and demographic changes. In the eight cases where financial mismanagement was evident, several loud warning signals were given to government officials that they either ignored or did not know how to handle. The Town of North Courtland, Alabama State Fair Authority, Greene County Commission, and the City of Prichard were all severely delinquent in their requisite payments to the Internal Revenue Service and their statutory payments to the State of Alabama and other counties and municipalities. At the time of its 1999 bankruptcy filing, Prichard owed the Internal Revenue Service $439,647 for unpaid federal income and FICA tax payments on behalf of the city's personnel system. Greene County, Prichard, and Millport violated Alabama Code by incurring insufficient fund charges and disbursing monies prior to insuring that funds were available on deposit (Alabama Code §11-8-10; §11-43-120). Greene County incurred $20,368 in insufficient fund charges for the 1991 to 1994 periods (Accounts Examiners, 1996).

Furthermore, all of the fiscally stressed municipalities that filed bankruptcy were severely delinquent in payments to bondholders and vendors. They did not have an adequate reserve in the fund balance to continue operating nor had public officials planned for any financial emergencies. While North Courtland's bankruptcy documents stated that the tort judgment against the city caused the town's financial woes, at the time of the filing the municipality was $50,320 delinquent in statutory payments to the State of Alabama and Lawrence County. Also, Lipscomb and Millport incurred additional

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interest and penalty charges because of late payments. Lipscomb paid $119,843 in late interest fees and penalties to the FmHA on the bond and warrant issued by the city in 1979. These charges resulted from court cases in 1987 and 1988 related to the city's failure to make timely payments on the debt issuance since 1985 (City of Lipscomb, 1991, p. 6).

The West Jefferson Amusement Public Park and Authority never made a full payment to bondholders on the $90 million of revenue bonds issued in 1999. A partial payment of $844,000 was made in February 2001. When the authority filed for bankruptcy on June 4, 2002, it owed $10 million to creditors in addition to the $90 million to bondholders (Sigo, 2002). In comparison, Millport paid $137,000 in additional interest and penalty charges to the United States Department of Agriculture to settle its bankruptcy case and will continue making payments to the bondholders until 2046. These added costs were from late and erratic payments occurring since 2000 (Confidential Interview with Public Official, March 12, 2007). Finally, in 1985, Prichard was assisted by the court in creating the Lasner Fund to help shelter unpaid liabilities. Although the original fund balance already had been repaid, the city continued to put additional liabilities in the fund and had an unpaid balance of $730,903, a significant portion of the city's overall liabilities of $4,884,830 at the time of the bankruptcy filing (Confidential Interview with Public Official, February 28, 2007).

Howell and Stamm (1979) stated that most fiscal stress is likely to be economic. I found that several of the local governments were adversely affected by loss of industry and subsequent tax base, but that the economic conditions were not the sole cause of

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these municipal bankruptcies. A decline in revenues for Lipscomb, the Alabama State Fair Authority, Greene County Commission, Prichard, the West Walker Water Authority, and Millport is notable. However, these problems did not happen overnight, and officials did not react in a timely manner. This reinforces the findings of Martin (1982) and Frank and Dluhy (2003). The Alabama State Fair Authority had incurred losses from operating the annual fair since 1989, borrowing funds to operate the fair, spring festival, and flea market. The 1993 fair operations alone suffered a net loss of $800,000. Greene County went from receiving revenues of $908,000 in 1990 to $14,400 in 1996 from GreeneTrack, the revenues having dropped 11% in 1991, 30% in 1992, and 61% in 1993. The decline in receipts should have been evident to the Commission. These findings are only a few of the added costs incurred by the municipalities for not maintaining positive financial condition and further support the findings of Rubin (1982), Ladd and Yinger (1991), Park (2004), and Watson, Handley and Hassett (2005) in that even though the financial management was not up to par, the loss of industry and retail establishments, along with a loss of tax revenues, was a contributing factor to the financial woes for the public officials. These losses often reflected population changes that also should have been evident to the decision-makers.

If the incidents of financial mismanagement had been corrected, the argument for financial reform in Alabama might be moot. However, it should be noted that in 2000, Lipscomb again faced the prospect of bankruptcy and was severely delinquent in payments to vendors. It also owed $23,000 to the Internal Revenue Service for employee withholding taxes (Bryan, 2000). Similarly, in the 2001 to 2004 audit, the Alabama

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Examiners of Public Accounts found that Greene County had continued to incur insufficient fund charges ($9,217). Also, the county was delinquent in payments to the IRS and other municipalities, did not publish semi-annual financial statements as required under §11-3-21 of the Code of Alabama, and did not comply with the provision in the bankruptcy plan to obtain timely audits by a CPA firm. Further, contrary to the bankruptcy plan, Greene County did not obtain assistance from any firm in developing and implementing accounting procedures in compliance with state and federal law as well as generally accepted governmental accounting and auditing standards (Report on the Greene County Commission, 2006, pp. A-F).

The West Jefferson Amusement Public Park and Authority sold VisionLand for $5.25 million in 2002. However, the 11 municipalities that agreed to fund the venture were to continue making the collective $2,952,360 annual payment to the bondholders through 2007. Many municipalities tried to opt out of the original funding agreement. In 2003, a federal court ordered one of the municipalities, Birmingham, to continue making the $1,000,000 annual payment to the bondholders. Even with this ruling, 9 of the 11 municipalities (including Lipscomb, one of the case study cases) have either stopped or been delinquent in making payments under the original agreement (Bryan, 2002).

In comparison, Prichard has made significant strides towards attaining a positive financial status since the 1999 bankruptcy. According to the current mayor, the city will complete the bankruptcy payments in 2007 instead of in 2008 as forecast. However, Prichard is still facing a large unfunded pension plan in the amount of $16,000,000 as of

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2007. The pension plan has been unfunded since 1975 (Confidential Interview with Public Official, March 28, 2007).

In 1985, the ACIR forecast the possibility that liabilities from lawsuits would be an additional cause of financial emergencies for local governments (1985, p. 6). Further, Frank and Dluhy (2003) studied the fiscal stress of Miami and found that public officials were negligent in establishing internal checks and balances especially when delegating authority to lower levels of management. A tort judgment was cited as the stimulus for North Courtland in filing for Chapter 9 protection. In the Etowah Solid Waste Authority bankruptcy, the Etowah County Commission did not establish internal checks and balances to maintain accountability of the authority management. Although the Alabama State Fair Authority and West Jefferson Amusement Public Park and Authority were not labeled fraudulent in their management of public funds, the oversight governments, the City of Birmingham and the 11 municipalities respectively, should have enforced stricter accountability of the funds they apportioned. In the case of the West Jefferson Amusement Public Park and Authority, member municipalities were cited as stating that they were not receiving financial reports on a timely basis and did not even know when the next business meeting would be held. Further, one of the members told the press he was not even aware of the additional $10 million bond offer in early 2000 which, ironically, was never issued due to the underwriter declining to back the issuance (Nicholson, 2000).

In this research, five public officials who had first-hand knowledge of three of the municipal bankruptcies discussed above cited a mixture of financial mismanagement,

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economic decline, and political problems as the main causes of fiscal stress. One public official stated that many officials seemed to be hesitant to admit to the financial problems since they did not want the city to publicly declare bankruptcy "while on their watch" or during their elected term of office. Another public official stated that filing bankruptcy was the only recourse; there were no other options available because the line of credit had been reached and bills had gone unpaid for over three months. Yet another official shared that elected officials felt the need to maintain services at current levels even when there was a noticeable reduction in the revenues. Some vendors started to require cash payments in lieu of credit to the municipality. Finally, an official stated that the former administration had lived beyond its means and incurred deficits for many years; the newly elected administration inherited vast financial problems along with economic decline. Park's (2004) assertion that government officials choose Chapter 9 because they do not see any other option or hope for recovery was echoed by many of the public officials during the confidential interviews.

Watson, Handley and Hassett (2005) assert that mismanagement of public funds causes civic distrust. Financial emergencies emphasize the need to enforce accountability and stewardship over public funds with a system of state monitoring and reform in the accounting and budgeting practices currently found in Alabama municipalities.

Impact on Financial Health of Affected Municipalities

I conducted an analysis of the interest rates paid on bonds by two municipalities that underwent municipal bankruptcy, Greene County (1996) and Millport (2004). Both bond issuances were non-rated and non-insured junk bonds (Confidential Interview with

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Industry Official, May 2, 2007). This analysis shows the financial impact on obtaining interest rates for the respective debt issuances in comparison with the municipal bond market at the time of the issuance.

The interest rates for the Greene County debt issuance were analyzed utilizing the staggered term general obligation warrants in 2002 ($4,590,000). This issuance was after the 1996 municipal bankruptcy filing. Interest rates for the general obligation refunding warrants issued by Millport in 2003 ($820,000) prior to the 2004 bankruptcy filing were also compared to the fair market yield curves for general obligation debt issuances rated as AA-, A and BBB- (high grade/high quality; upper medium grade; and lower medium grade credit ratings).

The Greene County debt issuance was for $4,590,000 with semiannual interest payments and had eight staggered terms in various amounts due within seven years to 30 years. In comparison of the market interest rates and the Greene County general obligation warrant, I used the $1,405,000 term warrant for the 30-year term using the related interest rates for each type of credit rating. The interest costs are shown in Table 8.2.

Table 8.2
Analysis of Total Interest Costs
Greene County

Principal Amount	Greene County GO Nonrated Uninsured	General Obligation Insured	General Obligation AA-; Uninsured	General Obligation A-; Uninsured	General Obligation BBB-; Uninsured
$1,405,000; 30-year term	$2,655,450 (6.30%)	$2,103,285 (4.99%)	$2,107,500 (5.00%)	$2,204,445 (5.23%)	$2,259,240 (5.36%)

Source: Greene County, Alabama General Obligation Warrants Series 2002; Bloomberg Investor Services database Fair Market Yield Curves for August 1, 2003 (May 2, 2007).

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As Table 8.2 indicates, for the $1,405,000 portion of the $4,590,000 general obligation warrant across 30 years, Greene County Commission incurred 1.31 percent above the average insured general obligation debt and $552,165 in excess interest costs over other general obligation insured debt issuances in the municipal bond market for the same issuance date. (This number was calculated by taking the difference between the third and second column of Table 8.2.) In comparison with the lower medium grade issuances, Greene County Commission incurred .94 percent above the uninsured and rated BBB- general obligation debt and $396,210 in excess interest charges were paid on the $1,405,000 portion.

An analysis of the fair market yield interest rates and those of Millport, Alabama is shown in Table 8.3. The table indicates the Town of Millport incurred excess interest of .68 percent and paid $14,280 (in total on the $140,000 portion of the $820,000 warrant across 15 years) in excess interest costs over those other general obligation insured debt issuances in the municipal bond market for the same issuance date. (This number was calculated by taking the difference between the third and second column of Table 8.3.) In comparison with the lower medium grade issuances, $6,510 in excess interest charges was paid.

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Table 8.3
Analysis of Total Interest Costs
Millport GO Refunding Warrants

Principal Amount	Millport GO Nonrated Uninsured	General Obligation Insured	General Obligation AA-; Uninsured	General Obligation A-; Uninsured	General Obligation BBB-; Uninsured
$140,000; 15-year term	$112,350 (5.35%)	$98,070 (4.67%)	$98,070 (4.67%)	$101,430 (4.83%)	$105,840 (5.04%)

Source: Millport, Alabama General Obligation Warrants Series 2003; Bloomberg Investor Services database Fair Market Yield Curves for August 1, 2003 (May 2, 2007).

Figures 8.1 and 8.2, respectively, show a graphical depiction of the comparison of interest yields. Both municipalities incurred higher-than-average interest rates on debt issuances both prior to the municipal bankruptcies and after the municipal bankruptcies. Again, both debt issuances were non-rated by the investment credit rating agencies and non-insured. Normally, bond insurance is given to those municipalities that meet certain credit criteria based on financial management practices and audits (Confidential Interview with Investment Official, May 2, 2007). The bottom line is that the higher interest rates for both municipal debt issuances necessitated a higher burden on the local taxpayer to repay the debt.

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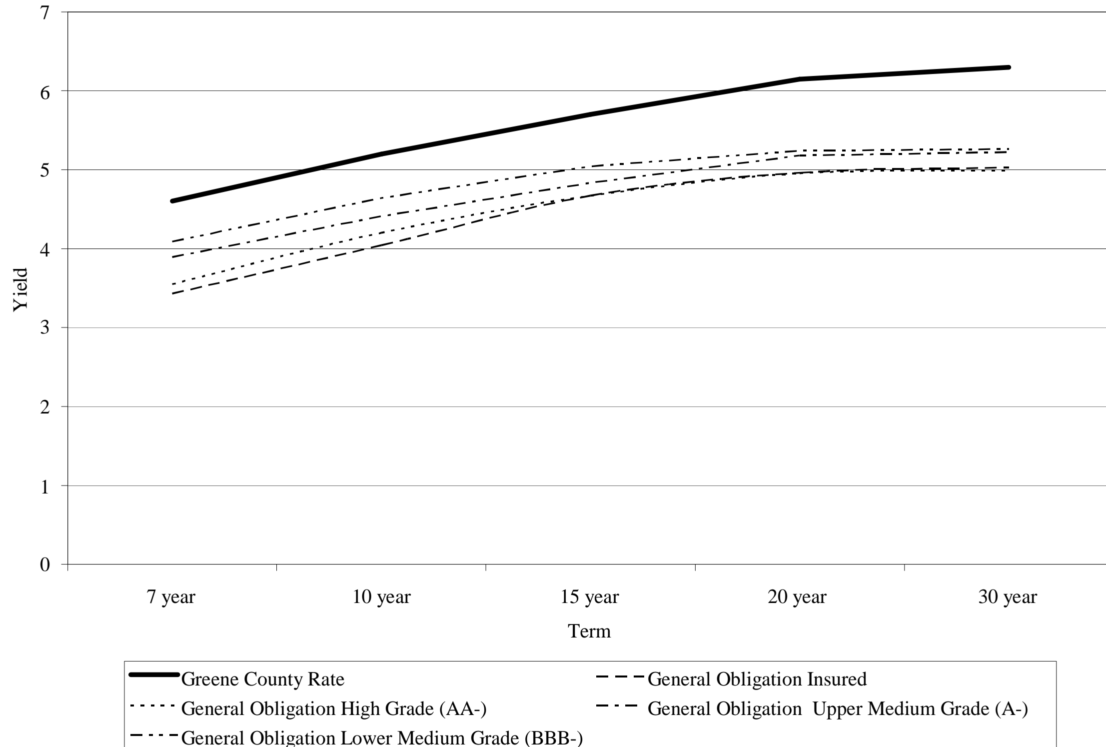
Figure 8.1
Analysis of Greene County 2002 Debt Issuance Interest Yields
With Fair Market Yield Curves at August 1, 2003



Source: Bloomberg Investor Services Database, May 2, 2007; Fair Market Yield Curves – Historical Comparison for August 1, 2003.

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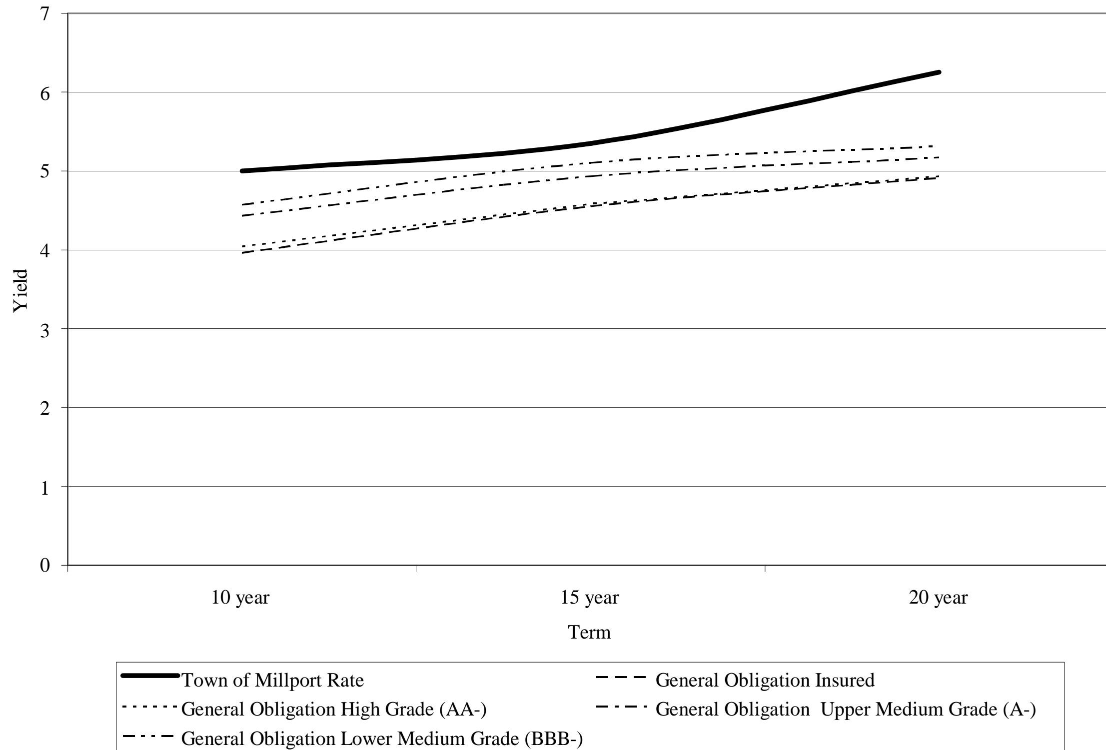
Figure 8.2
Analysis of Town of Millport Debt Issuance Interest Yields
With Fair Market Yield Curves at July 31, 2002



Source: Bloomberg Investor Services Database, May 2, 2007; Fair Market Yield Curves – Historical Comparison for July 31, 2002.

Impact on Alabama's Bond Ratings

The ACIR (1973, p. 7) and Kloha, Weissert and Kleine (2005, p. 314) stated that fiscal stress in a state's municipalities also has a negative impact on the state's overall bond ratings. Since the State of Alabama had nine municipal bankruptcies, a compilation was done of *Moodys'* credit ratings for general obligation bonds issued by Alabama during the period from 1970 to 2005. *Moodys Investors Service* performs financial research and analysis on commercial and government entities and also ranks the credit-worthiness of borrowers using a standardized ratings scale. *Moodys* ratings reflect both

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the likelihood of default and the probability of a financial loss. *Moodys* uses the following scale when issuing ratings for U.S. municipal tax-exempt borrowing:

Aaa – judged to be the highest quality, with minimal credit risk

Aa – judged to be of high quality and are subject to very low credit risk

Aa1 -- the issuer or obligation ranks in the higher end of Aa category;

Aa 2 – the issuer or obligation ranks in the mid-range of Aa category;

Aa3 – the issuer or obligation ranks in the lower end of the Aa category

A – considered upper-medium grade and are subject to low credit risk

A1 -- the issuer or obligation ranks in the higher end of A category;

A2 -- the issuer or obligation ranks in the mid-range of A category

A3 -- the issuer or obligation ranks in the lower end of the Aa category

All of the Alabama rankings for the 1970-2005 time periods ranged from A1 to Aa3. The movement of credit ratings for Alabama, as compiled by this author using *Moodys Investor Services* database, is shown in the Figure 8.3.

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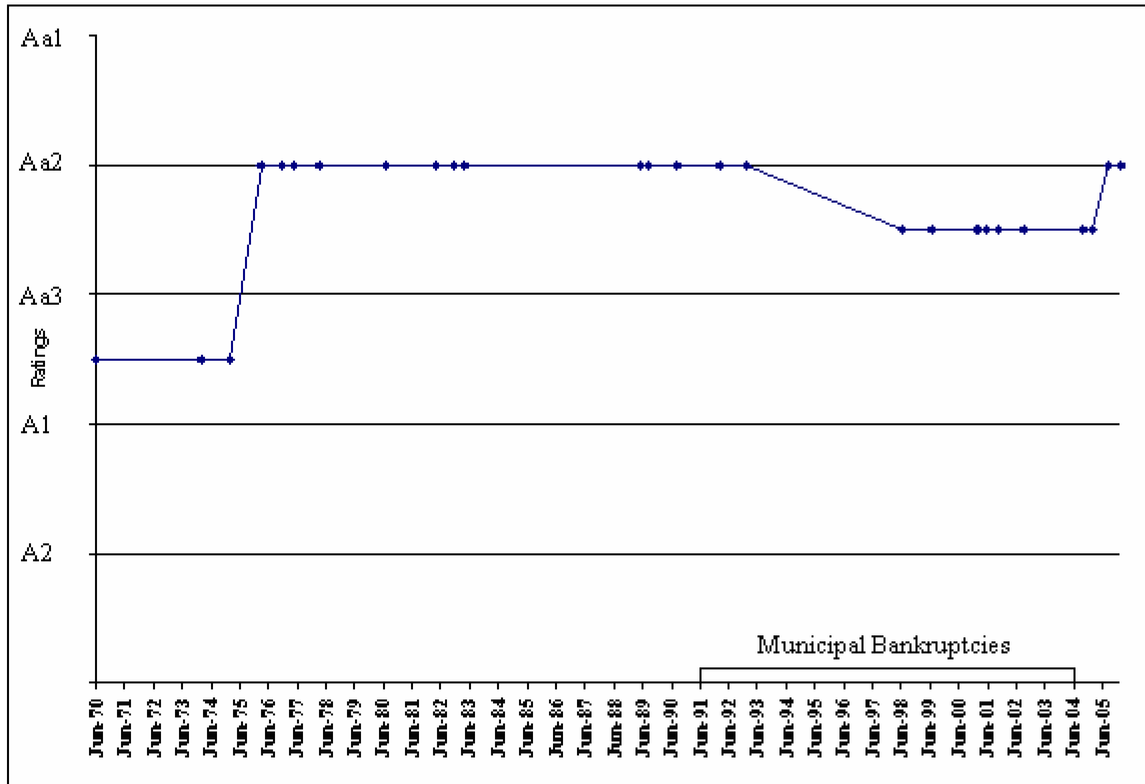
Figure 8.3
Moodys Investment Rating for State of Alabama
General Obligation Debt Issuances
1970 – 2005



Source: *Moodys Investor Services*, 2007

It is uncertain how much Alabama local governments, and taxpayers, might have saved if the credit ratings were higher during this period; however, the chart does indicate that municipal bankruptcies might have contributed negatively to the credit rating of the state bond issuances during the time period of 1990-2004. More research is needed to further identify the impacts on municipality and state interest payments.

For comparison purposes, North Carolina's bond ratings are Aaa presently and have been consistently in the Aa1 or higher range in the past 10 years. Furthermore,

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according to Coe (2007), North Carolina has the most local governments with the highest bond rating of any state. As a result, with $7.5 billion in outstanding bonds in June 2005, these ratings helped North Carolina's local governments and citizens realize a savings of $6.75 million or more in interest costs alone (Confidential Interview with Public Official, March 30, 2007; Coe, 2007, pp. 1-11).

Rubin (1982) found that lower credit ratings by *Moodys* brought about a public awareness that puts political pressure on city officials to address financial problems. This research could not address Rubin's finding because all of the municipal bonds and warrants issued by these nine municipalities were unrated and uninsured both before and after the municipal bankruptcy. This may be due to the lack of state statutory requirements that local governments use insured bonds (Park, 2004; Landry, 2007). Further, the ACIR reports (1973, 1985) warned of the adverse impact on state and local governments' credit ratings if the state did not establish guidelines for dealing with local financial emergencies, appoint a state agency to monitor local government finances, and offer remedial action to localities for coping with fiscal emergencies.

Comparative Analysis of Other States and the Alabama SDE

Rose (1993) and others have suggested that policies studied from other locations as well as in history can teach us lessons about which policies work and which do not. In this light, I examined a variety of existing policies related to fiscal stress and municipal bankruptcy.

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Comparison of the States

I analyzed current municipal finance methodologies used in Alabama and six other states. The results are compiled in Table 8.4.

Table 8.4
Comparative Analysis of States Municipal Finance Methodologies

State	Allow Municipal Bankruptcy	Utilize Intervention in Local Government	Review Annual Financial Reports	Review Annual Operating Budgets	Approve Debt Issuances
Alabama	Yes	No	No	No	No
Florida	Yes	Yes	Yes	No	No
Georgia	Prohibits	No	Yes	No	No
North Carolina	Yes	Yes	Yes	No	Yes
Ohio	Yes	Yes	Yes	No	No
Pennsylvania	Yes	Yes	Yes	No	No
Tennessee	No	No	Yes	Yes	Yes

Source: See Chapter VI of this research

As the table shows, Georgia and Tennessee do not allow municipal bankruptcy. Georgia expressly prohibits the filing for Chapter 9 in Georgia Code §36-80-5. Tennessee does not address municipal bankruptcy in its statutes; therefore, municipalities do not have specific authority from the state to file, which is a requirement under current federal legislation. Like Alabama, Florida, North Carolina, Ohio, and Pennsylvania allow their municipalities to file for Chapter 9 protection. However, these states have an additional step prior to the filing while Alabama does not. Florida and Pennsylvania require approval by the Commissioner of Education for local boards of education and the Governor for all other municipalities. North Carolina requires approval by the Local Government Commission, a nine-member commission composed of the State Treasurer,

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State Auditor, Secretary of State, Secretary of Revenue, three gubernatorial appointees, and a member from both the Senate and House of Representatives. Ohio takes a similar approach in that the State Auditor and the Financial Planning Supervision Commission must approve the bankruptcy filing of Ohio municipalities.

All four of these states take additional steps such as oversight, technical assistance, grants or loans, and restructuring of debt issuances to avoid a Chapter 9 filing. According to a North Carolina public official, the state will only allow a municipal bankruptcy filing when the financial condition is such that no other recourse is possible (Confidential Interview with Public Official, March 29, 2007). Florida, North Carolina, Ohio, and Pennsylvania have programs in place to intervene in local governments in a proactive manner. All have the statutory power to review the annual operating budget and related debt issuances when the municipality is under state intervention, along with other financial management powers, discussed fully in Chapter VI. Furthermore, all employ a financial indicator system in analyzing the audited financial reports to detect fiscal stress and avoid future financial problems. Alabama has none of these steps in place.

An interesting side note discovered during the course of this research was the practice of employing a uniform chart of accounts by local governments in many of the states studied. Georgia mandated this practice in 1997 after the Georgia Future Communities Commission made a recommendation to the legislature. Florida, North Carolina, Ohio, and Tennessee also all require this practice as does the Alabama State Department of Education. This ensures that all local government financial information is

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compiled uniformly for all state government agencies. This provides local policy makers and citizens a means to compare local finances.

I found no mention of a uniform chart of accounts in the Code of Alabama. An interview with a public official at the Examiners of Public Accounts confirmed that no uniform chart of accounts presently exists for the local governments in Alabama; however, the Examiners do assist county governments in presenting their information in a like manner (Confidential Interview with Public Official, May 9, 2007).

Comparison of Alabama State Department of Education Procedures

The Alabama State Department of Education (SDE) takes a similar approach to that of other states for municipal finance procedures for Alabama local boards of education. SDE officials mentioned that Ohio's system of public school finance methodologies was used as a template in considering possible reform methods for Alabama local boards of education in 1995 (Confidential Interview with Two Public Officials, March 22, 2007). Table 8.5 depicts the SDE finance practices for local boards of education in Alabama.

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Table 8.5
Alabama State Department of Education
Local Boards of Education Finance Practices

State Program	Allow Bankruptcy Filing	Utilize Intervention	Review Annual Financial Reports	Approve Annual Operating Budgets	Approve Debt Issuances
Alabama State Department of Education	Yes	Yes	Yes	Yes	Yes

Source: Confidential Interview with Public Officials, March 22, 2007; Alabama Acts 1995-313; Alabama Acts 2006-196; Code of Alabama, 1975.

Although the SDE must allow bankruptcy in accordance with the current law in Alabama (Code §11-81-3), the SDE takes proactive measures to avoid municipal bankruptcy in the local boards of education (Confidential Interview with Public Official, March 22, 2007). Prior to 2006, the SDE staff would review and make a determination of fiscal stress in the budget of the respective local board as provided for in the Accountability Act (Act 95-313). The staff reviewed audited financial reports and other financial information submitted to the department as required under state and federal regulations. In 2006, the focus changed from the budget to the annual financial report and a minimum operating fund balance requirement. The SDE has consistently approved all local board of education debt issuances for the past 30 years and has been active in monitoring debt principal and interest payments. No local board of education in Alabama has filed for bankruptcy, and the financial monitoring in place since 1995 proactively addresses fiscal problems (Confidential Interview with Public Officials, March 22, 2007).

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Financial Oversight of Alabama Local Governments

Like the ACIR (1973), Honadle (2003a, 2003b) and Kloha, Weissert and Kleine (2005), I found no state level municipal finance reform administered by an Alabama state agency for Alabama localities. Although the Alabama legislature created the Department of Examiners of Public Accounts in 1947 to conduct auditing of state and county offices, this department does not intervene when a county faces financial distress, as demonstrated in the Greene County Commission audits and its subsequent municipal bankruptcy. Nor does this department publish a list of the county governments that do not meet certain accounting and auditing standards. However, audit reports normally cover a two-year period and are available via Internet and through the Alabama Department of Archives and History (Confidential Interview with Public Official, May 9, 2007).

The Alabama Department of Economic and Community Affairs (ADECA) was created by the Legislature in 1983 to help with economic and development endeavors in Alabama's communities. ADECA administers many federally funded programs including the Community Development Block Grant and the Workforce Investment Act. The agency does audit local governments once they receive grant funds from ADECA; however, these audits are normally limited to compliance with the grant requirements (Code of Alabama, 1975, §41-22-1).

A search of state statutes yielded an Alabama law that mentions state oversight of local government finances. However, the statute seems to be unused and irrelevant. This

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statute was issued in 1939 and 1940, respectively, and is found under the Alabama Department of Finance (Code of Alabama, 1975, §41-4-2). It states:

> There shall be a Department of Finance, which shall be an executive and administrative department and which shall have general supervision of all matters pertaining to the finances of the state and the departments, boards, bureaus, commissions, agencies, offices and institutions thereof and, to the extent herein indicated, over the finances of the counties, municipal corporations, political subdivisions and local public bodies in the state, and to furnish the physical facilities, equipment and supplies and, to the extent herein indicated, the personnel, for the operation of the state and such departments, boards, bureaus, commissions, agencies, offices and institutions thereof (1939, 1940).

In talking with public officials in the offices of the Alabama Attorney General, Department of Finance, Department of Examiners of Public Accounts, and ADECA, no one knew whether this statute had ever been enforced since its enactment. Furthermore, the phrase "to the extent herein indicated" was never revisited in subsequent statutes in the same section of Code (Confidential Interviews with Public Officials, March 30, 2007; May 8, 2007, May 9, 2007).

In a search of legislation supporting the code, I found that the legislature did take a partial step towards municipal finance reform in Alabama in 1994 under Alabama Acts 94-414, a resolution passed in the legislature but never placed into the Code of Alabama.

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This resolution, found in Code §41-5-14, states:

> That all entities receiving or disbursing, or both, public funds forward a copy of every audit report issued on the entity to the Department of Examiners of Public Accounts at the time of its receipt by the entity; and that the Department of Examiners of Public Accounts shall establish a repository of audit reports received, provide notice to the public weekly of reports received by the repository, and provide copies of audit reports in the repository to the public upon request (Alabama Acts 94-414).

Interestingly, the Alabama Constitution of 1901 contains a provision that laws must be passed in the form of a bill. This excludes resolutions from being a permissible vehicle for enacting laws. Thus, a statute cannot be amended by joint resolution of the Legislature (Confidential Interview with Public Official, May 8, 2007).

To determine whether this resolution had been implemented, I requested a copy of this repository of audit reports from the Examiners. It shows that as of the end of 2006, only 42 municipalities had deposited all of their 1993 to 2004 annual audited financial statements with the Examiners. Several municipalities deposited their audited financial statements once or twice during this time period, mainly in the initial years after the 1994 legislation. Since the legislation is a resolution and does not specify what level of authority the Examiners have to enforce it nor possible sanctions if a municipality fails to comply, this provision has largely been ignored by the state and local officials (Confidential Interview with Public Official, May 8, 2007).

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As stated previously, the Alabama Department of Examiners of Public Accounts has the legislative power to audit all state and county offices, officers, bureaus, boards, commissions, departments and agencies, but it does not have any power to audit any other forms of local governments. At the date of this writing, two city school boards, Tuscaloosa and Birmingham City, are audited by the Examiners due to legislative agreements. County offices are normally audited on a two-year cycle.

Presently, under the Code of Alabama (1975), other financial practices that are required by the state include a requirement that the county commission prepare and adopt an annual budget for the county (§11-8-3). Cities and towns are required to have an annual audit with the appointment of an independent, certified public accountant to review and audit the financial reports under Code of Alabama §11-43-85. Cities, towns, and all special authorities are not required to adopt an annual budget, but the Alabama League of Municipalities does encourage this practice. Counties, cities, and towns are required to report to their commission or council on their financial status under Alabama law. Counties are required by law to publish financial statements on a semiannual basis (§11-3-21). Cities and towns are directed to present the financial condition of the municipality to the council at least every six months (§11-43-84). All expenditures of Alabama municipalities must be approved by either a County Commission or designated chairman (§11-8-9) or the mayor or some other person designated by the council (§11-43-120). Municipalities are directed by the Code of Alabama (1975) to not make payment until funds are available for disbursement (§11-8-10; §11-43-120).

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In comparison with other state practices and the SDE practices in this area, it is obvious that Alabama municipal accounting and budgeting practices are much more lax and should be reconsidered by the legislature. Most of the existing legislation was enacted in 1935, 1940, and 1960. All other states studied under this research had enacted or amended legislation concerning municipal finance reforms since 1990.

I interviewed public officials directly involved with the municipal bankruptcies of Greene County, Prichard and Millport. These interviews were conducted during the period of March 12-28, 2007. Questions were posed to the interview participants as to whether they would have welcomed additional state oversight and possible state intervention when financial emergencies arose for the local governments. The interview participants also were asked what lessons could be learned from their experiences with municipal bankruptcy to help avoid future financial emergencies for other Alabama local governments. Two of the interview participants asked to participate in a group interview so their responses are grouped together in Table 8.6.

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Table 8.6
Responses from Local Officials on
State Oversight and Involvement

Did any state official/branch of government get involved?	Should the state become involved?	If yes, at what point?	What lessons can other Alabama municipalities learn from your experience?
Not to my knowledge	Yes	• At the beginning to give guidance • Subsidize training of public officials to be proactive in financial monitoring	• Training of current financial practices for commission and county personnel • Keep accounting records current • Watch revenues/expenditures closely for trends • Avoid municipal bankruptcy, if at all possible • Political problems can hinder financial progress
No	Possibly, not sure	• Not sure • Training of financial practices and accountability for all public officials, including council, commission and board members	• Accountability of public officials should be a priority in Legislature • State Examiners should audit all municipalities • Without impeachment of public officials in place or ways to deal with former administration who did not uphold financial status, there is no recourse for the taxpayers left behind • Training of personnel is key

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Table 8.6 (cont.)
Responses from Local Officials on
State Oversight and Involvement

No	Yes	• Beginning • Examiners should have more power over other municipalities	• Beware of who you elect to office • Financial training is a necessity for all levels of management in government • Be proactive instead of reactive
Yes (Examiners; County Commission)	Yes	• Continuous monitoring • Audit review at state level done annually • Assistance and guidance on how to avoid bankruptcy • Training of accountability and financial education for Boards appointed to make financial decisions	• Work together in politics • Training of public officials elected to office • Monitoring by state necessary to keep public trust • Adopt best practices by other municipalities • Collaboration with other municipalities

Source: Confidential Interviews with Public Officials, March 12-28, 2007

State oversight and guidance in municipal finances, especially in the area of municipal bankruptcy, seems to be desired by local officials. State subsidized training in financial matters was an overwhelming response in all interviews conducted. Presently, the Association of County Commissions of Alabama and the Alabama League of Municipalities provide a form of financial training to publicly elected officials in Alabama; however, the number of officials that have gone through this training is less than one-half of those eligible. Further, this training is not necessarily geared toward

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those who are handling the financial transactions of the municipalities. There are no state guidelines for the hiring of public personnel to act in financial oversight, such as the Custodian of Accounts or Municipal Clerk. The SDE instituted minimum education requirements in 2003 for individuals involved in financial matters in the local boards of education. This step also grandfathered those who were already employed in such a position but required them to receive Alabama School Board Officers Association (ASBOA) certification to maintain the position (Confidential Interviews with Public Officials, March 12-28, 2007).

Considering Alabama's present state-level financial guidelines for local governments, the findings of Howell and Stamm (1979), Martin (1982), Rubin (1982), Ladd and Yinger (1991), Cahill and James (1992), McConnell and Picker (1993), Lewis (1994), Berman (1995), Spiotto (1996), Baldassare (1998), Frank and Dluhy (2003), Park (2004), and Honadle (2003a, 2003b, 2004) all support the need for a solid municipal finance system to promote financial health in local governments. In essence, Howell and Stamm (1979), Martin (1982), Hildreth (1996), Frank and Dluhy (2003), and Baldassare (1998) all encouraged better financial management practices, including the Government Financial Officers Association (GFOA) recommended practices for the functional areas of public finance. These practices are kept current on the GFOA's website and are easily accessible to public officials.

Most of the researchers also supported state mandated financial reforms. Rubin (1982), McConnell and Picker (1993), Freyberg (1994), Berman (1995) and Spiotto (1996), and Baldassare (1998) believe that states should address current and future fiscal problems in local governments. A prevalent theme among these researchers was that

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municipal bankruptcy should be avoided and reserved for worst-case scenarios. Honadle (2003a) found that states typically take four roles in dealing with fiscal crisis of local governments. These are: predict, avert, mitigate, and prevent. In addition, the research of Honadle and Li (2004) showed that states that monitor or predict the financial conditions of their local governments will eventually take the additional steps of averting, mitigating, and preventing future fiscal crisis and municipal bankruptcies. Further, Kloha, Weissert, and Kleine (2005) found through their 2002-2003 survey that 15 states had financial indicators in place to monitor local governments, and 7 of the 15 states employed both proactive and reactive measures in application of the indicators. Four states studied in my research (Florida, North Carolina, Ohio, and Pennsylvania) were among those 15 states. Georgia and Tennessee then lacked an indicator system. Georgia has implemented an indicator system.

All of the states studied, along with the Alabama State Department of Education (SDE) policies and procedures, are more proactive (involved in monitoring local governments before problems fully develop) and reactive (involved once the problems or bankruptcy is in place) in dealing with local government fiscal stress than the system now employed in Alabama. Currently, the state government takes no role at all in local finances. Only the SDE governs local boards of education finances and the Alabama Department of Examiners of Public Accounts audits the county finances. Even when the massive fiscal crisis was experienced by the West Jefferson Amusement Public Park and Authority, the legislature amended and then Governor Siegelman signed into law, under Alabama Acts 2001-959 (p. 839), to allow the Authority the power to seek Chapter 9 protection. As a result, the bondholders are still trying to seek repayment as of the date

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of this writing. In essence, once they took action to allow the filing, the legislature and Governor adopted a "hands off" approach to facing the fiscal crisis and did not attempt to avert, mitigate, or prevent the municipal bankruptcy.

Summary

The increase in the number of municipal bankruptcies since 1990 and most notably the financial crises that were experienced in Orange County, California (1994) and Bridgeport, Connecticut (1991) reinforces the continued importance of studying fiscal crisis of local governments. In 2005, the federal bankruptcy legislation was changed to include credit counseling as a prerequisite for individuals who filed for Chapter 7 bankruptcy. Although Chapter 7 is a liquidation of debts and Chapter 9 is a reorganization of debts, it suggests that individuals, like municipalities, rush to bankruptcy without consideration for their financial future and that all entities should be counseled as to prudent and sound financial practices before and during a financial emergency to preserve their future financial health.

It is my contention that the State of Alabama should follow the lead of other states in taking a tougher approach to municipal finances. Municipal bankruptcy and the fiscal stress associated with it impacts not only the local entity and its constituency, it impact the state government and the citizenry in general. The ACIR (1973, 1985) stated that it was the state's responsibility to monitor and evaluate the finances of the local governments and that Chapter 9 should be only used when there was no other recourse. Chapter IX discusses the policy options from among those examined in this study that appear to offer the best fit for Alabama as well as future directions for further research.

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CHAPTER IX

CONCLUSIONS AND FUTURE DIRECTIONS

The purpose of this research was to identify the specific factors of the nine municipal bankruptcies in Alabama and examine the municipal finance reform methodologies employed in six other states and the Alabama State Department of Education. No other research has examined all of the municipal bankruptcies that occurred within a single state. Thus, this research is the first single state municipal bankruptcy case study held constant for the political environment within a state and makes a significant contribution to existing literature.

Theoretical Implications of Research

The research presented here confirms the findings in the limited research in the public finance field related to municipal bankruptcies (ACIR, 1973, 1985; Baldassare, 1998; Park, 2004; Watson, Handley and Hassett, 2005; Landry, 2007) that most municipal bankruptcies occur as a result of financial mismanagement and economic decline. However, this research also found that most of the Alabama municipal bankruptcies occurred in localities where socioeconomic conditions had declined which affected the availability of resources. The migration of the upper- to middle-class residents and the loss of industry left the local governments with a disproportionate number of poor, uneducated, and unemployed residents who were unable to sustain the

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necessary revenue base and possibly had a higher level of need for government services. The deteriorating fiscal capacity of the local governments may have had an additional affect on the implementation and maintenance of sound financial policies and the ability to hire educated financial personnel.

This research also provides lessons for public officials when facing fiscal stress and possible municipal bankruptcy. The lack of state mandated budgeting and financial management techniques for all local governments, including special districts, should be a primary concern for public officials. Presently, the Code of Alabama only requires that county governments adopt an annual budget. Further, the lack of state oversight into audit findings, which normally signal fiscal stress in a local government, was particularly noteworthy in this research. This research also showed that the issuance of uninsured and unrated general obligation debt increases the related borrowing costs of the local government which has an additional negative impact on the fiscal capacity of the locality.

As with the other research related to fiscal stress studies, notably ACIR (1973, 1985), Rubin (1982), Ladd and Yinger (1991), Ward (2001), Frank & Dluhy, (2003), Park (2004), and Kloha, Weissert and Kleine (2005), this research also serves as another strong argument that state policies addressing fiscal stress in local governments are vital to fostering financial health in local governments. It demonstrated that lack of state level municipal finance policies and procedures may result in a greater number of municipal bankruptcies within a state. These municipal bankruptcies may also have a negative impact on the state's overall credit ratings as well as the related borrowing costs to all of the municipalities of the state as cited by the ACIR (1973, 1985) and Kloha, Weissert and

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Kleine (2005). Multiple municipal bankruptcies within a state seem to have a negative ripple effect on all of the municipal and state finances within that particular state. Further research in this area is needed. Although this research was primarily conducted for public officials in Alabama to consider municipal finance reform for local governments, this study also could benefit policy makers in other states that have not implemented municipal finance reform for their local governments.

The concepts in this study are related to the public finance, public administration, and public policy fields. For public finance, it is clear that public officials in Alabama, as well as other states, need to be educated in proper financial management techniques which include budgeting, sound financial policies, strategic planning for fiscal emergencies, and loss of revenues. Public administrators must also be strongly educated in government accounting, budgeting and financial areas to recognize when accounting and finance issues signal fiscal stress. Public administrators must be equipped to educate their constituencies about the available resources of the local government and which programs are feasible within the short-run as well as the long-run for their community. The public policy field should continue to consider which public policies and procedures yield the greatest benefit for fiscal health within local governments as well as for the citizenry within the state. As in the case of Alabama, many states should require more oversight in the creation and operation of special districts, such as economic development districts, which are often created in part to circumvent state constitutional limitations on local government borrowing and debt. As shown in Table 3.3, approximately 65 percent of the municipal bankruptcies that occurred from 1990 to 2004 stemmed from fiscal

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problems in special districts and public policy makers need to address this growing problem.

Policy Implications for Alabama

The Advisory Commission on Intergovernmental Relations (ACIR, 1973, 1985), Howell and Stamm (1979), Ladd and Yinger (1991), Freyberg (1994), Lewis (1994), Berman (1995), Spiotto (1996), Baldasarre (1998), Ward (2001), and Kloha, Weissert and Kleine (2003, 2005) all note that it is the state's responsibility to maintain oversight in its local government public finances. Alabama's current legislation allows municipalities to file for Chapter 9 protection without further procedures or steps of notification at the state government level.

This research uncovered several possible municipal finance reforms for Alabama's public officials to consider. The lesson drawing theories of Rose (1993) were employed to compare alternative policies for Alabama to emulate. This involved examining policies or programs elsewhere to determine what has been done to solve similar problems (p. 24). Rose's basic decision rule is when policy makers are addressing dissatisfaction with current legislation, they should initially start looking in their own backyard (p. 68). In that regard, policy makers should take an initial look at what legislation has already been enacted in Alabama. Using the Alabama SDE legislation for local boards of education finances as a template, legislation could be adapted that addresses municipal finances in the same accountability and public stewardship context.

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Rose also identifies a hybrid or synthesizing of public policies used elsewhere as an option for policy makers (p. 30). The programs currently used by the six states examined provide a variety of options to consider as well as the municipal finance reform currently employed by the Alabama State Department of Education.

To consider municipal finance reform, the first question Alabama policymakers need to consider is whether the policies should be proactive, reactive, or both. Proactive is when a state implements policies that act as an early warning system for fiscal distress in local governments and provides state and local officials the opportunity to recognize and prevent fiscal distress from becoming a fiscal emergency or a municipal bankruptcy. Reactive policies are those policies implemented in the aftermath of a fiscal emergency and may not be timely to prevent municipal bankruptcy. Honadle (2003a) posits that policies that predict or avert are considered proactive whereas policies that mitigate or prevent fiscal crisis are considered reactive strategies. The ACIR (1973, 1985), Howell and Stamm (1979), Baldassare (1998), Park (2004), and Kloha, Weissert and Kleine (2005) all advocate that state governments monitor the fiscal conditions of their local governments proactively, rather than reactively.

From the comparative analysis of the six states and the Alabama State Department of Education, I have created several policy options for Alabama public officials to consider. It is important to note that all of these options will entail state-enacted policies and procedures that establish criteria for determining fiscal stress, identify those parties that can instigate action, define the processes to address fiscal stress, name the entity or individual responsible for oversight, and identify how fiscal stress oversight can be

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terminated (Cahill & James, 1992, p. 91). Other considerations for policymakers include cost, public acceptance and method of creation -- whether a state statute can be amended or added by the legislature or a state constitutional amendment is necessary.

Most of these options require the use of public funds. This will necessitate the Legislative Fiscal Office determining the related costs of creating, staffing and maintaining such policies. In the case of the state constitutional amendment with the third option, this amendment must pass both the house and senate by a three-fifths majority and would require a majority vote of the electorate. Should the amendment be offered in a special election rather than during a regularly scheduled election, there would be added costs and that with either case education of the electorate on the policy would be needed and result in additional costs.

Further, all of these options require some level of public acceptance. The state agency oversight and the commission option may be considered as the state being intrusive in local affairs. The governor approval option would probably require a constitutional amendment which necessitates a vote by the electorate to amend the state constitution further. Cotter, Stovall, and Fisher (1994) found that historically most Alabama citizens distrust their state government and are more dissatisfied with their state government than other citizens on a national average (pp. 111-113). They found that there is a high level of cynicism and despite the presence of liberal beliefs, there is a conservative anti-government attitude among the state citizens (p. 116). The authors found that support for reform in Alabama is considerable, however, the chance of reforms being enacted into law is quite low (p. 119). Seroka (2005) and Cotter (2007) maintain

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that the distrust of state government continues today and posits that the voter's rejection of the proposed Alabama constitutional amendments for the Governor Siegelman's lottery proposal (1999) and Governor Riley's tax reform and government accountability proposal (2003) was directly related to Alabamian's distrust of state government (Seroka, 2003, p. 6; Cotter in Bullock & Rozell, 2007, p. 86).

Cotter, Stovall and Fisher (1994) suggest that state and local leaders, universities, and professional organizations can help overcome the public's distrust of state government by educating the public on needed reform measures. They suggest that the public needs specified outcomes for proposed programs in order to understand and accept the proposals. In this light, my analysis of bond interest costs in Chapter VIII would be used as a starting point to convince the legislature and the electorate that we can either address the need for municipal finance reform or continue to experience excess interest costs and the negative effects of municipal bankruptcies. In essence, an either "pay now or pay later" approach. Furthermore, the Government Finance Officers Association of Alabama (GFOAA), the League of Municipalities, the Association of County Commissions of Alabama, and academia should educate local officials and citizens about the need for municipal finance reform.

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Policies and Procedures Needed Despite Reform Option Chosen

- Accountability Standards for Public Funds - Cotter, Stovall and Fisher cite that accountability policies are a step towards reinstating good governance in Alabama's governments (pp. 122-134). In a poll directed by Seroka (2005), 74 percent of Alabamians believe that honesty in local politics is an urgent matter that needs to be addressed. The related liabilities of the nine municipal bankruptcies totaled over $115,000,000 in public funds. If the state were to impose criminal charges on public officials who knowingly commit fraudulent acts using public funds, this message would serve to reinforce the idea that stewardship of public funds is a requirement for accountability of public officials.
- Adoption of annual budgets for all levels of local government. Presently, the Code of Alabama §11-8-3 states that county governments in Alabama must prepare and adopt an annual budget. The Alabama State Department of Education requires that local boards of education adopt an annual budget and submit the budget for approval at the state level prior to the beginning of the fiscal year. Presently, cities, towns, and special district governments in Alabama are not required to adopt an annual budget. McKinney (2004, p. 265) states that the budget serves as a planning, political, social, economic and legal instrument and is essential to the success of governing in all levels of government. Further, budgeting can assist public officials to strategically plan for the future and provide the electorate a level of accountability for those officials.

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- Require all local governments to receive a financial audit. Presently, the Examiners audit the county offices of Alabama. Certified professional accountants audit cities, towns, local boards of education, and a few special districts (gas and electric utility boards, self-help business improvement districts, and municipal parking authorities) on an annual basis as required in the Code of Alabama. This legislation should be extended to all levels of local government at least on a bi-annual basis.
- Training. In the interviews conducted in this research, guidance in municipal bankruptcies/fiscal stress and training in financial matters were overwhelming responses from local public officials on how the state could assist the municipalities. Collaboration between universities and expert bodies such as the Alabama Government Financial Officers Association (GFOAA), the Alabama League of Municipalities (ALM), and the Association of County Commissions of Alabama (ACCA) could provide extensive and continuous training to public officials on strategic planning, financial management, budgeting, and their interrelations. Presently, these organizations do provide some level of training through the Certified Government Accounting Technician Program and the Certified Government Finance Officer (CGAT, CGFO - GFOAA), the Certified Municipal Official (CMO – ALM), and the Alabama Government Training Institute (ACCA). However, many public officials interviewed in this study suggested that the state should provide or supplement the costs of this training. Many of the interview participants cited that the local funds were not sufficient to attend the training. Also, this training should be modified to include those special authority administrators.

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- Bond Insurance. In this research, the municipal bond issuances studied were uninsured and unrated. These were considered junk bonds by an investment industry expert. In the case studies conducted in this research on the Alabama municipal bankruptcies, an analysis of two bonds related interest rates showed that the municipalities paid $566,445 collectively in excess interest costs over other general obligation insured debt issuances in the municipal bond market for the same issuance date. At a minimum, the state should require municipalities to receive insurance on bond issuances as advocated by Spiotto (1996), Baldassare (1998), and Park (2004).
- Liability Insurance. The ACIR (1985) predicted that future fiscal emergencies in local governments would be as a result of tort judgments against the local entity. In the case of the Town of North Courtland's municipal bankruptcy, the plaintiff was awarded over $100,000 and immediately began garnishing the town's tax revenues in order to receive payment. North Courtland did not have any insurance coverage to cover the judgment and filed municipal bankruptcy as a result of the judgment. The state should require that municipalities maintain adequate liability coverage in order to avoid such an occurrence.
- Chart of Accounts. A chart of accounts is a listing of accounts found in the general ledger of an entity. A chart of accounts to be utilized in all levels of local government should be created by the state government. This would result in similar financial data received at the state level as well as comparative data for public officials and the electorate. A chart of accounts would also provide investors and economic developers a means to compare local finances. Despite their varying degrees of

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municipal finance reform, Florida, Georgia, North Carolina, Ohio, and Tennessee all require this practice as does the Alabama State Department of Education. This would result in similar financial data received at the state level as well as comparative data for public officials and the electorate.

Municipal Finance Reform Options at State Level

Three of these policy considerations are proactive, requiring the state to monitor local government finances in order to prevent future municipal bankruptcies in Alabama's local governments. The fourth option serves as a reactive or intermediary step. Again, proactive fiscal policies are those that have an early warning system in place to avoid financial emergencies and municipal bankruptcies and reactive policies are those that act in response to a fiscal emergency that may have already resulted in a municipal bankruptcy. The four options discussed in this section vary in application. The three proactive options would necessitate a legislative amendment of existing statutes that would give state departments additional duties. The final option includes a constitutional amendment to give the governor the power to approve or disapprove a municipal bankruptcy prior to filing.

Option One - Department of Finance Oversight Into Local Finances

The ACIR (1973, 1985) stated that, at a minimum, a state agency or commission should be designated to have oversight authority in addressing current fiscal practices employed by local governments. For Alabama, a statute is already in place in the Code of Alabama, 1975, §41-4-2 that gives the State Department of Finance general

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supervision over the finances of the counties, municipal corporations, political subdivisions and local public bodies in the state. By enforcing this statute to create an additional division within the Department of Finance, the department could opt to receive and review annual budgets and annual audits of local governments, contact local officials on audit findings to determine how the deficiencies were handled, approve local government debt issuances, and monitor repayment of debts for likelihood of default. This office could also create and administer a financial indicator system.

Like Georgia and Tennessee, if any of the local governments fail to comply, the department could publish notice of this fact in the state newspapers stating that the required financial documents have not been submitted, approved, and the local government is operating without state approval. Another tactic would be to withhold state funds from all local governments until financial matters are resolved. Pennsylvania and Georgia both found that reliance on state revenues and the knowledge that state funds would be withheld if local governments did not comply provided a greater incentive for implementing municipal finance reform.

Basically, this office would copy the format employed by the Alabama State Department of Education's creation of the LEA Financial Assistance Division in response to the 1995 Alabama Education Accountability Act (Act 95-313). When this division was created, a chief accountant, six team accountants, four support accountants, and several contract personnel administered the financial monitoring of 130 local boards of education. As such, this option necessitates the hiring of several state employees to administer the financial monitoring of approximately 955 local governments in Alabama.

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Other states financial oversight agencies/divisions have the following staff size – Pennsylvania, 30; North Carolina, 25; Ohio, 23; and Florida, 12 (Coe, 2007a, p. 19).

One advantage of implementing an office within the Finance Department may be to improve the state's overall general obligation bond ratings as well as lower the related interest costs of state and local general obligation and revenue bond issuances. In regard to other states that employ a similar approach, North Carolina, Florida and Ohio all have a higher credit rating for their related general obligation bond issuances (*Moodys Investor Services*, 2007).

Option Two – Give Examiners Statutory Authority to Review and Publish Findings

Presently, the Examiners have the authority to audit state and county offices under Code of Alabama, 1975, §41-5. The present wording of the resolution found in Alabama Act 94-414 requires municipalities to deposit their audited financial statements with the Examiners could be amended by the Alabama legislature as a bill which is considered law under the Alabama Constitution. This amended legislation should give the Examiners the additional statutory powers to review and publish findings of any noted problems. The Examiners could also create a financial indicator system, apply this system to the audit reports, and create a public database for transparency and comparison purposes.

Presently, cities, towns, local boards of education, and a few special districts (gas and electric utility boards, self-help business improvement districts, and municipal parking authorities) are required to have an annual audit from an independent, certified public accountant. I also suggest that all forms of local governments have an annual

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audit by a certified professional accountant at least every two fiscal years. While this may prove to be costly, I believe the benefits outweigh the costs in that the independent auditor will be able to assess and note any financial irregularities. This requirement also provides additional accountability of public officials in assessing stewardship of funds.

The Examiners should be a point of reference for those independent auditors and require those auditors to apply the financial indicator system during their audits. Like Florida, if the independent auditor notes a deterioration of financial condition in the respective local government, the auditor must notify the local government management, document the presence of fiscal stress in the auditor's management letter along with a description of the related conditions of fiscal stress, and send notification to the Department of Examiners of Public Accounts.

As before in option one, this would require additional staffing to administer these additional duties. However, the Examiners already have an auditing staff which has the expertise and background in dealing with local government finances in Alabama. Further, this legislation could be strengthened (like Option 1) to include the authority to publish notice of lack of municipal cooperation in the state newspapers stating that the required financial documents have not been submitted, approved, and the local government is operating without state approval.

Option Three – State Level Commission with State Agency Oversight

Another proactive policy recommendation would be for the legislature to copy and adapt the Local Government Commission (LGC) structure used in North Carolina with appointed state agency oversight. This state level commission would be composed

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of the State Treasurer, the Secretary of State, the State Auditor, and the State Finance Director. The State Finance Director, a gubernatorial appointee, would serve as the Secretary of the Commission and the Finance Department would house the Local Government Finance Division. With the exception of the gubernatorial appointee, all of the other members are popularly elected in statewide elections.

Since the Code of Alabama, 1975, §41-4-2 gives the State Department of Finance general supervision over the finances of the counties, municipal corporations, political subdivisions and local public bodies in the state, this statute could be enforced with the creation of this Commission and create a division within the department to administer the same duties as described in option one (described above).

This commission was the only commission of this type in this comparative analysis that was in place to predict and prevent municipal fiscal stress and/or related bankruptcy. Financial intervention methodologies were still used when a fiscal crisis occurred. Florida, Ohio, and Pennsylvania all employ a variation of the commission oversight approach; however, it is in reaction to fiscal crisis in the municipality.

As with the first option, this policy recommendation will entail the use of state funds in order to create the state agency division to be housed in the Department of Finance. However, three members of this commission are elected to their office by a popular vote of the state electorate. The commission's actions or non-actions towards resolving local government fiscal stress situations may be viewed as an accountability factor in future elections of these offices. Also, this type of commission makes municipal finance oversight a joint effort by elected and appointed officials. No one

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person or party affiliation is responsible for making decisions relating to fiscal stress or municipal bankruptcy.

Option Four - Governor as Gatekeeper

This policy recommendation is reactive in response to fiscal crisis in a local government. This option may require a constitutional amendment to the Alabama Constitution, 1901, §120 relating to the powers of the Governor. Connecticut and Wyoming are two states that employ the precondition that the governor of the state must approve the municipal bankruptcy filing and state intervention methodologies are employed at the discretion of the governor. In Connecticut, the governor must report to the State Treasurer and the State General Assembly to explain the basis for this decision (Connecticut General Statute §7-566).

In his study of California's municipal bankruptcy legislation options, Tung (California Law Revision, 2001) recommended the governor as gatekeeper option to the California Law Revision Commission. He argued that this approach would best promote early state involvement in municipal fiscal stress situations and that the governor has the ability and means to initiate any legislative and/or executive action that is necessary for the fiscal problem at hand in order to avoid municipal bankruptcy. This option also puts the accountability in one elected official's hands and that official will either receive the credit or the blame for how the situation is handled (2001, pp. 24-27).

This approach may be the least costly option to enact in Alabama. If it does not require a constitutional amendment, a change in the wording of the current statute, AL Code §11-81-3, that gives municipalities specific authorization to file municipal

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bankruptcy in federal court would be necessary along with the aforementioned legislative establishment of fiscal stress criteria and related procedures for state intervention. In the comparative analysis of the six states, Florida and Pennsylvania has statutes in place for the governor to approve the local government bankruptcy filing plus a designated state agency to oversee the municipal finances. However, in accordance with Cotter (2007), a vote before the electorate of a change in the authority of the governor may be met with resistance by the electorate due to its distrust of state government in general.

Future Directions

Future research could focus on assisting a state department in creating a financial ratio database for Alabama municipalities to predict fiscal stress and municipal bankruptcy. Using financial ratios such as those discussed before by Brown (1993) and the International City Management Association (2003) facilitate the use of trend analysis to predict financial problems and allow public officials to change directions to possibly avert fiscal stress. My own research could use the past analysis of financial ratios using the former municipal bankruptcies as a dependent variable in a sample of Alabama municipalities to test for validity of certain ratios in predicting fiscal stress.

Also, future research could focus on whether the number of municipal bankruptcies, within the state, has a negative impact on the state's overall credit rating as well as the related credit ratings of the municipalities within the state. A comparison of the credit ratings between those states that do not specifically authorize (allow) and those states that do allow municipal bankruptcies is one option for analysis. Another direction for this type of research would be to consider whether a state requirement that

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municipalities issue state-approved and insured municipal bonds has any impact on the related credit rating and interest costs. Finally, this research could compare the bond ratings for those states that have proactive and reactive policies towards municipal bankruptcy against those who take hands off approach to municipal bankruptcy.

Conclusion

Albrecht and Lynch (2004) use Lindblom's analogy of decision making in public administration to characterize the present state of public financial management in stating that "Despite all the accumulated knowledge, a science of muddling through appears to be the current trend in public financial management research and practice" (p. 141). This certainly seems to be the case for Alabama's present approach to municipal finances. Almost 25 years have passed since the ACIR stated it is the state's responsibility to monitor and evaluate the finances of the local governments and Chapter 9 should be only used when there is no other recourse.

Numerous municipal bankruptcies, such as the nine experienced by Alabama, indicate underlying state policy problems in addressing local government finances. No state official or state agency intervened to prevent any of the municipal bankruptcies or the subsequent fiscal crises except in a peripheral manner. Several of the municipalities that went through bankruptcy proceedings have re-experienced fiscal stress and considered filing municipal bankruptcy a second time.

This research has offered several options that could be considered by Alabama policymakers in order to prevent future municipal bankruptcies and foster financial health in Alabama local governments. It is past time for Alabama policy makers to implement

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mandated municipal finance reform to gain back the public and investment community's trust in the public finances of government in all levels of Alabama.

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APPENDIX I

UNITED STATES CODE

TITLE 11 BANKRUPTCY

CHAPTER 1. GENERAL PROVISIONS

§ 109. Who may be a debtor

(c) An entity may be a debtor under chapter 9 of this title [11 USCS §§ 901 et seq.] if and only if such entity--

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter [11 USCS §§ 901 et seq.] by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter [11 USCS §§ 901 et seq.];

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5) (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter [11 USCS §§ 901 et seq.];

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter [11 USCS §§ 901 et seq.];

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title [11 USCS § 547].

Source: (Westlaw, 2006).

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APPENDIX II

CHAPTER 9 BANKRUPTCY FILINGS, 1971-2005

Year	State	Municipality
2005	Arkansas	Ridges Master Property Owners Improvement
2005	California	Sierra Nevada Public Financing
2005	California	Reclamation District No. 768
2005	Illinois	Slocum Lake Drainage District of Lake County
2005	Illinois	Village of Alorton
2005	Nebraska	Sanitary and Improvement District #425
2005	Oklahoma	Town of Muldrow
2005	Oklahoma	Muldrow Public Works Authority
2005	Texas	City of Camp Wood
2004	Texas	City of Westminister
2004	Oklahoma	Watonga Hospital Trust Authority
2004	North Carolina	South Brunswick Water and Sewer Authority
2004	Illinois	Village of Washington Park
2004	California	Tri-City Mental Health Center
2004	Alabama	Town of Millport
2003	Texas	Roman Forest Public Utility District No. 3
2003	Missouri	City of Iron Mountain Lake
2003	Illinois	Village of Brooklyn
2003	California	Indian Valley Health Care District
2003	California	Coalinga Regional Medical Center
2003	Arkansas	Madison County Property Owners Improvement
2002	Texas	City of Rio Bravo
2002	Missouri	City of Reeds Spring
2002	California	Alpaugh Irrigation District
2002	Alabama	West Jefferson Amusement and Public Park Authority
2002	Arkansas	Bentonville Municipal Property Owners Improvement
2002	Alabama	Etowah Solid Waste Disposal Authority
2001	Virginia	Alleghany Highlands Economic Development Authority
2001	Texas	Whitney Hospital Authority
2001	Texas	City of Kendleton
2001	Texas	Hall County Hospital District
2001	Missouri	Village of Hillsdale
2001	California	Aromas Water District

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2001	California	City of Desert Hot Springs
2000	Texas	Rockdale Hospital District
2000	Texas	Roman Forest Public Utility District #4
2000	Texas	Diagnostic Health Services
2000	Texas	City of Westminister
2000	Oklahoma	Town of Tyrone
2000	North Carolina	Shkolir
2000	Missouri	The City of Macks Creek
2000	Idaho	East Shoshone Hospital Center
2000	California	Sierra Valley District Hospital
2000	California	Chowchilla Memorial Hospital District
1999	Louisiana	Lower Cameron Parish Hospital District
1999	California	Southern Humboldt Community Healthcare District
1999	California	Southern Inyo County Local Healthcare
1999	Alabama	City of Prichard
1998	Missouri	The City of Macks Creek
1998	Idaho	East Shoshone Hospital Center
1998	Alabama	West Walker Water Authority
1997	Tennessee	Mercer Utility District of Madison County, Tennessee
1997	Oklahoma	Eufaula Industrial Authority
1997	Mississippi	Town of Winstonville
1997	Colorado	Mount Carbon Metropolitan District
1997	California	Kingsburg Hospital District
1997	Arizona	Superstition Mountains Community Facility District #1
1996	Texas	Retama Development Corporation
1996	Texas	Northwood Municipal Utility District #1
1996	Nebraska	Sanitary and Improvement District #281
1996	Colorado	Hamilton Creek Metropolitan District
1996	California	Cooperative Library Agency for Systems and Service
1996	California	Los Medanos Community Hospital District
1996	Alabama	Greene County
1995	West Virginia	Procious Public Service District
1995	Texas	Harris County Municipal Utility District #250
1995	Texas	Montgomery County Municipal Utility District #42
1995	Missouri	Community Memorial Hospital District
1995	Missouri	Reynolds County General Memorial Hospital District
1995	Illinois	Central Alexander County Public Water District
1995	Florida	The Lake Apopka Natural Gas District
1995	California	Hefferman Memorial Hospital District
1995	California	Corcoran Hospital District

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1995	California	Test Hospital
1995	California	Eastern Plumas Hospital District
1995	Arkansas	Town of Ozan
1994	Texas	Greens Parkway Municipal Utility District
1994	Texas	Harris County Municipal Utility District #202
1994	Texas	Fort Bend County Municipal Utility District
1994	Texas	Rankin Road West Municipal Utility District
1994	Missouri	City of Kinloch
1994	Colorado	City of Colorado Springs Spring Creek General Improvement District
1994	California	Gualala Community Services District
1994	California	Los Medanos Health Care Corporation
1994	California	Orange County Investment Pool
1994	California	County of Orange
1994	Arizona	New Magma Irrigation Drainage District
1994	Alabama	Alabama State Fair Authority
1993	Texas	Montgomery County Municipal Utility District
1993	Texas	Cypress Hill Municipal Utility District #1
1993	Texas	Fort Bend County Levee Improvement District
1993	Texas	Harris County Municipal Utility District #165
1993	Texas	Big Oaks Municipal Utility District
1993	New Hampshire	Sullivan County Regional Refuse Disposal District
1993	New Hampshire	Southern Windsor/Windham Counties Solid Waste District
1993	Nebraska	Sanitary and Improvement District #131
1993	California	West Side Community Hospital District
1993	California	Avenal Hospital District
1993	California	Ventura Port District
1992	West Virginia	Jefferson County Solid Waste Authority
1992	Nebraska	Sanitary and Improvement District #113
1992	Nebraska	Sanitary and Improvement District #284
1992	Missouri	Chilhowee R-IV School District
1992	Alabama	Town of North Courtland
1991	West Virginia	Claywood Park Public Service District
1991	Washington	Whatcom County Water District #13
1991	Nebraska	Sanitary and Improvement District #293
1991	Nebraska	Sanitary and Improvement District #151 of Dougl
1991	Nebraska	Sanitary and Improvement District #89 of Sarpy
1991	Nebraska	Sanitary and Improvement District #289 of Dougl

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1991	Montana	City of Columbia Falls Sanitary and Improvement District #28
1991	California	Indian Valley Hospital District
1991	Alabama	City of Lipscomb
1991	Texas	Northeast Round Rock Road District #1
1990	Utah	Timpanogos Community Mental Health
1990	Pennsylvania	Carroll Township Authority
1990	Nebraska	Sanitary and Improvement District #330 of Douglas County
1990	Nebraska	Sanitary and Improvement District #235
1990	Montana	City of Columbia Falls Sanitary and Improvement District #25
1990	Colorado	Colorado Centre Metropolitan District
1990	Nebraska	Sanitary and Improvement District #264 of Douglas County
1990	Nebraska	Sanitary and Improvement District #257
1989	Montana	City of Columbia Falls
1989	Nebraska	Sanitary and Improvement District #7
1989	Nebraska	Sanitary and Improvement District #279 of Douglas County
1989	Nebraska	Sanitary and Improvement District #52 of Sarpy County
1989	Nebraska	Sanitary and Improvement District #69 of Sarpy County
1989	Oklahoma	Valliant Public Water Authority
1988	Nebraska	Sanitary and Improvement District #92 of Sarpy County
1988	Tennessee	Copperhill
1988	Arkansas	Cooper River School District
1987	Mississippi	Mound Bayou
1987	Nebraska	Sanitary and Improvement District #103
1987	Nebraska	Sanitary and Improvement District #254
1987	Nebraska	Sanitary and Improvement District #267
1987	Nebraska	Sanitary and Improvement District #3 of Saunders County
1987	Nebraska	Sanitary and Improvement District #67 of Sarpy County
1987	Nebraska	Sanitary and Improvement District #93
1987	Nebraska	Sanitary and Improvement District #4 of Saunders County
1987	Nebraska	Sanitary and Improvement District #6 of Platte County
1987	Texas	NW Harris County Municipal Utility District #19
1986	Nebraska	Sanitary and Improvement District #250 of Douglas County
1986	Nebraska	Sanitary and Improvement District #265 of Douglas County
1986	Nebraska	Sanitary and Improvement District #287 of Douglas County
1986	Nebraska	Sanitary and Improvement District #65 of Sarpy County
1986	Nebraska	Sanitary and Improvement District #7 of Lancaster County
1985	Missouri	City of Wellston
1985	Oklahoma	Atoka Municipal Authority

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1984	Kentucky	Whitley County Water District
1984	Missouri	Pulaski Memorial Hospital, Waynesville
1984	Nebraska	Sanitary and Improvement District #63 of Sarpy County
1983	California	San Jose Unified School District
1983	Arizona	South Tucson
1983	Nebraska	Sanitary and Improvement District #4 of Lancaster County
1983	Nebraska	Sanitary and Improvement District #42 of Sarpy County
1983	New Jersey	Jersey City Medical Center
1982	Nebraska	Sanitary and Improvement District #5 of Cass County
1982	Oklahoma	Wapanucka
1982	Tennessee	Pleasant View Utility District of Cheatham County
1981	California	The Management Institute of Alameda County
1981	Pennsylvania	North and South Shenango Joint Municipal Authority
1977	Mississippi	Bay St. Louis
1977	Colorado	Steamboat Lake Sanitation District
1977	Colorado	Steamboat Lake Water District
1976	Colorado	Roxborough Park Metropolitan Water and Sanitation District
1976	Colorado	Woodmoor at Breckinridge Water and Sanitation District
1976	Colorado	Morrison Creek Metropolitan Water and Sanitation District
1976	Oklahoma	Fort Cobb Irrigation District
1974	Indiana	American Milling Research and Development
1973	Florida	Lake Apoka Natural Gas District of Orange and Lake Counties
1971	North Carolina	Saluda
1971	Texas	Ranger

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APPENDIX III

STATE STATUTES ADDRESSING MUNICIPAL BANKRUPTCY

State	Statute
Alabama	AL Code §11-81-3
Alaska	No statute found.
Arizona	AZ Code §35-603
Arkansas	AK Code §14-74-103
California	CA Code §53760
Colorado	CO Code §32-1-1403
Connecticut	CT Gen Stat. §7-566
Delaware	No statute found.
Florida	FL Stat §218.501
Georgia	GA Code §36-80-5
Hawaii	No statute found.
Idaho	ID Code §67-3904
Illinois	IL Code §50 ILCA 320
Indiana	No statute found.
Iowa	IA §76.16A
Kansas	No statute found.
Kentucky	KY §66.400
Louisiana	LA §13:4741
Maine	No statute found.
Maryland	No statute found.
Massachusetts	No statute found.
Michigan	§141.1213
Minnesota	§471.831
Mississippi	No statute found.
Missouri	MO §427.100
Montana	MT §7-7-132
Nebraska	NE §13-402
New Hampshire	No statute found.
New Jersey	NJ Gen Stat §52:27-40
New Mexico	No statute found.
New York	NY CLS Loc. Fin §85.80
North Carolina	NC Gen Stat §23-48

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North Dakota	No statute found.
Ohio	OH Code §133.36
Oklahoma	OK Code §62-283
Oregon	OR Code §548.705
Pennsylvania	53 PA Stat. §12720.203
Rhode Island	No statute found.
South Carolina	SC Code §6-1-10
South Dakota	No statute found.
Tennessee	No statute found.
Texas	TX Code §140.001
Utah	No statute found.
Vermont	No statute found.
Virginia	No statute found.
Washington	WA Code §39.64.050
West Virginia	No statute found.
Wisconsin	No statute found.
Wyoming	WY Code §9-4-706

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APPENDIX IV

INTERVIEW QUESTIONS FOR MUNICIPAL OFFICIALS

1. What were your thoughts – back in 1996/1999/2004 – when you first learned that Greene County/Prichard/Millport was going to declare bankruptcy?
2. How did you learn that filing bankruptcy as a municipality in Alabama was an option?
3. What do think were the main causes of the financial crisis?
4. How would you describe the initial response to the financial crisis?
5. Did any other government or public official, including the state, get involved in dealing with the crisis?
6. If so, at what point in the crisis and how did they become involved?
7. If another government or public official (outside the entity that filed for municipal bankruptcy) did not become involved, should state government be involved in a financial crisis such as experienced by your government?
8. At what point in the financial crisis, do you think the state should become involved?
9. What level of involvement would you consider appropriate in a circumstance such as this?
10. Is the financial crisis resolved now?
11. What are your thoughts on how the financial crisis was resolved?
12. Is Greene/Prichard/Millport taking a more proactive approach to financial condition now that the government has experienced a financial crisis?
    a. Examples would be trends in revenues/expenditures, financial health ratios as taken from ICMA, GFOA guidelines of best practices in financial reporting.
13. What are the lessons other municipalities in Alabama can learn from your financial crisis in order to avoid dealing with financial woes or municipal bankruptcy in the future?
14. Do you recommend any other public official that could help me learn more about the municipal bankruptcy?

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APPENDIX V

INTERVIEW QUESTIONS FOR STATE OFFICIALS

1. How does your state define a fiscal crisis for local governments? For example, financial indicators such as those suggested by the ICMA or defining events such a municipality filing Chapter 9 or requesting to file Chapter 9 through the appropriate channels?
2. What do you perceive to be the role of the state in dealing with fiscal crisis by local governments in your state?
3. Are there any local governments in your state that experienced a financial crisis in recent history? If so, please name those governments.
4. Did the state get involved with any of these financial crises?
5. If so, at what point in the crisis and how was the state involved?
6. Was the state involved before, during, or after the financial crisis?
7. Does the state provide technical assistance, financial bailout, sanctions on the government, receivership?
8. What policies does your state have that are largely designed to avert financial emergencies in local governments?
9. How are those policies administered or enforced?
10. What state agencies and/or legislative/executive contacts are involved in the administration or enforcement of those policies?
11. Does your state have a monitoring program that acts as an early warning system in predicting potential fiscal problems in local governments?
12. If so, what actions, if any, would be taken by the state to try to avert the catastrophe?
13. Once a local government reaches the point of financial crisis, what does your state do (or has it done) to mitigate the situation? After a local government is past the crisis stage, does the state take steps or actions to ensure that a recurrence does not occur?
14. In the past, what are the main causes of financial crises that occurred in your state? For example, loss of industry in the area; poor financial management by public officials; economic trends.

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APPENDIX VI

INTERVIEW QUESTIONS FOR SDE OFFICIALS

1. How do you define a financial emergency or fiscal crisis for local education agencies (LEA) in the state?
2. What policies does the SDE have in place to avert fiscal emergencies in LEAs and how are these policies administered and enforced?
3. How many LEAs have met the SDE definition of financial emergency (fiscal crisis) since initial legislation was enacted in 1995 for school accountability? Please name those LEAs and give some background on each event. Could I please have a copy of their respective audited financial statements from the period of intervention to the present period?
4. How did the SDE get involved in dealing with these crises?
5. What was the level of involvement?
6. If the notification of need for involvement (in Question 4) was from a public official, what level of public official notified the SDE? (Local, regional, state – if state, legislative or executive branch?)
7. Does the SDE provide additional funding to the LEAs in the form of loans or grants and/or negotiate with creditors and employees in order to avoid a severe financial emergency?
8. Has the fiscal accountability legislation and/or intervention of the SDE at the local level been met with resistance by the LEA officials or community? (Elaborate.)
9. How does the 2006 legislation differ in SDE regulation/enforcement than the 1995 legislation? What was the driving force behind the change in legislation?
10. To your knowledge, has any LEA considered seeking municipal bankruptcy protection under Chapter 9 federal bankruptcy law and the SDE intervened and encouraged the LEA otherwise?
11. What actions, if any, does the SDE encourage the LEAs to be proactive in monitoring their financial condition and averting future financial emergencies?

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