

1980

Proposed Fiscal Monitoring Legislation in New York: A comparative Analysis

Donald H. Elliot

Follow this and additional works at: <https://ir.lawnet.fordham.edu/ulj>



Part of the [Banking and Finance Law Commons](#)

Recommended Citation

Donald H. Elliot, *Proposed Fiscal Monitoring Legislation in New York: A comparative Analysis*, 8 Fordham Urb. L.J. 109 (1980).
Available at: <https://ir.lawnet.fordham.edu/ulj/vol8/iss1/6>

This Article is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in Fordham Urban Law Journal by an authorized editor of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.

Proposed Fiscal Monitoring Legislation in New York: A comparative Analysis

Cover Page Footnote

Partner, Webster & Sheffield. Chairman of the New York Urban Coalition. Formerly Chairman of the New York City Planning Commission and Counsel to the Mayor of the City of New York: A.B. Carleton College, L.L.B. New York University.

PROPOSED FISCAL MONITORING LEGISLATION IN NEW YORK: A COMPARATIVE ANALYSIS

*Donald H. Elliott**

I. Introduction

Financial management and budgeting are two of the most difficult and least engaging matters confronting legislators. State legislators often attempt to promote financial stability by requiring municipalities to adopt budgets that balance anticipated expenditures with estimated revenues. However, this may not be an easy task for those who govern the municipalities.

Budgeting involves a great deal of guesswork since fiscal policy is often affected by forces over which local governments exert little, if any, effective control. For example, an increase in oil prices, a shortfall in anticipated state aid to education due to an unforeseen drop in public school enrollment or the onset of a recession may upset legitimate budget estimates.

Another pitfall of budgetary planning is that political motivations may lead local officials to overestimate revenues or underestimate expenditures in order to avoid facing unpleasant fiscal realities. Elected officials may prefer to run budgetary deficits, financing such deficits by the issuance of public debt as the alternative to increasing taxes or cutting services. Indeed, as noted above, even in politically and financially stable periods, it is difficult to provide for needed expenditures because of the margin of error inherent in budget planning.¹ At times, fiscally sound budgeting practices may defeat the long-term interests of a municipality. For instance, moneys earmarked in a budget for major collective bargaining contracts to be negotiated in that budgetary year will become the starting point for the negotiators.²

* Partner, Webster & Sheffield. Chairman of the New York Urban Coalition. Formerly Chairman of the New York City Planning Commission and Counsel to the Mayor of the City of New York: A.B. Carleton College, LL.B. New York University.

1. See Comment, *The Constitutional Debt Limit and New York City*, *infra* at 185. Comment, *Local Finance: A Brief Constitutional History*, *infra* at 135.

2. See generally *Oneida County v. Berle*, 91 Misc. 2d 694, 398 N.Y.S.2d 600 (Sup. Ct. 1977); *Meaney v. City of New Rochelle*, 58 A.D.2d 605, 395 N.Y.S.2d 209 (2d Dep't 1977);

Municipal budget administration would be no less troublesome for outsiders to manage. Decisions concerning attrition policies regarding public employees, the distribution of sanitation services and the allocation of police and fire protection should be made by those officials closest to the situation and accountable to the public.³

Notwithstanding the difficulties outlined above with respect to control over local finance, the recent financial difficulties of New York City, Cleveland and other financially strapped municipalities demonstrate the need for the preparation and maintenance of balanced budgets and effective monitoring of local budget planning and administration. The state undoubtedly has a legitimate concern for the fiscal practices of its localities. Local governments are creatures of state law possessing only those powers delegated by the state legislature and the constitution.⁴ Traditionally, states have attempted to effect balanced budgets by imposing statutory⁵ and constitutional⁶ limitations on the power of municipalities to incur debt. In New York, however, this system did not prevent "massive deficit financing, uncontrolled issuance of long-term obligations and even, for a period, default on over a billion dollars in municipal obligations."⁷ This occurred through the issuance of permissible

Kotlikoff v. Township of Pennsauken, 131 N.J. Super. 590, 331 A.2d 42 (Super. Ct. Law Div. 1974).

3. For a thorough discussion of the forces affecting financial management and budgeting in municipalities see ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, CITY FINANCIAL EMERGENCIES: THE INTERGOVERNMENTAL DIMENSION 31-58 (1973) [hereinafter cited as ACIR].

4. Ringleib v. Township of Parsippany-Troy Hills, 59 N.J. 348, 283 A.2d 97 (1971); Board of Police Comm'rs of New Haven v. White, 171 Conn. 553, 370 A.2d 1070 (1976); United Tavern Owners of Philadelphia v. School Dist. of Philadelphia, 441 Pa. 274, 272 A.2d 868 (1971).

The state may mandate expenditures to be made by a local government. See Bonnet v. State, 141 N.J. Super. 177, 357 A.2d 772 (Super. Ct. Law Div. 1976); Meadowlands Regional Dev. Agency v. State, 112 N.J. Super. 89, 270 A.2d 418 (Super. Ct. Ch. Div. 1970), *aff'd*, 63 N.J. 35, 304 A.2d 545 (1973), *appeal dismissed*, 414 U.S. 991 (1973). A local unit may not tax unless explicitly given that right. See Salomon v. Jersey City, 12 N.J. 379, 97 A.2d 405 (1953). The State even has limits on its taxing power. In Robinson v. Cahill, 62 N.J. 473, 303 A.2d 273, *cert. denied*, 414 U.S. 976 (1973), the New Jersey Supreme Court declared unconstitutional a system of financing public schools which relied on local taxation and led to great disparity in dollar input per pupil.

5. See, e.g., N.Y. LOCAL FIN. LAW §§ 10, 11 (McKinney Supp. 1978).

6. See, e.g., N.Y. CONST. art. VIII, § 3.

7. Committee on Municipal Affairs of the Association of the Bar of the City of New York,

debt⁸ and the creation of public authorities which may contract indebtedness outside the constitutional debt limit.⁹

The City Bar Association Committee on Municipal Affairs has proposed a revision of the existing debt limits, the exclusion in the New York Constitution of a provision mandating localities to adopt and maintain balanced budgets and the establishment of a state-operated fiscal monitoring system to supplement the traditional approach to budgetary control.¹⁰ This Article will examine the Committee's proposal in light of the monitoring systems employed in Pennsylvania and New Jersey. These two states illustrate two types of state monitoring systems. Pennsylvania imposes reporting requirements upon local governments, but does not permit active state supervision of local budgetary practices.¹¹ New Jersey imposes strict state supervision and control over local budgeting.¹²

II. The Pennsylvania and New Jersey Approaches

In Pennsylvania, statewide supervision of local budget administration is performed by the Department of Community Affairs.¹³ The department is empowered to install a "uniform system of accounts" at the local level of government.¹⁴ However, the statute does not indicate if this would permit the department to establish a uniform system of accounting.¹⁵ The department's primary function

Proposals to Strengthen Local Finance Laws in New York State, 34 THE RECORD 58, 83 (Jan./Feb. 1979, No. 1/2) [hereinafter cited as *Proposals*].

8. The New York Constitution contains many exclusions from the debt limitation; for example, indebtedness issued in anticipation of taxes and revenue, indebtedness contracted to provide for the supply of water and indebtedness incurred by the cities of Buffalo, Rochester, Syracuse and New York for enumerated purposes. N.Y. CONST. art. VIII, §§ 5, 6, 7, 7a.

9. See Comment, *The Constitutional Debt Limit and New York City*, *infra* at 185.

10. One means of controlling local finance is the body of requirements surrounding the issuance of local debt. Limitations on the power to borrow money may be a most effective budgetary control. The recommendations of the City Bar Association Committee concerning disclosure and the issuance of debt will have a profound effect on budget administration. See *Proposals*, *supra* note 7, at 101-05. See also Sigal, *The Proposed Constitutional Amendments to the Local Finance Article: A Critical Analysis*, *supra* at 29; Currier, *Mandating Disclosure in Municipal Securities Issues: Proposed New York Legislation*, *supra* at 67.

11. See notes 13-17 *infra* and accompanying text.

12. See notes 17-67 *infra* and accompanying text.

13. PA. STAT. ANN. tit. 71 § 339(b) (Purdon Supp. 1979).

14. *Id.*

15. "Accounting" may be defined as a "system of making up or settling accounts." BLACK'S LAW DICTIONARY 36 (4th ed. 1968). In contrast, "accounts" is defined as "a list of debits and credits." *Id.* at 34. It may be argued that under the general rule of statutory

is the distribution of forms for budgets and annual reports of municipalities' financial condition.¹⁶ The department, however, lacks explicit statutory authority to confirm the accuracy of these reports and recommend or compel corrective action. Furthermore, the reports are not audited by independent municipal accountants. Nor is the department authorized to supervise or control the preparation and administration of local budgets. The department merely collects and publishes annual reports.¹⁷ In short, Pennsylvania law

construction in Pennsylvania, the power to install a uniform system of accounts does not permit the department to establish a comprehensive system of accounting. *See generally* Note, *State Control of Local Government Finances—A Comparative Look at the Pennsylvania System*, 81 DICK. L. REV. 575 (1976-1977). Such a construction clearly limits the effectiveness of the statute. Moreover, no penalties are imposed for failure to install a "uniform system of accounts." *See* PA. STAT. ANN. tit. 71 § 334 (Purdon Supp. 1979).

16. PA. STAT. ANN. tit. 71 § 339 (Purdon Supp. 1979).

17. Section 339 provides:

The Department of Community Affairs shall have power and its duty shall be:

(a) To prepare, in cooperation with duly authorized committees of local government officials, and furnish annually at the expense of the Commonwealth, to the corporate authorities of each county (except counties of the first class), city of the third class, borough, incorporated town, township, school district of the second, third, and fourth class blank forms suitable for the making of budgets by the proper authorities of said local government and for the filing of a copy of the budget after adoption with said department.

(b) To furnish to the corporate authorities of each county (except counties of the first class), city of the third class, borough, incorporated town, township suitable blank forms for the making of annual reports of the financial condition of their respective local governments to the department, which forms for financial report purposes shall be placed by said corporate authorities into the hands of the director, controller or auditors who by law are required to make such financial reports to the department. Such annual financial reports shall be prepared in cooperation with aforesaid duly authorized committees of local government officials and shall contain: (1) a statement of the receipts of the unit of local government from all sources and of all accounts and revenue which may be due and uncollected at the close of the fiscal year; (2) a statement of the disbursements for all the governmental activities of the unit of local government during the fiscal year; (3) a detailed statement of the indebtedness of the unit of local government at the close of the fiscal year, the provisions made for the payment thereof, together with the purposes for which it was incurred; (4) a statement of the cost of ownership and operation of each and every public service industry owned, maintained or operated by the unit of local government; (5) such further or more specific information in relation to the cost of any branch of the local government and improvements therein as may be required by the department.

In the case of blank forms for financial reports by townships of the second class and counties, the same shall be so arranged that corresponding data and information, required to be reported by said units of local government to the Department of Highways or the Department of Public Welfare, may be used for the information required

adopts a disclosure approach to the control of local budgeting.

A disclosure approach assumes that complete public access to a municipality's financial information will pressure such municipalities to adopt sound budgeting procedures. The disclosure approach in Pennsylvania has proved unsuccessful as displayed by the experience in Darby, Pennsylvania. Notwithstanding the filing of financial reports for eight years between 1962 and 1970, in September, 1971, Darby officials notified the Pennsylvania Department of Community Affairs that it was unable to meet its financial obligations and had decided to put the borough in receivership or bankruptcy.¹⁸

New Jersey has implemented a comprehensive state monitoring system designed to assure fiscal responsibility. In general, New Jersey's approach consists of three complementary statutes: The Local Budget Law,¹⁹ Chapter 27BB of the State Government Law²⁰ and

to be furnished to the Department of Community Affairs under this section.

Id.

18. ACIR, *supra* note 3, at 40-41. The Pennsylvania scheme is even further emasculated by the exclusion of Philadelphia, Pittsburgh and Scranton from the statutory audit and financial report requirements. See note 17 *supra*.

Several other states provide for reporting requirements, but few also impose monitoring and control requirements. In Connecticut, for example, an annual audit is required. However, the audit is not subject to state control. CONN. GEN. STAT. §§ 7-391 to 7-397 (1979). The audit required by Connecticut must be "prepared in accordance with the principles and standards related to accounting, auditing and financial reporting . . . published by the National Committee on Government Accounting and Audits of State and Local Governmental Units, published by the American Institute of Certified Public Accountants." *Id.* § 7-394a. Evidence of fraud or embezzlement shall be reported to the State's attorney. If an audit is not in accordance with § 7-394, the Secretary must report to the municipality's chief executive and auditor of public accounts. *Id.* § 7-395.

Montana is somewhat stricter than Connecticut. A state agency is delegated the power to "make rules and classifications, and prescribe forms, necessary to carry out the provisions" of the budget statute and to "define what expenditures are chargeable to each budget account, and to establish accounting and cost systems necessary to provide accurate budget information." MONT. REV. CODES ANN. § 16-1909 (Supp. 1977); see also MONT. REV. CODES ANN. §§ 11-1401 to 11-1414 (1968 & Supp. 1977).

In Colorado there is both a local government audit law, COLO. REV. STAT. §§ 29-1-601 to 29-1-608 (1977 & Supp. 1978), and a Local Government Budget Law, *id.* §§ 29-1-101 to 29-1-118 (1977 & Supp. 1978), applying to all subdivisions of the state except home rule cities, cities and counties. These laws require an annual budget and provide for a budget procedure. No expenditure may exceed an appropriation which has been budgeted. Accounting principles are prescribed in the Colorado Local Government Uniform Accounting Law, COLO. REV. STAT. §§ 29-1-501 to 29-1-506 (1977).

19. N.J. STAT. ANN. §§ 40A:4-1 to 40A:4-87 (West Supp. 1979).

20. N.J. STAT. ANN. §§ 52:27BB-1 to 52:27BB-66 (West 1955).

Chapter 27 of the State Government Law.²¹ The Local Finance Board in the Division of Local Finance in the Department of Community Affairs is empowered to enforce the provisions of these statutes.²²

The New Jersey Local Budget Law contains detailed requirements concerning budget preparation, adoption, amendment and review. The governing body²³ of a municipality is directed to adopt a budget on a cash basis²⁴ for each fiscal year.²⁵ The procedure for adoption of a budget requires the introduction of the proposed budget in writing and approval by a majority of the governing body, public advertising of the budget, a public hearing and final approval by a resolution of the governing body.²⁶ Revenue estimates for the proposed budget must be compared to the amounts actually received in the preceding fiscal year and the estimated amount to be received in the current fiscal year to prevent unwarranted optimism in forecasting projected revenues.²⁷ In addition, the proposed budget must appropriate funds to close any budget gap for any deficit which may have developed during the preceding fiscal year.²⁸ With certain exceptions,²⁹ the statute imposes a five percent limita-

21. *Id.* §§ 52:27-1 to 52:27-56.

22. The responsibility for the enforcement of these provisions was transferred to the Division of Local Finance from the Division of Local Government in the Department of the Treasury by a 1966 amendment to the State Government Law. *Id.* § 52:27D-18 (West Supp. 1979). For a list of the preceding supervisory bodies, see *id.* §§ 52:27A-1 to 52:27A-18, 52:27A-18.1, 52:27A-19 (West 1955) (Historical Note).

23. *Id.* § 40A:4-2 (West Supp. 1979).

24. A cash basis budget is defined as:

a budget prepared in accordance with this chapter, and in such form that based on the limitations, percentages and estimates hereinafter provided there will be sufficient cash collected to meet all debt service requirements, necessary operations of the local unit for the fiscal year and, in addition, provide for any mandatory payments required to be met during the fiscal year.

Id.

25. *Id.* § 40A:4-3.

26. *Id.* §§ 40A:4-4 to 40A:4-10. For an application of these statutes, see *Donoto v. Essex County Bd. of Chosen Freeholders*, 146 N.J. Super. 39, 368 A.2d 961 (Super. Ct. App. Div. 1977).

27. *Id.* §§ 40A:4-45.3 to 40A:4-45.5.

28. *Id.* § 40A:4-45.2. See *Clark v. Degnan*, 163 N.J. Super. 344, 394 A.2d 914 (Super. Ct. Law Div. 1978). In *Clark*, the court was confronted with a situation where the New Jersey legislature authorized increases of more than five percent to be spent by localities for certain health and welfare programs. Several localities brought an action for declaratory judgment in order to avoid the personal responsibility and criminal liability imposed by the statute. The court held that the five percent limit referred to the overall budget and not to each line

tion upon annual increases in municipal expenditures.³⁰ Expenditures are controlled by line item³¹ and transfers from lines are strictly limited.³² An expenditure is void if made without an appropriation or in excess of the amount appropriated for such purpose in the budget.³³

The Director of the Division of Local Finance is required to examine a municipal budget to insure its compliance with the statute.³⁴ Upon the Director's certification of approval the governing body shall adopt a final budget.³⁵ If the Director finds that the statutory requirements have not been met he is required to refuse to approve the budget³⁶ and will notify the governing body of the reasons for the disapproval.³⁷ The Director may not "substitute his discretion with respect to the amount of an appropriation when such amount is not made mandatory because of the requirements of law."³⁸ Local officials must either amend the disapproved budget according to the

and that the mandated expenditures were legitimately within the province of the legislature. Statutory provisions are made for emergency appropriations. N.J. STAT. ANN. §§ 40A:4-46 to 40A:4-55.1 (West Supp. 1979).

29. N.J. STAT. ANN. §§ 40A:4-22, 40A:4-32 (West Supp. 1979). Expenditures are compared against past expenditures for a particular item not against the total budget. "The Local Budget Law is intended to control municipal expenditures by line item in order to insure that anticipated revenues equal anticipated expenditures." *Kotlikoff v. Pennsauken Township*, 131 N.J. Super. 590, 594, 331 A.2d 42, 44 (Super. Ct. App. Div. 1974).

30. *State v. Boncelet*, 107 N.J. Super. 444, 258 A.2d 894 (Super Ct. App. Div. 1969).

31. N.J. STAT. ANN. § 40A:4-23 (West Supp. 1979) provides, in pertinent part:

In parallel columns to the right of the several items of anticipated revenues, the following shall be stated:

a. The amounts estimated to be realized from the several items of revenue in the current fiscal year.

b. The amounts anticipated from the same source in the preceding year.

c. The amounts actually received in cash or realized in accordance with regulations of the local government board during such preceding year.

32. *Id.* § 40A:4-42.

33. *Id.* § 40A:4-57 (West Supp. 1979). "The purpose of this section of the statute . . . in requiring appropriations in advance of expenditures is to foster sound municipal management of finances by prohibiting undisclosed or irresponsible expenditures." *Essex County Bd. of Taxation v. City of Newark*, 73 N.J. 69, 74, 372 A.2d 607, 610 (1977). See also *Manning Eng'r, Inc. v. Hudson County Park Comm'n*, 71 N.J. 145, 364 A.2d 1 (1976), *reopened on other grounds*, 74 N.J. 113, 376 A.2d 1194 (1977); *Monroe County v. City of Asbury Park*, 40 N.J. 457, 193 A.2d 103 (1963).

34. N.J. STAT. ANN. §§ 40A:4-76, 40A:4-77 (West Supp. 1979).

35. *Id.* § 40A:4-79.

36. *Id.* § 40A:4-78.

37. *Id.* § 40A:4-80.

38. *Id.* § 40A:4-78.

Director's instructions or petition the Local Government Board for a hearing.³⁹ Subsequent to the hearing the governing body may petition for judicial review.⁴⁰ The Local Budget Law imposes a personal fine on the members of the governing body who refuse to comply with the Director's order unless they seek judicial review.

The budget requirements are complemented by statutory provisions requiring a uniform accounting system, annual audit and the preparation of an annual financial statement: The Local Finance Board is directed to prescribe a uniform accounting system for municipalities.⁴² The Director is implicitly empowered to compel reluctant municipalities to comply with state accounting regulations.⁴³ In addition, municipalities must be audited annually by a registered municipal accountant.⁴⁴ The Director of the Local Finance Board may conduct an audit, at the locality's expense, if the municipality should fail to comply with the statute.⁴⁵ Finally, the chief financial officer of each local unit must file an annual financial statement of the financial condition of the local unit as of the close of the fiscal year.⁴⁶

A separate statute⁴⁷ governs the financial affairs of a financially

39. *Id.* § 40A:4-81.

40. *Id.* § 40A:4-82. Notwithstanding this application for judicial review, the governing body must adopt a budget conforming to the board's determination subject, of course, to the court's decision. *Id.*

41. *Id.* § 40A:4-84. In *State v. Boncelet*, 107 N.J. Super. 144, 258 A.2d 894 (Super. Ct. App. Div. 1964), the court upheld the conviction of a member of the Borough Council of Carteret and chairman of its finance committee for voting to incur liabilities chargeable to four line items in the budget in amounts which exceeded the sums appropriated. The court held that the statute made willful voting of these expenditures a violation of the law without the necessity to establish a corrupt motive on the defendant's part.

42. N.J. STAT. ANN. §§ 52:27BB-27 to 52:27BB-34 (West 1955).

43. *Id.* § 52:27BB-30.

44. *Id.* §§ 40A:5-4, 40A:5-9 (West Supp. 1979). The Local Fiscal Affairs Law requires annual audits within five months after the close of a fiscal year and provides a procedure for the publication of such audit. *Id.* §§ 40A:5-4 to 40A:5-7. The Local Fiscal Affairs Law, enacted in 1960, seems to have supplemented and, in part, superseded similar requirements contained in N.J. STAT. ANN. §§ 52:27BB-35, 52:27BB-36 (West 1955).

45. N.J. STAT. ANN. § 40A:5-8 (West Supp. 1979). If the director of the Local Finance Board finds the audit inaccurate, he may order supplementary examinations or direct the auditing staff of the division to conduct the audit. N.J. STAT. ANN. § 52:27BB-37 (West 1955).

46. N.J. STAT. ANN. § 40A:5-12 (West Supp. 1979). To effectively enforce the aforementioned statutory provisions, the director may conduct extensive inspections into a locality's financial affairs. N.J. STAT. ANN. §§ 52:27BB-46 to 52:27BB-52 (West 1955).

47. N.J. STAT. ANN. §§ 52:27BB-54 to 52:27BB-100 (West 1955).

distressed municipality. The Local Finance Board may exercise significantly more extensive control over local financial practices where any one of five conditions is shown to exist.⁴⁸ These conditions are: 1) a default in the payment of public debt, 2) overdue payments of taxes to the State or other agencies, 3) a budget deficit in excess of five percent of the tax levy for each of the preceding two years, 4) excessive floating debt, and 5) excessive tax delinquency.⁴⁹ If, after a public hearing, the Local Finance Board concludes that any one of the five conditions exists, state control provisions are put into effect.⁵⁰ Under these provisions the issuance of debt is limited,⁵¹ the rate of taxation may not be increased by more than five percent⁵² and current debt may be liquidated.⁵³ In addition to these measures, the Board may compel the appointment of an administrator.⁵⁴ This administrator may exercise such powers as are assigned by the governing body upon the recommendation of the Local Finance Board,⁵⁵ including the power to liquidate all of a municipality's assets,⁵⁶ to act as comptroller⁵⁷ and to act as agent of the Board.⁵⁸ The application of these provisions terminates when the condition (or conditions) which activated the state control is eliminated or the municipality has operated for three successive years without incurring a cash deficit in excess of five percentum.⁵⁹

While the above provisions take effect only upon the initiative of

48. *Id.* § 52:27BB-55.

49. *Id.*

50. *Id.* § 52:27BB-56. Notice of the institution of this state control must be given by registered mail to the clerk of the municipality. *Id.*

51. *Id.* § 52:27BB-57. The section does not limit debt issuance entirely. For example, a municipality subject to these provisions may issue tax anticipation notes or "other obligations of a strictly current character." *Id.*

52. *Id.* § 52:27BB-58. "This section shall not be construed to authorize an appropriation of less than the full amount required for the payment of debt service; or to authorize the abrogation of any covenant entered into with bondholders." *Id.*

The board may authorize the adoption of a budget in excess of the limitation imposed by this section under several circumstances, for example, "[t]he protection of the public health, safety, morals or welfare." *Id.*

53. *Id.* § 52:27BB-61.

54. *Id.* § 52:27BB-80.

55. *Id.* § 52:27BB-81.

56. *Id.* § 52:27BB-82.

57. *Id.* § 52:27BB-85.

58. *Id.* § 52:27BB-88. The director of the Local Finance Board may be appointed as administrator upon resolution by the board. *Id.* § 52:27BB-90.

59. *Id.* §§ 52:27BB-91, 52:27BB-64.

the Local Finance Board other, more drastic emergency measures may be implemented on the initiative of a municipal bondholder if a municipality has defaulted in the payment of the principal or interest of its outstanding bonds.⁶⁰ If the superior court enters a judgment declaring the municipality in default for over sixty days,⁶¹ the Municipal Finance Commission⁶² is automatically empowered to assume responsibility for the fiscal affairs of the defaulting municipality.⁶³ In carrying out its functions, the Municipal Finance Commission may appoint an auditor⁶⁴ to recommend an annual budget, to review municipal contracts and to make recommendations concerning capital improvements.⁶⁵ Through the Commission, New Jersey applies the principles of an equity receivership to the problem of insolvent municipalities.⁶⁶

60. *Id.* §§ 52:27-1 to 52:27-66. If these provisions are applicable, the extensive state controls provided for by sections 52:27BB-54 to 52:27BB-100 do not apply. *Id.* § 52:27BB-65.

Rather than await a lawsuit, a municipality may file a resolution with the superior court stating that it is unable to meet its obligations as they come due. If the court concurs with the resolution, it may enter a judgment to that effect. Once the judgment is entered the Municipal Finance Commission is authorized to function in that municipality. *Id.* § 52:27-3.

In *Rippel v. City of Asbury Park*, 118 N.J.L. 45, 48, 190 A. 489, 490 (1937), the supreme court said:

The statutory scheme was designed to secure, through the agency of the finance commission, a formula for liquidation, as speedily as may be reasonably possible, of the obligations in default. The commission is charged with the duty of attaining economic stability, without a cessation of essential municipal function, through a solvent that will also provide to the unsatisfied creditor every reasonable remedy for the enforcement of his contract. Considerations of public policy, grounded in a sound economy, ordain that the taxing power shall be reasonably used. Its unbridled exercise ordinarily frustrates the ultimate purpose, to say nothing of the hardship and loss inflicted upon the taxpayer, and pushing it to the extreme in an attempt to raise the moneys necessary for the satisfaction of a relatively large indebtedness oftentimes renders the remedy inefficacious, as well as subversive of the public interest. Such is plainly the genius of the statute, enacted as an emergency measure.

61. N.J. STAT. ANN. § 52:27-2 (West 1955).

62. When sections 52:27-1 to 57:27-66 are activated, the Local Finance Board becomes the Municipal Finance Commission. *Id.* § 52:27-1. See also note 25 *supra*.

63. N.J. STAT. ANN. § 52:27-2 (West 1955). "Upon the entry of the judgment, the commission shall have and exercise with respect to such [defaulting] municipality the powers and duties prescribed by this chapter." *Id.*

64. *Id.* § 52:27-6.

65. *Id.* § 52:27-13.1. The auditor is also given access to all books of accounts, records, papers and memoranda of the municipality. *Id.* § 52:27-8. In addition, banking institutions may not honor the municipality's checks unless countersigned by the auditor. *Id.* § 52:27-9.

66. "In broad terms, the legislation, through combined administrative and judicial action, adapted the underlying principles of an equity receivership to the solution of the problem of

The efficacy of New Jersey's finance laws is illustrated by the success of Newark in maintaining a sound financial structure. Despite its high property tax rate and a state order in 1970 to restore \$10 million to the public school budget, Newark achieved a balanced budget in fiscal year 1971 with no short-term loans outstanding for operating purposes.⁶⁷

III. The Bar's Proposal for Fiscal Monitoring in New York State

Under existing law, New York State does not closely monitor and control formulation of local budgets, except in New York City and Yonkers, where emergency financial control boards have been established.⁶⁸ In New York State, a municipality is required to submit an annual report of its financial condition to the comptroller.⁶⁹ Failure to do so is made a misdemeanor and subjects the chief fiscal officer to certain fines.⁷⁰ The state comptroller may inspect all accounts of a municipal corporation as he deems necessary.⁷¹ In addition, cities and villages are required to file certified copies of their budgets with

insolvent municipalities." *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 504 (1942).

In Nevada, the local budget and all amendments thereto must be approved by a state agency; if the locality fails to enact a budget meeting the state's standards, the power to do so vests in the state. *NEV. REV. STAT. §§ 354.524, 354.596, 354.598, 354.599* (1977). If the locality fails to pass a proper budget, the last year's budget adjusted by the State Department of Taxation becomes the budget. *Id.* § 354.598. Each locality must submit quarterly reports showing performance against budget. *Id.* § 354.602. There are detailed provisions to correct conditions of financial difficulty in local government, involving a new financial plan and controls over revenues and expenses. *Id.* §§ 354.650-354.720. Financial difficulty is defined as a default on a debt payment or inability to meet two consecutive payrolls or a qualified or adverse audit. *Id.* § 354.660. The State Department of Taxation can require certain stringent actions, (e.g., withholding of state and local tax distributions from the locality until a local government financing plan is adopted by the local government and approved by the Department), after a hearing before the State Board of Finance at which the Department and the locality are represented. *Id.* Finally, in Nevada, if a local government fails to comply with a departmental order, the district court can compel compliance. *Id.* § 354.690.

67. *ACIR, supra* note 3, at 45-46.

68. *See* 1975 N.Y. Laws ch. 869 (New York); 1976 N.Y. Laws ch. 488 (Yonkers). *See also Proposals, supra* note 7, at 102.

69. N.Y. GEN. MUN. LAW § 30(1) (McKinney 1977 & Supp. 1978).

70. *Id.* § 30(5).

71. *Id.* § 30(1). Power is delegated to the comptroller to compel the appearance and attendance of any person whose testimony may be required to understand the financial affairs of a municipal corporation. *Id.* § 34(1).

the comptroller.⁷² The failure of this approach is evidenced by New York City's fiscal crisis in the mid-1970's.⁷³

The proposed fiscal monitoring legislation recommended by the Committee resembles the monitoring system of New Jersey, but is not as stringent. The Committee's proposal seeks to spare local control from excessive state intervention without sacrificing the state's interest in fiscal conservatism. The heart of the proposal is the requirement that municipalities adopt and maintain balanced budgets.⁷⁴ The monitoring procedures are designed to enforce this requirement. The Committee did not attempt to precisely define a "balanced budget."⁷⁵ Instead, the state comptroller is authorized to determine if local budgets are balanced in accordance with accounting principles promulgated by the comptroller's office.⁷⁶

Under the proposed legislation, compliance with the balanced budget requirement is monitored and enforced under a three-stage monitoring mechanism. The first stage requires all municipal and district corporations to submit copies of planned budgets and annual financial statements to the comptroller.⁷⁷ If, after reviewing these documents, the comptroller determines that a municipality is experiencing financial difficulties, it is placed under closer state scrutiny in the second stage.⁷⁸ The ailing municipality is then required to submit quarterly financial statements and operating reports to the comptroller.⁷⁹ If the comptroller finds that the locality has violated the law with respect to the balanced budget requirement or the issuance of municipal obligations, he may advise local officials of necessary remedial action.⁸⁰ The comptroller, however,

72. N.Y. STATE FIN. LAW § 54a (McKinney 1974).

73. See Comment, *The Constitutional Debt Limit and New York City*, *infra* at 183. See also *Proposals*, *supra* note 7, at 75-80.

74. PROPOSED LOCAL FINANCE ARTICLE, § 5, *Proposals*, *supra* note 7, at 113 (reprinted in Appendix A).

75. Balanced Budget is described as a budget wherein "total revenues [equal or exceed] total expenditures." PROPOSED FISCAL MONITOR LEGISLATION, § 1, *Proposals*, *supra* note 7, at 120 (reprinted in Appendix C).

76. *Proposals*, *supra* note 7, at 64-65.

77. PROPOSED FISCAL MONITOR LEGISLATION, § 2, *Proposals*, *supra* note 7, at 120-21 (reprinted in Appendix C).

78. *Id.* at 121.

79. *Id.*

80. *Id.*

may not impose a budget upon the municipality.⁸¹ He must bring suit against the municipality to compel compliance.⁸²

In the final stage, a financially distressed municipality may face complete state control when its financial predicament portends financial disaster.⁸³ This stage of the monitoring system is intentionally broad and undefined. The Committee rejected the inclusion of a statutory provision mandating the establishment of an emergency financial control board when fiscal crisis is at hand.⁸⁴ Instead, the comptroller is required to deliver annual reports to the legislature concerning fiscally insecure municipalities.⁸⁵ Presumably, it is intended that the state legislature take such *as hoc* action as is necessary to correct the problem.⁸⁶

This *ad hoc* approach is defective in that it fails to account for the political pressures which accompany legislative action. Automatic corrective measures which do not depend upon future legislative will are needed.

Although the monitoring function given the comptroller under the Committee's proposal is adequately comprehensive, complementary enforcement powers are lacking. The comptroller must apply to the court in order to compel compliance with the monitoring legislation.⁸⁷ This is in contrast to New Jersey's provision wherein the Local Finance Board need not go to court to compel compliance with the statute.⁸⁸ In this respect, the Committee's proposal may impose a difficult, time consuming, and inappropriate role upon the judiciary. The proposed enforcement provision provides:

[t]he comptroller may proceed, in his own name by suit, action or proceeding, at law or in equity, to require such corporation to comply with the applicable requirements of law In any such suit, action or proceeding, the actions taken by such corporation shall be upheld if the court determines

81. *Id.* In Nevada, if a locality fails to adopt a budget complying with state standards, the state may impose a budget upon a locality. See note 66 *supra*.

82. PROPOSED FISCAL MONITORING LEGISLATION, § 2, *Proposals, supra* note 7, at 121 (reprinted in Appendix C).

83. *Proposals, supra* note 7, at 47.

84. *Id.* at 45.

85. PROPOSED FISCAL MONITOR LEGISLATION, § 4, *Proposals, supra* note 7, at 122 (reprinted in Appendix C).

86. *Proposals, supra* note 7, at 104.

87. See text accompanying notes 50-62 *supra*.

88. See notes 19-66 *supra* and accompanying text.

that there exists substantial evidence to support such corporation's determination that its actions comply with the requirements of law.⁸⁹

This provision would require a court to review the financial practices of municipalities with multi-million dollar budgets. The court would be required to act as a large judicial accounting board. In *Wein v. Carey*,⁹⁰ the New York Court of Appeals expressed its reluctance to take on such a role. In *Wein*, a taxpayer claimed that the state had violated the constitutional balanced budget requirement during fiscal year 1976-1977.⁹¹ In rejecting plaintiff's argument that given two successive annual deficits the state should carry the burden of proving its good faith attempt to maintain a balanced budget, the court observed:

[a]ssuming it were feasible to convert a courtroom into a super-auditing office to receive and criticize the budget estimates of a State with an \$11 billion budget, the idea is not only a practical monstrosity but would duplicate what the Legislature and Governor do together . . . each year.⁹²

IV. Conclusion

In the face of political realities in New York, the Committee's proposal is an important step forward, but it is only the first step. The proposals would be improved by replacing the judicial enforcement provision with an administrative procedure. The comptroller's recommended remedial actions should be evaluated at an administrative hearing. This procedure would give the municipality an opportunity to be heard and would guard against arbitrary decisions by a single political office. It would also be appropriate to have a standby financial control board that the comptroller could convene if his suggestions for action are ignored by the locality. New York State already has two Emergency Financial Control Boards in operation and is familiar with the procedure they follow. The financial control board would make the decision whether to take jurisdiction and, if so, direct the locality to take appropriate action.

89. PROPOSED FISCAL MONITOR LEGISLATION, § 5, *Proposals, supra* note 7, at 123 (reprinted in Appendix C).

90. 41 N.Y.2d 498, 362 N.E.2d 587, 393 N.Y.S.2d 955 (1977).

91. *Id.* at 503, 362 N.E.2d at 590, 393 N.Y.S.2d at 958.

92. *Id.* at 504-05, 362 N.E.2d at 591, 393 N.Y.S.2d at 960. Judicial review of the procedure of budget formulation is similarly difficult. See *Saxton v. Carey*, 44 N.Y.2d 545, 378 N.E.2d 95, 406 N.Y.S.2d 732 (1978).